# LENDING TO COMPANY GROUPS - THE PROBLEMS OF CORPORATE POWER AND DIRECTORS' AUTHORITY

## PITFALLS TO BORROWERS AND LENDERS

**THE HON MR JUSTICE PAUL DEJERSEY**

**Supreme Court of Queensland, Brisbane**

## INTRODUCTION

Lord Wedderburn has reminded us that the reality today is not the company but the corporate group. As he put it:

> "We speak, teach, litigate and legislate about 'company law'. But predominant reality is not today **the** company. It is the corporate group."

("Multinationals and the Antiquities of Company Law" (1984) 47 *MLR* 87, 92.)

The obligation of a group member when borrowing is made clear by Mason J in **Walker v Wimborne** ((1975-76) 137 CLR 1, 6-7), in this passage:

> "... the emphasis given by the primary judge to the circumstance that the group derived a benefit from the transaction tended to obscure the fundamental principles that each of the companies was a separate and independent legal entity, and that it was the duty of the directors of Asiatic to consult its interests and its interests alone in deciding whether payments should be made to other companies."

Infringement of that duty has led to great disadvantage to lenders in two recent cases: **ANZ Executors and Trustee Company Limited v Qintex Australia Limited** ((1991) 2 Qd R 360) and **Northside Developments Pty Ltd v Registrar-General** ((1991) 70 CLR 146). I will analyse those cases, because they say important things about corporate power, authority of directors, and limits on the protection of those who deal with companies.

One might at first glance have thought that statutory changes in recent years had widened corporate power and increased protection for those who deal with companies. In light of those decisions, however, one cannot be completely confident that that is so. The **practical** significance of those cases, for the prudent lender, is that he must now make the same enquiries as if the doctrine of ultra vires were still in full flight and with limited protection for those who deal with companies.

## STATUTORY PROVISIONS: ULTRA VIRES AND PROTECTION TO LENDERS

Before going to the cases, I will examine the statutory provisions. It is convenient to go to the current law, the Corporations Law. The provisions to which I will refer are not however new. The first set concerns company capacity: ss160, 161 and 162. The second set, ss164, 165 and 166, concerns the protection of those who deal with companies. The provisions about capacity date back to s20 of the Uniform Companies Acts of 1961. There were modifications in 1983 and 1985, to which Professor Baxt refers in a note in the *Company and Securities Law Journal*, April 1991, p101.

### Ultra vires provisions

Turning to the provisions in relation to company power, one begins with the declaration in s161(1) that a company has "the legal capacity of a natural person". That would include, therefore, the power to make gifts of its property to others. The amplitude of that power is confirmed by sub-s2, which says that sub-s1 has effect in spite of any restriction or prohibition contained in the company's constitution, and despite the objects specified in the memorandum of association. Sub-section 3 goes so far as to confirm that the fact that the doing of an act by a company would not be in its best interests, does not affect its legal capacity to do the act. (That was apparently introduced to exclude the application of **Rolled Steel Products (Holdings) Ltd v British Steel Corporation** [1982] 3 All ER 1057.) It is no surprise, then, to see in s160, as the declared object of the sections, "to abolish the doctrine of ultra vires in its application to companies".

There is, however, some back-tracking then to be found in s162. Sub-section 1 provides that a company's constitution **may** contain a restriction on or prohibition of the exercise of a power by the company. By sub-s2, if the company acts contrary to such a restriction or prohibition, then it contravenes that sub-section. By sub-s3, officers of a company involved in such a contravention also contravene the sub-section. There is then an acknowledgment that there should be **some** residual control on directors. But the consequences of any such contravention are very limited. Sub-section 5 provides that the exercise of the power is not invalid merely because of the contravention. By sub-s6, the validity of the act of an officer of the company is preserved notwithstanding such contravention.

Sub-section 7 does however list a number of circumstances, although a very limited number, in which such a contravention may be relevant. They include, for example, applications for orders under s230 precluding certain persons from managing companies, oppression proceedings under s260, applications for injunctions under s1324 to restrain a company from entering into an agreement in advance, proceedings by a company against its officers, and winding up applications. The object of this set of provisions, as confirmed by s160(b), is "without affecting the validity of a company's dealings with outsiders, to ensure that the company's officers and members give effect to provisions of the company's constitution relating to objects or powers of the company".

Those provisions seem clear enough. A company has the legal capacity of a natural person. Whatever it does is valid. If it gives away its property, for example, then that will be valid. But there is the residual possibility of proceedings against officers, should there be contravention of limitations expressed in the memorandum of association.

## Statutory "Turquand" provisions

The second set of provisions amount to a statutory adoption of the rule in **Turquand's** case ([1856] 119 ER 886). In a sense, there is an abundance of caution behind these provisions, in view of the earlier, emphatic statutory assertion that ultra vires is dead and transactions beyond specified powers are valid. But the extent of the protection **has** been specified, and in one important respect, the protection has been increased.

Section 164 confirms the protection available to persons having dealing with companies, or with other persons who have acquired property from companies. A person having those dealings is, by force of the section, entitled to make certain assumptions in relation to his dealings. Further, if the company asserts in any proceedings that the assumptions are not correct, then the court must disregard that assertion. What are these assumptions?

In summary, they are that the company's constitution has been complied with, that a person who appears to be a director, principal executive officer or secretary has been duly appointed and has the usual authority of a person in that office, that a person held out to be an officer or agent of the company has been duly appointed and has the usual authority of such a person, that an officer with authority to issue a company document has authority to warrant that it is genuine, that a document apparently sealed and attested has been duly sealed and attested, and that the officers of the company properly perform their duties.

Section 166 provides that the assumptions may be made even though the company officer has acted fraudulently, and even though the relevant document is a forgery.

The assumptions are not available in two circumstances: if the person dealing with the company, or with the other person, has **actual** knowledge that the matter which would be assumed is incorrect, or if because of the person's connection or relationship with the company, he ought to know that the matter which would be assumed is incorrect.

The overall position, therefore, is that there is a plenitude of company power, and a plenitude of protection for those who deal with companies. But yet, whether courts will support that statutory intent is still not clear.

## THE QINTEX CASE

The first doubt arises from the **Qintex** decision. The facts, taken from (1990) 8 ACLC 791, were that Qintex Australia Limited ("QAL") was indebted to the plaintiff, ANZ Executors and Trustee Company Limited ("ANZ"), for about $100 million under three deeds. In the deeds, QAL covenanted that it would, at the request of ANZ, procure any one or more of its wholly owned subsidiaries to give a guarantee in respect of the payment of money owed by QAL under the deeds. ANZ sought specific performance of the covenant by QAL. QAL conceded that damages were an insufficient remedy but argued that the court should in its discretion refuse to grant specific performance. It argued that the giving of a guarantee would cause hardship to existing unsecured creditors of the subsidiaries, as well as to the subsidiaries themselves. The principal ground relied on by QAL was that to compel the subsidiaries in a general meeting to give a guarantee, would involve an abuse of the shareholder's power by QAL, as the giving of a guarantee would give no arguable advantage to the subsidiary immediately concerned. The court should not, it was argued, compel an unlawful act by specific performance.

## At first instance: Byrne J

Byrne J, the trial judge, dismissed the claim. He refused to decree specific performance because to order the giving of the guarantees would involve compelling the commission of an illegal act. He made it clear that the subsidiaries had the **power** to grant the guarantees (p797), but concluded that they should not **exercise** that power because it would not benefit them (p797). The judge put it this way:

> "To give them (the guarantees) now is not even possibly to the companies' advantage and to do so would prejudice existing unsecured creditors. Of course, the subsidiaries all have the power, one a general meeting may exercise, to give the guarantees: see s68 of the Companies Code. The litigation, however, is not about the subsidiaries' capacity. Rather it concerns whether the guarantees would involve an impropriety."

So he declined to order specific performance on that discretionary basis.

His judgment is a model of concise clarity, the more compelling for its brevity. One commentator has said the reasoning is confused (Dawson: "Commercial Benefit" (1991) 107 *LQR* 202), but I do not agree.

The case went on appeal. Before turning to the appeal judgment, I pause to see how the trial decision fits with the statutory provisions to which I have referred.

The case was really about the granting of an equitable remedy. There was a discretionary bar to the granting of specific performance: the illegality of the proposed act. Would it have been illegal?

## Byrne J's decision vis-a-vis sections 160-162

Well, there was **power** in the subsidiaries to grant the guarantees. That is clear enough, and in any event, there is the provision in s161(1) that a company has the legal capacity of a natural person. But that power had to be exercised incidentally to the **objects** of the company, as Byrne J pointed out through his adoption of this passage from **Hutton v Westcork Railway Co** ([1883] 23 Ch D 654, 671 per Bowen LJ):

> "They can only spend money which is ... the company's if they are spending it for purposes which are reasonably incidental to the carrying on of the business of the company. That is the general doctrine. Bona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company, and paying away its money with both hands in a manner perfectly bona fides yet perfectly irrational. The test must be what is reasonably incidental to, and within the reasonable scope of carrying on, the business of the company."

In this particular case, to give the guarantee would not have been reasonably incidental to the carrying on of the business of the subsidiary companies. There was therefore the possibility of contravention of the objects clause of the memorandum, in terms of s162(2)(b) of the Act. That would not have invalidated the act of **giving** the guarantees, as sub-s5 makes clear. But the court would nevertheless have the power to restrain such an act **in advance of its being accomplished**. That is because of s162(7)(f), which provides that the fact that the doing of an act would involve such a contravention may be relied upon, on an application for an injunction under s1324 to restrain the company from entering into an agreement.

So, in my respectful opinion, Byrne J was right to decline to decree specific performance on that discretionary basis, and his approach in no way conflicted with the statutory provisions with which I am concerned.

## Judgment on appeal: Full Court

As to the appeal, one gathers from the judgment of McPherson J that different matters were argued before the Full Court - an unsatisfactory but frequent feature of litigation. The ultra vires provisions seem to have assumed much greater importance in the appeal court's consideration. Before coming to those provisions, I briefly recount the process of reasoning in the appeal judgment.

The first question, "whether a company that is insolvent or verging on insolvency may properly make a gift of its assets to some other person" (p365), was answered no. If there were no interests involved other than that of the shareholders, then there would be no objection to that action, because there would be no-one to complain (p367). But in these particular cases, the interests of creditors **did** intrude. The judge referred to the statement of Street CJ in **Kinsela v Russell Kinsela Pty Ltd** ((1986) 4 NSWLR 722, 730), as follows:

> "In a solvent company the proprietary interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholders' assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."

McPherson J then turned to the ultra vires provisions. He concluded (p370) that the purposes of the Code equivalents of ss160 and 161 of the Corporations Law:

> "... are sufficiently achieved if, despite deficiencies in corporate capacity, the validity of corporate dealings with outsiders is made unimpeachable. Beyond that point the legislation does not affect to abrogate restrictions, explicit or implicit, on the exercise of directors' or shareholders' powers."

Then he said (p371), that "the present case is not one in which the validity of company dealings with outsiders comes into question. None of the subsidiary companies dealt with ANZ. It was the holding company that entered into the trust deeds". He concluded in terms that "our order cannot compel QAL to do something that, apart from the order, the law does not permit".

To my mind, the potential exercise of power by subsidiaries **did** arise, if indirectly, and the real answer to the problem was that the court could stop that improper exercise of power in advance.

## Significance for lenders

There may in the judgment of the Full Court be an implicit reluctance to acknowledge the width of the provisions now seen in ss160 to 162. Had the guarantees been given, would the court have declared them valid? In my view, that declaration should necessarily flow from those provisions. But in view of the very emphatic assertions of the Full Court as to the limitation of the subsidiary's power, I am not at this point completely confident that such a declaration would be forthcoming in such circumstance. Professor Baxt has expressed similar doubts: "Ultra Vires - Has it been revived?" *Companies and Securities Law Journal*, April 1991, p101.

If I am right, then this all leaves the lender in an inconvenient if not difficult position. While, having read of the abolition of the doctrine of ultra vires in s160, one may have felt confident about proceeding fairly robustly, without inquiry about the power of the manner of its exercise, in the absence of actual knowledge of any irregularity, there remains a risk that a transaction like this might be upset before its fulfilment. Beyond that, there is a risk arising from the emphatic assertions in **Qintex** about lack of capacity - as I read them - which might lead to the re-examination of such a transaction even post-completion. The prudent lender is therefore effectively left having to consider the question of power, and the manner of its exercise with relation to benefit to the company. That is the only prudent course.

## The duty to consider creditors

Of particular interest is Queensland's acceptance now of the relevance of the interests of creditors in this situation. That complicates the position of a lender yet further. He is obliged now to turn his mind, in addition, while assessing the manner of exercise of the power, to the financial position of the company. How has this duty of directors evolved?

## A duty implicit in the liability: section 592

When a company faces liquidation, directors, including non-executive directors, and managers, run the risk of personal liability for the debts of the company under s592 of the Corporations Law. That is the successor to s556 of the Companies Code. They may avoid liability if, broadly speaking, those debts have been incurred behind their back as it were, or unless, having made all enquiries reasonably open to them as to the financial stability of the company, they properly and reasonably conclude that the company should be able to pay its debts as they fall due. This potential statutory liability plainly, to my mind, carries with it a correlative duty to prospective creditors of a company in financial difficulties, and that is, to avoid having the company contract with such prospective creditors where there is no reasonable ground for expecting that the company will be able to discharge the debt.

There has however been long standing jurisprudential debate as to whether directors owe a duty to creditors rather than simply to their company. Is the duty still really confined to the company, "on the basis that a failure to take into account the interests of creditors will have an adverse effect on the interests of the **company**"? In his article, "Recent Developments in Director's Duties" (1991 *Australian Bar Review*, vol 7, no 2, pp121-129) Mr Ashley Black suggests, consistently with that, that "the duty of a director to the company will require that the director consider the interests of the company's creditors at least in a case where the company's insolvency is likely". Although the issue is perhaps sterile, I have ventured the view that the creation of the liability directly to creditors under s592 now carries with it a corresponding duty **directly** to creditors, and not one disguised as part of the duty to the company.

A more interesting question is whether the directors of a **solvent** company have a duty to protect creditors. I do not think that they do have such a duty. It is confined to a situation of impending or likely insolvency.

## The case law

As to the cases, one begins with a reasonably conservative observation by the present Chief Justice of the High Court in 1975 in **Walker v Wimborne**, where he said this (at p7):

> "... It should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them. The creditor of the company, whether it be a member of a group of companies in the accepted sense of that term or not, must look to that company for payment. His interests may be prejudiced by the movement of funds between companies in the event that the companies become insolvent."

About ten years later, the New South Wales Full Court put that into a practical context in **Kinsela**, in the passage to which I have already referred. There was no talk of **duty** there by Street CJ, but he came perilously close to it. Lord Templeman reached the point of speaking of duty the following year, in **Winkworth v Edward Barron Development Co Ltd** ([1987] 1 ALL ER 114, 118). He made the subsequently much criticised statement that "a company owes a duty to its creditors, present and future". This explanation followed:

> "The company is not bound to pay off every debt as soon as it is incurred and the company is not obliged to avoid all ventures which involve an element of risk, but the company owes a duty to its creditors to keep its property inviolate and available for the payment of its debts. The conscience of the company, as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of directors themselves to the prejudice of the creditors."

A number of highly respected commentators debunked that suggestion, especially in its application to future creditors, and absent insolvency. But it was adopted by the West Australian Full Court, in **Jeffree v National Companies and Securities Commission** ((1989) 15 ACLR 217), which held that a director owed a duty to the present and future creditors to ensure that the assets of the company were not dissipated to defeat creditors' claims. That court was really only concerned to construe s229(4) of the Companies Code, which prohibited a director's improperly using his position to gain an advantage for himself. That director feared that an imminent arbitrator's award would throw his company into insolvency. So he formed a new company and transferred to it the assets of the other one, for full value, to avoid payment to the successful party in the arbitration. The director was convicted of contravention of the section. The present significance of the decision is the endorsement by the court of the remarks of Lord Templeman as to the duties of directors to present and prospective creditors. It may be felt that the court went unnecessarily far. It may be, however, that by also endorsing **Kinsela**, the West Australian decision should be regarded as confined to a situation of imminent financial difficulty.

Finally, then, we reach the position now where in **Qintex**, our own Full Court has endorsed **Kinsela**.

No doubt the High Court will eventually pass upon this issue. It does however seem clear now that intermediate courts are not shy to extend the duties of directors beyond their companies, although on the balance of authority, as to creditors, that duty would presently not arise until insolvency or likely insolvency. As I have said, in my opinion, such a duty is the correlative of the statutory liability under s592. In terms of commercial morality, there could I think be no serious objection to it. While the limited liability company has no doubt contributed enormously to the development of society, one wonders whether the restrictions on directors' personal liability under that mechanism are justified: the recent history of fairly obvious abuses suggests that we should perhaps be looking more regularly towards protection for the victims of entrepreneurs gone awry, than to making the way even more attractive for development we often probably neither want nor need.

### The prudent lender's course

From the prudent **lender's** point of view, this does however mean now that he has to consider not only (1) the existence of the power, and (2) the manner of exercise of the power with relation to benefit to the company, but also (3) the possibility of detriment to creditors, turning his mind in that process to the financial stability of the company.

## THE NORTHSIDE DECISION

Let me turn now to **Northside**. That case is extremely important for three reasons.

In the first place, the High Court in **Northside** for the first time comprehensively analysed the rule in **Turquand's** case. Secondly, the case throws up a number of issues concerning s164 of the Corporations Law. Third, **Northside** contains some good advice from the High Court to credit providers anxious to extend finance to debtor companies.

We are all familiar with the "indoor management" rule established by **Turquand**: that persons dealing with a company in good faith may assume that acts within its constitution and powers have been duly performed, and are not bound to inquire whether acts of internal management have been regular. As Lord Simonds said in **Morris v Kanssen** ((1946) AC 459, 475), "it is a rule designed for the protection of those who are entitled to assume, just because they **cannot know**, that the person with whom they deal has the authority he claims".

Though simply expressed, the rule has been the bane of lawyers.

The law which has built up around the rule is hard to follow, probably because of the complexity of the exceptions to it. Then there has been acute judicial disagreement as to the basis of the rule - is it agency, or estoppel, or the peculiar demands of the commercial life? What is the scope of the forgery exception?

These issues have meant that the application of the rule has not been completely clear: cf 64 *ALJ* 688. The High Court's analysis in **Northside** does however to some extent illuminate those issues.

### Significance of Northside vis-a-vis section 164

You might be wondering why one should bother to persist with **Turquand**, and **Northside**, in light of s164. That section is the statutory adoption of the rule in **Turquand**. It did not apply to the situation before the High Court in **Northside**, because it was not introduced until 1984, whereas the security in **Northside** was given in 1979. Section 164, as we have seen, sets out assumptions which may be made by persons dealing with companies as to, for example, compliance with the company's constitution. I will come to it again later. I mention it now to confirm that it does not cover the field, as it were: there is still operation left for **Turquand**. It is therefore important to look to **Northside** for a current exposition of the **Turquand** rule for use in those cases not covered by s164, and as well, to enhance one's appreciation of s164 itself.

I go now to the facts of **Northside**.

## Facts of Northside

Northside owned land at Frenchs Forest in Sydney. Robert and Gerrard Sturgess controlled Northside. Barclays Credit lent $1.4 million to companies owned by Robert Sturgess, but not including Northside. To secure the loan, the Sturgesses purported to execute a mortgage in favour of Barclays, by Northside, over the Frenchs Forest land. Northside received none of the $1.4 million, and had no legal or commercial connection with the borrowing companies. Northside defaulted under the mortgage. Barclays sold the land. Northside then sued the Registrar-General under the provisions of the New South Wales Real Property Act (s127). That provision entitled a person, who had lost through the registration of another as the proprietor of land, to sue the Registrar-General for damages.

Robert Sturgess had attested to the mortgage and the affixing of the Northside common seal. Gerrard Sturgess purported to sign as company secretary. In fact, he had not been properly appointed as company secretary. The other problem was that the directors had not, as required, by resolution, authorised the affixing of the seal. Neither had they approved the giving of the mortgage.

The trial judge found for Northside. He held that the mortgage was not properly executed. **Turquand** would have saved it, however, but for the fact that Barclays had been put upon inquiry. The assumption of regularity cannot be made "if he who would invoke it is put upon his inquiry. He cannot presume in his own favour that things are rightly done if inquiry that he ought to make would tell him that they were wrongly done" (**Morris v Kanssen**, *supra*, per Lord Simonds, p475).

Although the Court of Appeal felt differently, the High Court agreed with the trial judge.

## Northside in the High Court

The five judges in the High Court disagreed as to the basis of the rule, but they all agreed that Barclays had been put upon inquiry. As to the basis of the **Turquand** rule, Mason CJ favoured a rationale of business convenience, Brennan J regarded the rule as a presumption of regularity, Dawson J spoke of a mixture of estoppel, agency and commercial convenience, Toohey J saw the rationale as indoor corporate management, and Gaudron J saw estoppel as the basis of the rule.

I do not propose elaborating on that largely academic point. The significance of the case for the present is **what circumstances should put a lender on inquiry**, such that if he fails to make the inquiry, he will not be protected if the security is not authentic.

The High Court judges all held that **the very nature of this transaction** should have put Barclays upon inquiry. What the Chief Justice called the "decisive consideration" was that the mortgage was given to secure an advance to a third party without any indication that that related to Northside's business. On the face of things, the transaction did not serve any interest of Northside. Barclays should therefore have looked more closely into whether the transaction was valid from Northside's point of view. Brennan J put it this way (p182):

> "A creditor will ordinarily be put on inquiry when his debtor offers as security a guarantee given by a third party company whose business is not ordinarily the giving of guarantees, for the execution of guarantees and supporting securities for another's liabilities, not being for the purposes of a company's business nor otherwise for its benefit, is not ordinarily within the authority of the officers or agents of the company. Of course, the circumstances may show that the giving of such a guarantee and supporting security ... is for the company's benefit. For example, it may be for the benefit of solvent companies within a group to guarantee the liabilities of a holding company in order to benefit the guarantor companies as well as other members of the group. In such a case, provided that the creditor has been satisfied that it is such a case, the apparently regular execution of a guarantee and supporting security may be relied on pursuant to the indoor management rule. Of course, the only but important consequence of a creditor being put on inquiry is that, in the event that an apparently regular guarantee turns out not to have been authorised by the guarantor company, the guarantor company may show that it is not bound.
>
> When a creditor is put on inquiry, he cannot rely on the apparent regularity of execution of the instrument of guarantee and the indoor management rule but must be satisfied that the relevant officers and agents of the company have the company's authority to execute an instrument pledging the creditor assets of the company to guarantee another's debts."

Dawson J considered that the document was a forgery (p205), and that **Turquand** therefore could not apply. So did Toohey J (p206), although each of them agreed that Barclays was in any event put on inquiry. Dawson J said that on their face, the transactions were no more than a director "attempting to have a company apply its property for the benefit of other companies in which he had an interest" (p206). Hence the mortgage was invalid.

The Chief Justice spoke of a balance. On the one hand, **Turquand** should protect and promote business convenience. Persons dealing with companies should not have to investigate their internal dealings before entering into an agreement. On the other hand, fraud may result if the protection is too wide. He concluded in this way (p164):

> "... to hold that a person dealing with a company is put upon inquiry when that company enters into a transaction which appears to be unrelated to the purposes of its business and from which it appears to gain no benefit is, in my opinion, to strike a fair balance between the competing interests. Indeed, there is much to be said for the view that the adoption of such a principle will compel lending institutions to act prudently and by so doing enhance the integrity of commercial transactions and commercial morality."

As he also said, a court cannot give specific guidance on what circumstances should put prospective lenders on inquiry. One should look, obviously, to any relevant powers of the company, the nature of its business, any apparent relation of that transaction to the company business, the actual or apparent authority of those acting on behalf of the company, and any particular representations made by them about the transaction. If the provision of the security will not apparently promote the business of the company giving the security, or result in some other benefit accruing to that company, then a lender would have to set about affirmatively establishing that the company's officers have authority to enter into the transaction on its behalf, and that the affixing of the seal had been duly authorised under the company's articles of association.

## Section 164

Let me revert now to s164. As I said earlier, it is the statutory adoption of the **Turquand** rule. It confirms the protection available to persons having dealings with companies, or with others who have acquired property from companies. I briefly mention the assumptions again, while pointing out first that the person need not in court proceedings prove that he made them. It will, in effect, be assumed that, if open, the assumptions were made. They are that the company's constitution has been complied with, that a person who appears to be a director, principal executive officer or secretary has been duly appointed and has the usual authority of a person in that office, that a person held out to be an officer or agent of the company has been duly appointed and has the usual authority of such a person, that an officer with authority to issue a company document has authority to warrant that it is genuine, that a document apparently sealed and attested has been duly sealed and attested, and that the officers of the company properly perform their duties.

When are those assumptions **not** available? In short, when there is **actual** knowledge of the true and different facts; or where because of the person's **connection or relationship with the company**, he ought to know that true and different position. Actual knowledge must mean and be confined to "actual" knowledge, and not for example encompass imputed knowledge. It may be argued that where a blind eye has been turned to a fact arrived at by inference from facts actually known, then the actual knowledge should be taken to include that inferred fact. That question is mentioned in **Lyford v Media Port Folio Ltd** ((1989) 7 ACLC 271, 280). But I think that that would run against the plain meaning of the section, which in my view is such as to exclude an innocent or even calculated abstention from inquiry.

As to the constructive knowledge arising through the person's connection or relationship with the company, Nicholson J emphasised in **Lyford** (p281) that the provision is not concerned, as was **Northside**, with knowledge one ought to acquire when put on inquiry by the nature of the transaction. The section excludes the assumption only when there is **actual** knowledge to the contrary, or when one ought to know the true position because of one's connection or relationship with the company. Nicholson J said that one should look to the "whole history" of that connection or relationship. Clearly, the wider "put on inquiry" test referred to in **Northside** has been replaced, by s164, with a narrower, more protective test.

What then are the circumstances in which the **Turquand** rule, as re-stated in **Northside**, can still apply?

## Residual application for Turquand

First, the common law rule will apply to mortgages and debentures and other company documents issued or executed prior to 1 January 1984. On that date, s68A, the predecessor to s164, was first introduced into the Companies Codes. There was previously no like provision. Secondly, the common law may apply where a person does not deal with the company, or with another who has acquired property from a company. Third, there is the example given by Gummow J in **Australian Capital Television Pty Ltd v Minister for Transport and Communications** ((1989) 7 ACLC 525). Assume A sues B for damages in tort for inducing company X to break its contract with A, and B denies formation of the contract on the ground of irregularity in the internal management of the company. Section 164 would not apply, but A could rely on **Turquand** to meet B's allegation.

## Future prospects for section 164

There is an interesting disparity between s164 and **Northside**, insofar as the former does not deny protection to a person dealing with a company who, because of **the nature of the transaction**, should have been put on inquiry as to its validity. The High Court will no doubt interpret s164 at some stage. It will be interesting to see how the carefully balanced policy worked out in **Northside** may influence the interpretation of the more protective statutory provision. Brennan J, for example, expressed concern that the **Turquand** rule should not become "a charter for dealings between fraudulent officers of companies and supine financiers" (p245). Does "actual knowledge" mean just that? And it would not surprise me to hear an appellate court say that "connection or relationship with the company" is a very broad concept.

In any event whether **Northside** or s164 apply, financiers have to be very careful in investigating borrower companies. Financiers are now expected to minimise the risk that money advanced may fall into the hands of fraudulent company officers (cf Mourell: "Northside" February 1991, *Australian Business Law Review*, at p45).

## A CLEAR ROAD AHEAD?

The rather surprising result of all of this is the degree of uncertainty. The statutory provisions were obviously intended to constitute a clear charter to help financiers and others who deal with companies. Yet cases like **Qintex** and **Northside** leave me with nagging uncertainty as to whether that clear charter will ultimately find favour with the courts. (Compare the views of Cooper and Robertson: "Subsidiary Companies' Guarantees - Their Continued Existence", *Journal of Banking and Finance Law and Practice*, December 1990, p284.) What **is** clear is that to lend to companies within groups which face insolvency is to enter a mine field of difficulty. Even where the companies are healthy financially, the wise and careful prospective lender must still, regrettably, examine the question of power and the propriety of its exercise.