LIVING ON THE EDGE: UTOPIA UNIVERSITY LTD

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ONE HUNDRED YEARS OF *SALOMON'S* CASE

> [R]aces condemned to one hundred years of solitude did not have a second opportunity on earth.[1]

This article considers the impact of the doctrine of legal personality as enunciated in the classic corporate law case, *Salomon v Salomon & Co Ltd*,[2] on our theories concerning the role of the membership within a corporation, in particular the role of the membership within a university corporation.

Universities live on the edge of corporate law. Although it has been one hundred years since the judgment in *Salomon's* case, the ground rules of university governance were established well before that judgment. Furthermore, *Salomon's* case involved a one-man company organised under the Companies Act 1862 (UK) and universities are not typically organised under business incorporation statutes. Nevertheless, *Salomon's* case has had a dramatic effect on the way we view the constitutional structure of all corporations, including university corporations.

I begin with a quotation from the novel *One Hundred Years of Solitude* (in fact the very last line of the book) because that novel sees time as circular with characters and events constantly reinventing themselves and, never being able to extract themselves from the curse of their heredity. I feel that way about *Salomon's* case. It is a legal precedent which defines the character of our corporate law, but it sometimes also seems like a kind of curse, at least insofar as it has robbed us of any ability to take a second look at legal personality.

The analysis of the problem of the appropriate weight and precedence to be given to the members as a group in the governance structure of university corporations requires (1) a definition of the interests of the "distinct legal person" created by incorporation, and (2) an elaboration of the degree to which the interests of the substratum—the membership and purpose of the corporation—form a part of the interests of that distinct legal person. I will be using the term "substratum" throughout this article to refer to the underlying association of members for a particular purpose. This idea of association is similar to that which would constitute a partnership if the entity were not incorporated. I have borrowed the term from cases dealing with the winding up of companies on "just and equitable" grounds for failure of the substratum.

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1 G Marquez, *One Hundred Years of Solitude* (1982).

2 [1897] AC 22.

Those cases deal with situations in which the main objects of the company are no longer attainable for some reason.[3]

We all know that principles of corporate governance require that the Aron Salomons of this world must act in the best interests of their corporate entities. However, the question of what constitutes the "best interests" of a particular corporation is almost never straightforward, essentially because a corporation is not a monolith.[4] Furthermore, university corporations have their own special problems. The issue of corporate purpose, for example, is more important in the university corporation, as are latent questions of capacity and power (the *ultra vires* question).

With the university corporation one must ask, as a question of corporate governance, whose interests ought members of senior management and members of university councils consider when taking action on behalf of a university corporation? And, following from that question, who has standing to complain on behalf of the corporation in circumstances in which the interests or purpose of the corporate entity is not pursued. To whom, beyond the corporate entity itself, is university management accountable?

The announcement by the University of Melbourne in July 1997,[5] that it was "going private" (to use merger and acquisitions jargon) with the formation of Melbourne University Private Ltd made this issue and *Salomon's* insistence on the independence of the corporate entity from the underlying motives of the incorporators or members, suddenly more relevant. By all accounts, the University of Melbourne is planning a major shift in the organisation and objects of the university. The new corporation will not have the same membership as the established university. In fact, it is not clear whether the new corporation will be controlled by the old corporation. A major transfer of assets is contemplated. Revenue producing assets in particular will be concentrated in the new corporation. These actions are the kind of actions that require the approval of members in a business corporation. Who ought, as a formal matter, to approve Council's plans? And, are these plans in the best interests of the University of Melbourne as it is currently constituted? These questions can not be answered by a bold statement that the university is a separate legal entity. Quite the contrary. Cases in corporate law have consistently established that an examination of a corporation's substratum—its purpose and its membership—is necessary.

But who or what is the membership of the university corporation? And, what links, in terms of corporate purpose, do the members collectively have to the corporate entity? Does membership in the university corporation confer specific group rights

3 *Re Suburban Hotel Co* (1867) LR 2 Ch App 737 at 750-751; *Re Tivoli Freeholds Ltd* [1972] VR 445; *Strong v J Borough & Sons (Strathfield) Pty Ltd* (1991) 5 ACSR 296 at 299-300; *Roberts v Walter Developments Pty Ltd* (1997) 15 ACLC 882. For a general discussion of the principle see B H McPherson, "Winding Up: 'Just and Equitable' Ground" (1964) 27 *Mod LR* 282 at 286-293. The cases dealing with quasi-partnerships also discuss the underlying association of members. See M R Chesterman, "The 'Just and Equitable' Winding Up of Small Private Companies" (1973) 36 *Mod LR* 129.

4 For a discussion of this problem in relation to the business corporation see J D Heydon, "Directors' Duties and the Company's Interests" in P D Finn (ed), *Equity and Commercial Relationships* (1987).

5 "Uni Unveils Private Campus" *Age* 9 July 1997; "Privatisation Push Gathers Pace on Three Campuses" *Australian Higher Education Supplement* 9 July 1997 at 33.

with regard to governance? And, if so, what are they? It is this question of the role of membership, particularly as a group, that I pursue in this article. I believe that our ideas about the nature of membership are confused and that at least part of the blame for this confusion is due to the judgment in *Salomon v Salomon & Co Ltd*[6] and its insistence on form over function.

My thesis is as follows:

1. Membership is the residual base of governance in the common law of corporations. Corporations are by definition self-governing.
2. Under the common law, membership is linked to common enterprise and common burden—the purpose or end of the corporation—but admission to membership is controlled by the corporation, that is, the members as a group.
3. Classes of members and requirements for membership may be stipulated by statute.
4. General incorporation statutes required that a corporation's purpose be stipulated in its constitution. However, these statutes were based on the joint stock company form in which membership was based on contract.
5. The use of a contract model by general incorporation statutes shifted emphasis away from the common law requirement of common enterprise to a requirement of contract which emphasised form over substance.
6. *Salomon's* case found the membership nexus to be formal share holding only, shifting the emphasis even further from a factual test (common enterprise, common burdens) to the mere satisfaction of a formal minimum statutory requirement.
7. Modern statutes have eliminated even the formal requirement that a corporation stipulate a common purpose of the membership.
8. This shift from substance to form in the development of corporate law has undermined all of the common law on the role of the membership and has had a chilling effect on any further development of that law.
9. The focus in *Salomon v Salomon & Co Ltd* on the legal entity with almost complete disregard for the substratum has led to a bizarre flight from reality and endless confusion as to the appropriate consideration to be given to the nature, role and limitations of the membership in either a positive or negative sense.

The above synopsis of the argument in this article reflects a changing pathology in the role of members. The rest of this article considers the appropriate role of university members in the governance of universities. Two specific cases will be examined, both involving the University of Melbourne. However, the issues are relevant to all universities and, I believe, provide interesting contemporary examples of the reach of corporate law principles and the penalties we pay when they are misconstrued. I would hope that taking another look at *Salomon's* case after one hundred years will give us a "second opportunity" to move on.

6 [1897] AC 22 at 30.

THE COMMON LAW OF CORPORATIONS

From the establishment of civil society and political government, not only the individual acquires rights, and becomes subject to duties, which can exist only in consequence of that establishment, but collective bodies of men come to feel a common interest, acquire a common property, become subject to common burdens and common duties, assume a known character and description, and become objects of political regulation.[7]

Historically, the common law of corporations is the first source of information about the position, rights and responsibilities of membership. The common law on corporations finds its roots in Roman law.[8] The common law establishes certain characteristics as necessary for the formation of a corporation.[9] The essence of the common law corporation is an association of individuals for a particular purpose which is recognised at law.[10] Any treatise on the law of corporations written before the introduction of general incorporation statutes will focus almost exclusively upon those characteristics. Legal personality flows from legal recognition of a "distinct person" but the essence of that legal person is that it is made up of many persons with common interests and burdens. Beyond those characteristics corporations are classified with reference to their specific purpose or type of membership.[11] Thus we have the classification of corporations as "ecclesiastical" or "lay" and of "civil" or "eleemosynary". Admission to membership and governance of the corporation is vested in the membership as a body,[12]—a fact that made corporations politically dangerous (Kyd wrote his classic work on corporations in the Tower of London).

Legal regulation or supervision of a corporation is provided through visitation. The King (and ultimately King's Bench) is the visitor to all civil corporations and the Ordinary (the bishop or archbishop) is the visitor to all ecclesiastical corporations. Donors may play a role in eleemosynary corporations. The role of the visitor is to prevent deviation from the ends of the institution and to correct irregularities (that is make the members follow their own rules).[13]

The jurisdiction of the visitor is limited to matters concerning the substratum. The visitor has jurisdiction over domestic disputes within the corporation including disputes with regard to the internal procedures of the university and disputes as to the appropriateness of specific exercises of discretion.[14] It is the visitor who is the

7 S Kyd, *A Treatise on The Law of Corporations* (1793) Vol I, B1.

8 W Blackstone, *Commentaries on the Laws of England* (1765) Vol 1 Ch 18 at 456-457.

9 *Sutton's Hospital Case* (1612) 10 Co Rep 1a, 23a.

10 See *Sutton's Hospital Case,* ibid; W Shepheard, *Of Corporations, Fraternities, and Guilds* (1659) at 121; S Kyd, above n 7 at 1; J Chitty, *A Treatise on the Law of the Prerogatives of the Crown* (1820).

11 W Blackstone, above n 8 (1765) at 457-460.

12 See *Sutton's Hospital Case,* above n 9.

13 W Blackstone, above n 8 at 467-468.

14 *University of Melbourne; Ex Parte McGurk (Visitor)* [1987] VR 586 at 587. See W Ricquier, "The University Visitor" (1978) 4 *Dalh LJ* 647 at 650. In matters involving the exercise of discretion by a university member or officer, the Visitor may not interfere if that discretion was exercised honestly. *Ex parte Wrangham* (1795) 2 Ves Jun 610 at 625; 30 ER 803 at 810-811. This is a case involving the election of fellows. See also *Attorney-General v Black* (1805) 11 Ves Jun 191; 32 ER 1061. But, an appeal to the Visitor will lie in any situation where the

custodian of corporate purpose. Generally speaking it is beyond the jurisdiction of the visitor to make determinations affecting the rights and liabilities of persons who are not corporators or members of the university.[15] However, in situations where contract rights of members of the university are intermingled with internal rules of the university, such as conditions for appointment of professors, the visitor may have jurisdiction.[16]

The point of this brief description of the common law corporation is that its focus, in terms of legal recognition and in terms of governance, is on the membership and purpose of the association. Of course, after legal recognition the common law endows the corporate body with certain rights and liabilities (legal personality) when dealing with those outside the corporation. We are all familiar with the list—the right to hold property, to sue and be sued, and so on. The fact of legal recognition was achieved by grant of royal charter. If a royal charter could not be found but the "association" nevertheless operated as though it were a corporation, then a fiction was used and the corporation was said to be incorporated by prescription. The assumption operating here was that there must have been a charter at some point in time but it had been lost.

This common law regime was gradually displaced, at least in part. First we must remember 1688 and the fact that Parliament won the Glorious Revolution. The supremacy of Parliament had finally been achieved after centuries of contest. With the ascension of William and Mary, the Monarch became subject to the ultimate control of Parliament. Not long after we witness the first statute which applies to companies generally—the infamous Bubble Act of 1721. The Bubble Act forced the development of the joint stock company, in particular the Deed of Settlement Company, as an unincorporated alternative to the chartered company. In the nineteenth century the corporate form and the joint stock company substance come together in the general incorporation statutes beginning in the 1840s and culminating in the great Companies Act of 1862 which was immortalised by Gilbert & Sullivan in their opera "Utopia Ltd" and *Salomon v Salomon & Co Ltd.* Acts of Parliament regulating universities also appeared in the nineteenth century.

While the law applicable to business corporations was affected by general incorporation statutes and the decision in *Salomon's* case, the law applicable to university corporations was not—at least not in a formal sense. However, the strength and importance of *Salomon's* case is that it has had an impact on our ideas about corporations generally. And, those ideas affect the way we view all corporations

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discretion was improperly exercised, for example, due to a failure to comply with the requirements of natural justice or due to corrupt or illegal motives.

15 *Re University of Melbourne; Ex Parte de Simone (Visitor)* [1981] VR 378 at 386. The question of who is a corporator or member is determined by reference to a university's statutes and general corporate law. Academic officers and academic staff will be members, graduates and students might be members and other employees of a university generally are not.

16 See *Hines v Birbeck College* [1986] 2 WLR 97; *Thomas v University of Bradford* [1987] AC 795. Courts have held contracts referring to the internal rules of the university or incorporating university statutes were within the visitor's jurisdiction to the extent that interpretation of the contract requires interpretation of the university's statutes. Ibid. Even when a person's contract does not specifically refer to the university statutes, a person may take a position of employment subject to those statutes. See P Smith, "The Exclusive Jurisdiction of the University Visitor" (1981) 97 *LQR* 610 at 639. This is also consistent with general corporate law.

whether regulated by the general business incorporation statute or not. This brings me to my complaint about *Salomon's* case.

SALOMON'S SIN—SIDESTEPPING THE SUBSTRATUM

> Once the company is legally incorporated it must be treated like any other independent person with its rights and liabilities appropriate to itself ... *the motives of those who took part in the promotion of the company are absolutely irrelevant in discussing what those rights and liabilities are.*[17]

Much has been written about what constitutes the "best interests" of a business corporation and whatever one might say it is clear that much confusion remains.[18] The underlying question is how does one define the "corporation". Is it simply the sum of the parts or is it something else? As I mentioned earlier I would like to lay some of the blame for this confusion as to the nature of the "corporation" (or, if one prefers, the "company") on the judgment in *Salomon v Salomon & Co Ltd.*

The case constitutes one of the best examples of form over substance. To be fair to the Court, they were interpreting a statute. And they were doing so in a political and philosophical context which brought together doctrines of positivism and *laissez-faire* capitalism. What is wrong with the judgement is that the Court conducted its interpretation outside the framework of the common law of corporations. The case suggests that the purpose for the association and the nature of the membership is largely irrelevant to the constitution of the entity. I do not believe that this was the intention of the legislation. And, I cannot understand why the legislation was read so generously. To make matters worse, the case has also been read expansively.

Since *Salomon's* case we have stressed the separate legal entity analysis to the detriment of the substratum issues. In Australia we have stretched the concept of separate legal personality further than any other common law jurisdiction that I can think of—certainly further than the United Kingdom, Canada or the United States. We have promoted a view of shareholding as the sole nexus of membership within a corporation and a view of the shareholder as totally non-responsible and unaccountable to others connected to the corporation, such as lenders, involuntary creditors (victims of torts) and the local community. This has led to a lack of any clear idea of the role of membership outside of statutory rules and requirements. In situations in which shareholding is either lacking or not representative of the true beneficial interest (for example government corporations), confusion reigns. One has

17 [1897] AC 22 at 30 per Halsbury LJ (emphasis added).

18 For a contemporary discussion of this problem see M Blair, *Ownership and Control: Rethinking Corporate Governance for the Twenty-first Century* (1995).

only to look at the cases dealing with quasi-incorporation[19] and unincorporated associations or clubs for examples of this point.[20]

I would like to suggest that it is time to re-establish a balance and take another look at these substratum questions. Why do we think that share holding is the only route to membership? Can we have members who are not shareholders? Could we solve some of our current "stakeholder" problems[21] by taking another look at the membership question? Is the minimum standard of the statute expressive of the realities of the organisation? Why is it that victims of torts cannot proceed, even in a limited way against shareholders? Perhaps all shareholders should be members, but is the reverse necessary?

These are questions at the centre of corporate law. Let us move back to the edge and the impact of these developments on the modern university corporation. In particular, the questions of purpose and membership. What is the substratum of the modern university and how is that substratum recognised in terms of university governance?

LIVING ON THE EDGE—THE UNIVERSITY CORPORATION

Any determination of the "best interests of a university" must consider as a preliminary question, the definition of the entity. Universities as a class are older than most corporate forms. They are also outside the mainstream of corporate law development, at least since the rise of the business corporation and its formal legitimisation by general incorporation statutes and cases such as *Salomon's* case. The first edition of Halsbury's *The Laws of England,* published in 1910 and edited by our friend of Salomon fame, the Earl of Halsbury, tells us that "[a] university is nowhere legally defined"[22] and that "the term is usually understood to mean a body incorporated for the purposes of learning with various endowments and privileges."[23] The entry then goes on to describe the usual membership and governance structure of a university.

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19 There are some situations where the courts have been willing to treat unincorporated associations as separate legal entities. These cases involve situations where a statute can be said to support the treatment of the entity as separate from the members. In these situations the courts find that the legislature has expressly or impliedly directed that such an association be treated as a legal entity *for the purposes* of a particular statute. See *Willis v Association of Universities of the British Commonwealth* [1965] 1 QB 140; *Bailey v Victorian Soccer Federation* [1976] VR 13; *Re Independent Schools' Staff Association (ACT)* (1986) 60 ALJR 458; *Poulis v Adelaide Uni Union* (1982) 99 LSJS 227 at 239-240.

20 Courts have traditionally been reluctant to interfere in the internal affairs of an unincorporated association but have done so when important personal rights were involved or natural justice had been severely breached. See *Free Church of Scotland v Overtown* [1904] AC 515; *Macqueen v Frackleton* (1909) 8 CLR 673; *Cameron v Hogan* (1934) 51 CLR 358; *Harrison v Hearne* [1972] 1 NSWLR 428; *Finlayson v Carr* [1978] 1 NSWLR 657; *Plenty v Seventh-day Adventist Church of Port Pirie* (1987) 132 LSJS 299; *Scandrett v Dowling* (1992) 27 NSWLR 483.

21 Stakeholders are individuals or entities with an interest in a corporation that does not involve shareholding, for example, creditors or employees. Fundamental questions arise as to the definition and legal recognition of such interests as a matter of modern corporate law.

22 Earl of Halsbury (ed), *The Laws of England* (1910) Vol 12 para 222.

23 Ibid.

Today, the word "university" is still not a term of art.[24] In England, Vaisey J has stated that although a "university" may be identified on sight, it is not easy to define what it is in precise and accurate language.[25] In determining whether the particular institution under consideration was a university, Vaisey J applied an "ordinary university person on the street" kind of test. Whether a particular institution was a university could be determined by reference to the judgement of an ordinary person either with knowledge of what a university is or who has been educated in a university.[26] If this can be called a definition it is pragmatic but uninspiring.

The current edition of *Halsbury's Laws of England* cites Vaisey J's definition and then expresses the opinion that the essential feature of a university seems to be that it was incorporated as such by the sovereign power.[27] It then goes on to list other characteristics of a university such as government by terms of instruments of foundation or acts of parliament and an organisational structure usually consisting of a chancellor, a vice-chancellor and a body of scholars and students.[28]

The question of definition has also been considered in Australia. Kaye J in the Victorian Supreme Court surveyed the authorities and expressed his frustration (and perhaps boredom) with the question of what constituted a university. He noted that there was a great deal written about what a university should be and that "[t]here is not to be found unanimity of opinion among such authors, and the task of extracting from their works a definition is an unrewarding one."[29]

Kaye J concluded that Vaisey J's definition was as good as any but that it did not advance the inquiry of what is a university.[30] In the absence of a statutory definition Kaye J opted for the *Shorter Oxford Dictionary* definition:

> The whole body of teachers and students pursuing, at a particular place, the higher branches of learning; such persons associated together as a society or corporate body, having the power of conferring degrees and other privileges, and forming an institution for the promotion of education in the higher branches of learning; the colleges, buildings etc , belonging to such a body.[31]

DECONSTRUCTING THE UNIVERSITY CORPORATION—THE SUBSTRATUM

The essence of a university corporation is its substratum, that is its special purpose together with the nature of its collective membership. When one examines the various definitions of the term "university" it quickly becomes apparent that the substratum appears in all definitions. Thus, as far as the definitions are concerned, the entity is the substratum, and in order to examine the "best interests of the university" we must examine its substratum. In examining the substratum, we will also have to consider the

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24 *Clark v University of Melbourne* [1978] VR 457 at 461; *St David's College, Lampeter v Ministry of Education* [1951] 1 All ER 559 at 560.

25 Vaisey J in *St David's College, Lampeter v Ministry of Education* [1951] 1 All ER 559 at 560.

26 Ibid at 561.

27 *Halsbury's Laws of England* (4th ed 1990) Vol 15 para 256 ff.

28 Ibid.

29 *Clark v University of Melbourne* [1978] VR 457 at 462.

30 Ibid.

31 From the *Shorter Oxford Dictionary* (3rd ed) Vol II p 2305, cited in ibid.

problem of how to balance competing, and sometimes conflicting, interests as between the various parts of the substratum.

If we deconstruct the substratum of the university corporation we must consider several elements which are linked to purpose and to membership. For example, the question of whether the university is established for a public or a private purpose will be relevant not only to a proper understanding of purpose but also to the question of membership. The associational link between the members will also be a complex question, particularly in large universities with wide-ranging programs. Is the common enterprise of the members scholarship, education and research or something much less substantive, for example, employment? Is a definition of membership which refers only to scholars and students realistic or romantic?

UNIVERSITY PURPOSE

In attempting to distinguish universities from other corporations, purpose would appear to be the most critical substantive characteristic. While declining to precisely define what constitutes a university, the law has recognised that universities have a special purpose. Throughout their history, universities have been seen as having an institutional existence which could be identified by reference to an association of scholars with a specific purpose—the promotion of knowledge in the higher branches of learning. Most, but not all, university enabling acts set out some statement of purpose referring to education, research and learning. A notable omission from those "purpose statements" is any mention of "commercial purpose". There are obvious reasons for this.

A difficult problem of purpose for universities and other public institutions such as hospitals is the question of whether one ought to apply principles of public law or principles of private law when analysing the corporate entity. Whether a particular university can be said to have a "public" or a "private" purpose will be a matter of analysis of each university in terms of its enabling act and its particular substratum. However, one can probably say that all universities serve a social purpose which has elements of "state action"[32] in the sense that universities are "established for the maintenance and regulation of some particular object of public policy".[33]

If we admit that a university has a "public aspect" to its purpose even if it is for most purposes a "private" university, we are faced with the question of how that public aspect ought to be recognised in terms of university governance and, in particular, how it figures in any analysis of the best interests of a university. This is a problem for another day.

Lastly, one must remember that the question of purpose in a university corporation is connected to the question of capacity. The common law doctrine of *ultra vires* still applies to university corporations, with the consequence that rules regarding the

32 "State action" is a doctrine applied by courts in the United States under which the actions of a reputedly private party can be attributed to the state when there is a sufficiently close nexus between the government and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the government itself. *Jackson v Metropolitan Edison Co* 419 US 345 at 351 (1974) per Rehnquist J; see also *Lugar v Edmondson Oil Co* 457 US 922 (1982); *Patrick v Burget* [1988] 486 US 94.

33 J Chitty, *A Treatise on the Law of the Prerogatives of the Crown* (1820) at 122.

exercise of power within a university corporation are stricter than the rules which apply to today's business corporations.[34] At common law, officers acting without power will not bind the corporation and the officer acting beyond power may incur personal liability, despite the best intentions and utmost good will.[35] The purpose of the common law rules is the protection of the entity from misuse of power by individual officers. They are majoritarian rules, protecting the university and all members of the university from misuse of power.

UNIVERSITY MEMBERS

As with the question of university purpose, the issue of membership is a very real issue in university governance. The membership of a university is typically set out in its enabling Act. Beyond a rather bland statement of membership little more is said. What kind of powers, rights and responsibilities membership implies is generally unstated. University administrative procedures will say quite a bit about the rights and responsibilities of university members, but members as a group generally have very little to say about the formulation of those procedures. When members are employees, industrial law will govern their employment relationship with the university. Similarly, members may have personal contract rights with the corporate entity and those contract rights will operate in addition to any rights deriving from membership.

My focus here has to be limited to the question of members' rights as members and not rights deriving from some other relationship. Is the university truly self-governing in the traditional sense? The best source of information about the rights of university members are instances in which there has been recourse to the university visitor. This is because the university visitor is the custodian of university purpose and the arbiter of disputes concerning the internal operation of the university corporation. However, the jurisdiction of the visitor is not often invoked with regard to major issues of university governance. The majority of cases involving the visitor are cases concerning individuals complaining about unfair treatment or unfair procedures as those procedures have affected them personally, for example, preclusion from a course of study, unsuccessful applications for promotion and unfair termination of contract. Nevertheless, there is no reason why the visitor's jurisdiction could not be invoked by the members as a group.

Since I want to consider members' rights as a collective or group, rather than individual rights, it is useful to consider some examples of how the interests of the substratum may figure in a determination of the "best interests" of the university.

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34 See *Australia & New Zealand Banking Group Limited and Michael Tyler v The University of Adelaide and the State Bank of South Australia* (Supreme Court of South Australia, Perry J, Judgment Number S3836 of 1993, 4 March 1993, unreported).

35 *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285; *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112 See generally H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (8th ed 1997) at 321; R P Austin, "Moulding the Content of Fiduciary Duties" in A J Oakley, *Trends in Contemporary Trust Law* (1996) at 164; R Pennington, *Pennington's Company Law* (6ed 1990) at 583-4; R Pennington, *Directors' Personal Liability* (1987) at 37-39; P L Davies, "Directors Fiduciary Duties and Shareholders" in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (1992) at 83. See also J Jackson, "The Liability of Executive Officers under the Corporations Law" (1991) 3 *Bond LR* 275.

Members' collective rights as members are rights concerning the constitution and good governance of the corporation.

The policy issues I would like to consider are, first, what role should the membership of a university have in university constitutional arrangements—that is, corporate governance? Secondly, and in particular, what is the relationship of the membership to the governing board or council when the corporate entity is faced with major policy decisions or issues affecting control of the university corporation?

Assuming that the membership should play some role, I also have to ask several pragmatic questions. (1) How does the membership of a university act collectively? (2) What remedies does the membership have if management misbehaves? And, finally (3) How does one deal with competing interests at the substratum level?

Two recent developments at the University of Melbourne illustrate some of the tensions which exist in university governance. Neither case has involved the visitor—at least to date. And in neither case has the role of the membership or that of corporate purpose been expressly mentioned.

The first example is the registration of a new subsidiary of the University of Melbourne, Melbourne University Private Ltd. While information concerning the general structure of the new university has been released, many specific details of the precise legal arrangements are unavailable at the time of writing.[36] Nevertheless, it is clear from the information which has been made public that the magnitude of the project together with its impact on the University of Melbourne as an institution raises the question of the appropriate role of university members in the approval of a major corporate restructuring: the kind of major corporate event which under general principles of corporate law would require the approval of a general meeting of members or shareholders.

The second example does not have the same high profile. It involves a litigated matter and the facts are taken principally from the "witness statement" of the vice-chancellor of the university and from the actual judgment.[37] The case received no publicity that I know of, and the judgment is unreported. The case illustrates the tensions between academic interests and commercial pressures when defining university purpose.

Both examples also illustrate new directions in university management and structure, in particular the marginalisation of university governing bodies and the institutionalisation of senior management.

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36 Details about the new company are taken from the University's information brochure, *Melbourne University Private*, dated 16 February 1998 and from documents on file with the Australian Securities and Investment Commission (ASIC).

37 *Bernard Marks v CCH Australia Limited and University of Melbourne* (Supreme Court Victoria, No 2197 of 1996, 31 October 1996, unreported).

MELBOURNE UNIVERSITY LTD—THE RESTRUCTURING OF A UNIVERSITY

In July 1997, the vice-chancellor of University of Melbourne announced plans to launch a private university "MU Ltd"—"A Harvard of the South".[38] This new university would be spun off from the current University of Melbourne, a public institution. The reference to Harvard was a reference to the Harvard funding model which divides government, philanthropic and private funding in a ratio of 30, 30, 40 respectively.

Melbourne University Private Ltd (ACN 081 182 685) (MUP) was registered under the Corporations Law on 13 January 1998 as a public company limited by shares.[39] The use of the name "Melbourne University" is a key factor in the marketing of the new university. The goodwill and the recognition accorded to Melbourne University are substantial assets of the University—what its vice-chancellor calls its "brand name".[40] These have been, or will be, licensed to the new franchise. According to the vice-chancellor, one of the reasons for establishing the new entity is the "restrictions governing commercial activities" which affect the University of Melbourne.[41]

Such restrictions are not found in the Melbourne University Act 1958 (Vic). Unlike most university Acts, the Melbourne Act no longer has a purpose clause. The restrictions alluded to by the vice-chancellor come from the Commonwealth Government and from the general law. A particular advantage of the new entity is said to be the fact that it will be outside DETYA control imposed through the Higher Education Funding Act 1988 (Cth), and will not be subject to the same industrial relations regime as other public universities. In an informal sense, the incorporation of the new entity as a company limited by shares signals to the world that this legal entity is free to pursue profit in addition to, and even in preference to, other more traditional activities.

Elements of the plan include: (1) Melbourne University plans to retain only 10-15% of the private university equity (hoped to be in excess of $250 million); (2) this equity would reflect an investment of "Council funds" of up to $25 million; (3) this equity position, it is said, would still be enough equity to control the new university—unlike the private Bond University in Queensland—although MUP would have several large investors; (4) investors mentioned by name were Commonwealth Bank, CSR, Ford Australia, Fosters Brewing, Mobil, Shell, Western Mining, the Victorian Government and others; (5) the new university would be mostly postgraduate, emphasising the corporate upgrade market, and would offer programs in Asia; (6) the new university would charge annual fees of between $10,000 and $25,000; (7) all MUP award programs will be subject to the certification, quality assurance and control standards of

38 "Uni Unveils Private Campus" *Age* 9 July 1997; "Privatisation Push Gathers Pace on Three Campuses" *Australian Higher Education Supplement* 9 July 1997 at 33.

39 ASIC Document No 013 058 058. It is interesting that while the new university is explicitly called "private" the ASIC Company Extract on the new university lists its 'principal activity' as "public university".

40 "Buyer Education" *Bulletin* 5 August 1997 at 42.

41 *Weekend Australian* September 19-20, 1998 "MUP Blazes Private Trail" at 5. See also, *Weekend Australian* September 6-7, 1997 "Private Uni Offers $2.5 bn and 3600 Jobs" at 5; "Uni Unveils Private Campus" *Age* 9 July 1997; "Privatisation Push Gathers Pace on Three Campuses" *Australian Higher Education Supplement* 9 July 1997 at 33; "Buyer Education" *Bulletin* 5 August 1997 at 42; "The Corporate Campus" *Australian* 5 June 1997 at 13.

Melbourne University; (8) the campus of MUP will be developed commercially on University of Melbourne property. Refinements of the plan will continue as the university consults potential "equity partners" as to their business training needs and return on investment criteria.[42] The current structure is that Melbourne University Private Ltd will be a not-for-profit holding company with a number of schools as subsidiary companies. Whether these subsidiaries will be dividend paying subsidiaries has not yet been determined.[43] At writing the new university has an "Interim Board" of directors chaired by the vice-chancellor of Melbourne University and including members of the business and professional community. Presumably, membership on the Board will eventually be connected to investment in Melbourne University Private. The subsidiary schools will also have their own boards and chief executive officers.[44]

The question that one must ask in the context of this article is: what is the appropriate role of the membership in a situation which will clearly change the entire substratum of the university? While the university will continue to have educational objects as its principal common enterprise, the purpose of the university will change to the extent that it will seek to divert assets acquired through the expenditure of public funds to its private profit-making subsidiary. The nature of the membership will change as the university seeks major investors in the new private university. These major investors will demand some "control" over the new entity and thus control over the assets diverted to that entity. Indeed, the University of Melbourne hopes to be a minority partner in the new enterprise. Lastly, the equity of the university corporation will be diluted because of the transfer of assets, including good will, from the public university to the private university. It is also probable that there will be a net loss of corporate opportunity for the public entity as the university "brand name" is made available to the new corporation.

The common law of corporations would suggest that the membership should have a formal role to play in the approval of the above proposals because of their radical impact on the "interests of the university" and in particular on the substratum. (The transformation of what are essentially public assets into private assets raises additional problems in public law.) The information brochure published by the University of Melbourne makes it clear that the two universities will share resources:

> Melbourne University Private will occupy a campus on prime University owned real estate contiguous with the main Parkville campus of University of Melbourne, and will therefore be ideally-placed to mobilise—on a commercial basis—the intellectual resources, educational infrastructure and student amenities of the established public University.
>
> Proximity and inter-operability with the University of Melbourne will provide Melbourne University Private with a licensed trade mark and ready brand recognition from the outset. In perpetuity, all degrees, diplomas and other award and certificate courses in the new institution will be accredited by the University of Melbourne....[45]

The interests of the University of Melbourne are said to be protected in the corporate constitution of Melbourne University Private and its subsidiaries, and also through

42 Melbourne University information brochure, *Melbourne University Private*, 16 February 1998 at 6-11. See also *Weekend Australian* 19-20 September, 1998 "MUP Blazes Private Trail" at 5.
43 Ibid.
44 Ibid at 6.
45 Ibid at 2.

license and sub-license agreements.[46] This proposition is weak, since by virtue of s 136 of the Corporations Law the corporate constitution can be altered by a special resolution passed by the membership of the private university in which the University of Melbourne seeks to have a minority interest.

Having made the assertion that the membership has a role to play, one comes immediately to the question of how this should be done. Common law corporations had a constitutional structure which divided power between a governing board and the membership meeting as a group. The division of power in a business corporation is a statutory reflection of the old constitutional structure. Universities typically had the older common law structure with a governing board or council and a general body of members typically called a senate or convocation. Most Australian universities have either done away with the general body of members or rendered it powerless. Melbourne is no exception. This is a problem when analysing the constitutional structure of universities.

The "membership" of the University of Melbourne, as described in its enabling act,[47] is quite broad including members of Council and various categories of staff, academic staff, students and graduates. The University also has a Convocation and an Academic Board, neither of which has any formal power. Convocation can meet and can give advice to Council.[48] The Academic Board can give opinions to Council and can make reports.[49]

A further problem is the "public" aspect of the University of Melbourne. Like most older universities in Australia, the University of Melbourne was founded and subsequently funded by a combination of private and public (Commonwealth and State) monies. How does one obtain approval for the transfer of those quasi-public interests?

Melbourne University has said that it "consulted widely" within the University community. The Academic Board is said to have approved the establishment of the new university, the University Council approved the plan in September 1997 and the current Premier of Victoria is supporting the plan.[50] Is this sufficient? And if not, what more could be done? The statutory definition of membership in the University of Melbourne includes at least Council and the Academic Board and students and Convocation. But is that definition a sensible or meaningful identification of the university substratum? The issue becomes more compelling when one realises that the substratum of the current University of Melbourne will have to interact with what will be a clearly defined substratum of the new Melbourne University Private, a substratum which will likely exclude academic participation and not-for-profit objectives.

MELBOURNE'S FOLDING CHAIR OF TAXATION LAW

A second example of confusion about the role of the substratum is illustrated by the facts in an action against the University of Melbourne by one of its professors, Professor Bernard Marks. The action was brought after the University's vice-chancellor

46 Ibid at 6.
47 Melbourne University Act 1958 (Vic), s 4.
48 Melbourne University Act 1958 (Vic), s 20A.
49 Melbourne University Act 1958 (Vic), s 28.
50 Above n 42.

accepted the repudiation by CCH Australia Limited of a contract between CCH and the University in which CCH had agreed (from 1985) to fund a tenured chair in taxation law held by Professor Marks. The contract and the appointment of Professor Marks had been approved by the University's governing body, the Council. The repudiation was accepted (in 1996) by the University's vice-chancellor without any consultation with Professor Marks and without approval of the Council.[51] The effect upon the university of the loss of funding was that the chair of taxation law ceased to exist. The effect upon Professor Marks was that he lost his chair, his tenure, his income and his employment contract.[52]

The reason given for accepting the repudiation and consequent loss of income was that the vice-chancellor thought that it was in the best interests of the University, in that universities must maintain "amicable fruitful relationships with sponsors".[53] The University's position was that the effect upon Professor Marks was not relevant to its considerations.[54] How much consideration was given to the fact that the University lost a valuable asset—a tenured chair—is unclear.[55]

In his complaint and in the subsequent court action, Professor Marks argued that CCH and the University held the promise by CCH to fund the chair in trust for his benefit and that, as a consequence, he could enforce the performance of that trust.[56] The University argued that the agreement between the University and CCH was meant to confer a benefit upon the University and not a trust in favour of Professor Marks. The Supreme Court of Victoria (Mandie J) found the contract to be for the benefit of the University and not a trust, express or implied, for Professor Marks.[57] Agreeing that the

51 Professor Gilbert agreed with CCH in March 1996 that CCH ought to be able to cease funding the chair at their sole discretion. Witness Statement of Alan David Gilbert (31 October 1996) at para 8. Professor Gilbert testified that he was surprised to discover later that the Dean of Law thought that the matter was more complicated (Witness Statement at para 12), an opinion apparently shared by the Registrar (Witness Statement at para 20). Legal advice was sought from the University legal advisers sometime in early August. Following that legal advice, Professor Gilbert wrote to CCH saying that while the University accepted the repudiation it was reserving all of its rights under the contract. (Witness Statement at para 20). See also Testimony at 110-112.

52 The appointment and continued tenure of Professor Marks at the University of Melbourne was contingent upon the funding of the chair by CCH. It was clear from the testimony and other evidence that Professor Marks would not have accepted the appointment to the chair if CCH had an option to terminate the funding of the chair or if the chair had not been a tenured position with the usual rights and privileges attached to such a position. Judgment at 5-6.

53 Testimony of Vice-Chancellor Gilbert, Transcript at 123.

54 Testimony of Vice-Chancellor Gilbert, Transcript at 122-123. This is also evidenced by the vice-chancellor's refusal to discuss the matter with Professor Marks and his request to CCH that it also decline to discuss the matter with Professor Marks.

55 Presumably CCH was an existing sponsor but this issue is not discussed in the opinion. In making his order for costs, Mandie J ordered that CCH be responsible for its own costs, agreeing that Professor Marks was the ultimate victim of CCH's "fundamental breach of its obligations to the university" and stating that "it would be a travesty of justice" for the plaintiff to be obliged to pay costs to CCH. Revised Ruling of Mandie J, 20 December 1996.

56 Amended Statement of Claim, 12 September 1996, para 13.

57 *Bernard Marks v CCH Australia Limited and University of Melbourne* (Supreme Court Victoria, Mandie J, No 2197 of 1996, 31 October 1996, unreported).

contract was for the benefit of the University and acknowledging that the vice-chancellor thought that he was acting in the best interests of the university, one still has to ask how the "best interests of the university" are determined and by whom. This returns us to the questions raised at the beginning of this article—whose interests ought members of senior management and members of university councils consider when taking action on behalf of a university corporation?

We have seen that the interests of a corporate entity are generally identified by reference to the substratum, that is the whole body of members of the corporation viewed in light of the corporation's purpose and objects.[58] In this case, the body of members would include professors and other academic staff,[59] the purposes and objects being those of a university. It may include others, but there is no basis for saying that it would include commercial sponsors.

The facts in the *Marks* case force one to ask whether the interests of the university and the interests of the university community received adequate consideration, and whether consideration of a sponsor's wishes is a necessary part of analysing the best interest of the university.[60] It seems that sponsorship is big business at the University of Melbourne. A recent press report stated that:

> nearly half the 165 or so professorial chairs at Melbourne owe their establishment to the backing of big business, while the university's first effort at privatisation, the Melbourne Business School, ... only came into being through the support of several large companies.[61]

Clearly a vice-chancellor would want to think carefully before upsetting commercial sponsors as a class even if commercial sponsors are not part of the substratum. However, one would want to ask whether the vice-chancellor is the appropriate person to make this decision. Shouldn't policy issues relating to the interests of the substratum be decided by the substratum, that is the members? And, if that is the case, what governance structures are in place to give a voice to the university's substratum?

CONCLUSIONS

Over the past 100 years we have been gradually correcting some of the faulty reasoning in *Salomon's* case. That effort must continue. The substratum will never have the prominence it had in classic corporate law. In large part this is because there is no longer one substratum but many. Nevertheless, the substratum is the key to developing a coherent theory about the limits of corporate personality and the regard

58 *Mills v Mills* (1938) 60 CLR 150 at 188 per Dixon J; *Ngurli v McCann Ltd* (1953) 90 CLR 425 at 438; *Peter's American Delicacy Co v Heath* (1939) 61 CLR 457; *Australian Innovation v Paul Alexandre Petrovsky* (1996) 14 ACLC 1357 at 1361 per Lockhart J. See also H A J Ford, R P Austin and I M Ramsay, above n 35 at 300-311. For a detailed analysis of possible formulations of "best interests" see J D Heydon, above n 4.

59 Melbourne University Act 1958 (Vic) s 4 lists the "members" of the university. The list includes the Council, the professors, academic staff, graduates, students and others.

60 See *Walker v Wimborne* (1976) 137 CLR 1.

61 "Buyer Education" *Bulletin* 5 August 1997 at 43. We might also ask whether consideration of the interests of sponsors is similar to considering the interests of creditors. In situations of insolvency or near insolvency the interests of creditors may overtake the interests of members. *Kinsela v Russell Kinsella Pty Ltd (in liq)* (1986) 4 NSWLR 722; *Nicholson v Permakraft* (NZ) Ltd (in liq) [1985] 1 NZLR 242.

to be had to the various "interests of members" whatever the specific kind of corporation or statutory regime.

The two elements which make up the substratum are fundamental to the evaluation or determination of the best interests not only of a university but of any corporation. I say that despite the fact that most business corporations are without a formal statement of purpose as was traditionally required and despite the fact that membership links in most corporations are limited to the formal holding of a share. The debate, principally in the arena of acquisitions of shares, as to whether the interests of the corporation as an enterprise should take precedence over the interests of shareholders can be analysed as a contest between purpose and membership.[62] The subsidiary debate as to whether the interests of shareholders should be defined as short-term interests or long-term interests is merely a refinement of the question of corporate purpose.

What we see in the contemporary university corporation is a deep confusion as to both elements of the substratum. University purpose is being overtaken by business plans focusing on funding models. The University of Melbourne's move to a limited company is not an abandonment of educational purpose so much as it is a commercialisation of that purpose. University membership is similarly transforming its meaning. According to newspaper reports, the University of Melbourne plans to offer "long-term service agreements to its academics and faculties"[63] but the new membership will be linked not to the common enterprise of scholarship but to the common enterprise of investing in scholarship.

In corporate law generally, the courts have had to deal with fissures in the substratum, in particular conflicts between different classes of members as to the best interests of the corporation. This has been done by recourse to first principles and the development of a doctrine of "proper purpose".[64] It will be interesting to see if a similar analysis from first principles will be applied to university corporations as they develop more complex corporate structures; and, whether at the end of the day, the traditional substratum of the university corporation will have any role in university governance.

Lord Halsbury said that "[e]ither the company was a legal entity or it was not."[65] With respect, things have never been so simple.

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62 See, for example, *Mills v Mills* (1938) 60 CLR 150; *Ngurli Ltd v McCann* (1953) 90 CLR 425; *Harlowe's Nominees Pty Ltd v Woodside (Lakes Entrance) Oil Co NL* (1968) 121 CLR 483; *Hogg v Cramphorn Ltd* [1967] Ch 254; *Ashburton Oil NL v Alpha Minerals NL* (1971) 123 CLR 614; *Teck Corporation Ltd v Millar* (1973) 33 DLR (3d) 288; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285; *Bailey v Mandala Private Hospital* (1988) 6 ACLC 43; *Darvall v North Sydney Brick and Tile Co Ltd* (1988) 6 ACLC 154.

63 *Weekend Australian*, September 6-7, 1997 at 5.

64 See *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285; and *Gambotto v WCP Ltd* (1995) 182 CLR 432. Proper purpose requires an analysis of constitutional arrangements within a corporation and a consideration of the purposes for which powers are conferred.

65 *Salomon v Salomon* [1897] AC 22 at 31.