

# Background to making a company director personally liable

Over 150 pieces of legislation that make directors liable for the actions of the company

All corporations have what is termed a 'legal personality'. This means that corporations are a distinct legal entity, with their own rights and responsibilities. Companies can enter contracts, own property, sue and be sued. They are not, however, 'natural persons' in the sense that humans are, and some of their rights (or lack thereof) reflect this distinction: despite what *The Truman Show* would have us believe, corporations cannot adopt people (nor marry, nor form relationships generally).

The most common type of company is the proprietary company limited by shares (this is what Pty Ltd indicates in a company's name). Shareholders possess rights - or, more accurately, a bundle of rights - with regard to the company. These rights are heavily dependent on the constitution of the company, but examples of rights include the right to vote at general meetings and the right to appoint/remove directors.

Because corporations have a distinct legal personality, shareholders of a company limited by shares enjoy limited liability. This means that the individual shareholder cannot be called upon to pay money into the corporation (or to pay the corporation's creditors) beyond their share capital (the money they paid for the shares in the first place). If a corporation is wound-up, the shareholders can't be called upon to repay the debt. The corporation is liable for that debt because it is its own legal personality.

Clearly, this poses material risk for third parties that wish to deal with corporations. Corporate law is influenced by the common law, and by equity, and by the instruments of the corporations themselves; but far and away the primary source of corporations law in Australia is the *Corporations Act 2001* (Cth).

The Act is in 7 volumes, 1,681 sections, and is approximately one *bazillion* pages long (apologies for the strict legal jargon). Statutory regulation of corporations has become so important that the States voluntarily ceded their exclusive legislative authorities to the Federal Government by way of a national scheme.

The Act is designed to regulate the orderly behaviour of companies in Australia. As a company is legally distinct from its shareholders, directors and employees, the risk is that bad faith players will use corporations to limit their personal liability and engage in risky or unethical business ventures.

This is not to say that the common law (ie law that's made by judges in courts) has no place anymore. On the contrary, the common law plays a vital role in interpreting the Act in, for example, such areas as corporate governance, helping to fill in the Act's gaps when it comes to matters such as directors' duties. This allows a certain flexibility so that different directors from different companies are held to an appropriate, rather than universal, standard.

Companies were invented so that investors could pool their investment but that their losses could be limited to just that investment and no more. That 'limited liability' is the whole reason we use companies.

One interesting common law principle is that the court can 'pierce the corporate veil'. The corporate veil is the metaphor used to denote the fact that shareholders and directors are not personally liable for the corporation's actions because the corporation is a distinct legal entity.

The corporate veil can be pierced when a court determines that the directors should be made personally liable for the corporation's actions.

The default position is that directors are not liable. So if government regulators want to make them liable, they must specifically say so in legislation.

It has been estimated that there are over 150 pieces of legislation that make directors liable for the actions of the company. We can't list them all here but probably the most well-known is where a director is held personally liable for the debts of a company that trades while it is insolvent. Also it is important to note that tax law can make the director liable for unpaid company taxes in some circumstances.

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