DBA Lawyers

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'The constitution requires two directors yet, there's only one director — what do I do?'

Introduction

This article examines the importance of having an appropriately up to date constitution, especially in the context of single director companies where the constitution might require at least two directors.

Outdated constitutions

A notable change in law was brought on by the *First Corporate Law Simplification Act 1995* (Cth), which reduced the number of directors necessary for a proprietary company from two to one. The reasons for the change included providing greater independence to women seeking to start their own business, and to eliminate so called 'sexually transmitted debt'.

Sole director companies are now common in Australia.

However, companies that were created prior to the change in law face the very real prospect that their constitution is significantly 'out of step' with what the company actually does.

For example, old constitutions often provide that the company must have two or more directors, whereas today the company might in fact only have one.

Further, the constitution may state that resolutions require the consent of a majority of directors, or that meetings require a quorum of at least two.

Additionally, out of date constitutions may also specify that meetings and communications must be carried out with certain formalities. They may not allow for the use of electronic communications, circulating resolutions and similar modern methods.

This is a cause for concern because the validity of all company resolutions made in a state of non-compliance could be challenged, with many such companies tied up with the control of significant wealth.

Does non-compliance with a constitution render the exercise of the power invalid?

Company constitutions are read subject to the general law and legislation. According to *Halsbury's Laws of Australia*:

> A [constitutional] provision will be invalid if it is contrary to public policy, if it purports to limit the statutory rights or liabilities of its members [shareholders], or if it is expressly or impliedly rendered void by legislation.

Further, s 125 of the *Corporations Act (2001)* (Cth) broadly provides that the exercise of a *power* by a company contrary to the constitution or the company's stated objects is not invalid merely for that reason.

Despite this, it is not clear whether this provision also applies to internal decision-making of the company. Also, a claim might still be raised against individual directors for breach of fiduciary duties such as the duty to act in good faith in the best interests of the company.

Considering the above, if a power or decision is carried out that, while it does not contravene the *Corporations Act 2001* (Cth), does *not* comply with the constitution, this could be attacked as being invalid.

Given that legal challenges are often founded on technicalities and the end goal is certainty and risk minimisation, it is worthwhile striving to ensure actions comply with a company's constitution. Naturally, if any challenge were to occur, significant costs and time delays could arise.

Further, ensuring that actions are done in compliance with the constitution adds to the evidence that the relevant party was seeking to comply with the law.

Can non-complying acts be ratified to ensure their validity?

If shareholders of a company wish to ensure the validity of an action, they can elect to unanimously treat such an action as not being a breach of the constitution. This is because a company constitution is in essence a voluntarily created contract between the parties. It would therefore be open to all shareholders as parties to the contract to elect to treat the act or transaction as not being a breach of that contract.

This would assist in providing company officers (such as directors) protection from liability as a result of non-compliance, help ensure that all corporate acts are valid and also prevent non-compliance in the future resulting from an outdated company constitution.

It is important to note, however, that if only a majority of shareholders condone a non-compliance with the constitution, there would still be a breach, and the minority shareholders could complain.

Special purpose companies

Many SMSF trustee companies currently claim the lower ASIC annual fee reserved for special purpose companies, without having the provisions in their constitution that are required by law to be eligible.

DBA Lawyers' constitution is designed to cater for companies acting in any capacity, but also contains the specific provisions necessary where the company is acting solely as the trustee of an SMSF. Additionally, these 'special purpose' provisions only apply where the company acts solely as an SMSF trustee. If the company is later used for another purpose in the future, having a DBA constitution avoids the need to update the constitution.

With all this in mind, should I update my old constitution?

The short answer is yes. Also, as part of the constitution update, the shareholders should also ratify prior director acts. (DBA Lawyers is one of the few firms that provide such ratification as part of their update package.)

The longer answer is as follows. Procedural and decision-making irregularities may not necessarily invalidate a company's actions. However, any legal challenge or scrutiny is likely to be expensive to deal with. It is our recommendation that, for certainty, a constitution should be updated to reflect the current state of a company.

A constitution dated prior to 1995 would typically have been referred to as a 'memorandum and articles of association'. This terminology is a near-sure sign that a constitution may be out of date. An update may also be necessary to ensure eligibility to claim the reduced ASIC annual fee for special purpose companies.

DBA Lawyers offers a constitution upgrade service.

DBA Lawyers' constitution upgrade also includes shareholder ratification resolutions, whereby all shareholders ratify prior director acts to exonerate them of any potential liability.

Case study — what should happen

Adam and Andrea were directors of a corporate trustee company, which was registered in 1994. Adam and Andrea were the only shareholders in the company.

After Andrea lost capacity in 2009, she was removed as a director and Adam remained as the sole director. Andrea's shares were then transferred to Adam.

The constitution has not been updated, and still has provisions in it mandating a minimum of two directors, as well as quorum requirements for meetings and the passing of resolutions.

Adam decides to update his constitution to appropriately reflect the current status of the company as a sole directorship.

As the sole shareholder in the company, Adam decides to ratify all actions undertaken prior to the update, electing to treat them as not being in breach of the constitution.

DBA constitution updates

Constitution upgrade (with member ratification) $500 (+$50 for hardcopy)

For information on updating you company constitution, please visit the following link:
http://www.dbalawyers.com.au/products-order-forms/companies/constitution-upgrade

For further Information please contact:

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