AUTHORITY OF OFFICERS AND OBLIGATIONS OF COMPANIES TO CREDITORS

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You will have already heard Professor Ford's masterly exposition of the law and it is really left to me to make a few tangental observations and to deal with some problems that occur in practice. I make no apology for doing this latter thing, because even though I assume I am addressing a body of people who are dealing with company and banking law at a high level, unless such people issue directions to those working at grass roots level, problems will continue to be created. Indeed, the lawyer practising in this field must work at two levels. First, he must work in the area of prevention by making sure that those administering the system know what to do. Secondly, where disasters do occur, the skilled lawyer can still save his client from ruin on many occasions by utilization of various strategies.

On the level of prevention, the commercial reality of banking is that the more precautions that a lender takes before parting with his money, (a) the more expensive it will be for the borrower; and (b) it will tarnish the banker's friendly image, and as a result, business will be lost. It is thus quite understandable that, even apart from what I might call the "con man factor", bankers will be left with problem debts with the most competent legal advice having been given to local managers and the most expert local managers being in the field. Commercially they have taken a risk and every so often the gamble fails. Having said this however, let us look briefly at the problems in practice in the area dealt with by Professor Ford.

It is quite a mistake to assume that each company is administered according to the Companies Code even though there may be an accountant who looks after its affairs. Unfortunately, very often accountants assume that all they have to do is to file with the Corporate Affairs Commission each year a piece of paper and everything will be all right with the world even though there have never been any directors' meetings in fact held, or any annual general meeting in fact held. A minute book can be produced which will contain all sorts of pieces of paper which appear to be minutes, but a little probing shows that they are mere inventions of the accountants imagination and that no meeting was ever held. Very often in this sort of company one person continually asserts himself as having the authority of the company and gives the impression to observers that the company is his alter ego.

This sort of situation continues notwithstanding the increasing amount of judicial criticism about these activities. For instance, in Bay Marine Pty Ltd v. Clayton Properties Pty Ltd (1984) 9 ACLR 780, because there had never been any annual meetings or directors' meetings, the people who would appear to be the shareholders were not the shareholders, the people who would appear to be directors were not directors, and as a result, a contract to purchase land purportedly signed by a so-called director on behalf of the company was completely invalid. Mr Justice Needham said at p.782 of the report:

> "In the course of investigating the history of this transaction, some unusual incidents in the administration of a proprietary company were met with. Some incidents, unfortunately, in my experience, are not by any means unusual.For example, the drafting of minutes prior to a meeting, the preparation and confirmation of meetings of a meeting never held, these and other abuses of company law are frequently encountered in the administration of proprietary companies."

Professor Ford in his paper referred to my recent decision of Northside Development Pty Ltd v. Registrar General. The facts in that case are instructive to lenders. The lender involved was a well known British based bank. The company had three shareholders, Sturgess, Lees and Ellis. The company "used" Sturgess' accountants. The directors left most of the day to day administration to Sturgess and the accountants took instructions from Sturgess. The accountants prepared minutes and returns, but no meetings were ever actually held. In due course the accountants became justifiably frightened of acting as secretaries of their clients' companies and the accountants told Sturgess that they wished the current secretary, one of their partners, to retire and for someone outside their firm to be appointed. The other directors said in evidence that they would not have minded had some other member of the accountant's firm been appointed secretary in lieu of the retiring partner, but they were not in fact consulted and Sturgess nominated his son as the new secretary.

Sturgess owned another company, and this company was borrowing from the bank. The first company's land was being put as security for the second company's loan. The bank instructed well known commercial solicitors to make enquiries and searches. The mortgage transaction was settled in the board room of another reputable solicitor who Sturgess had retained. This solicitor had obtained the common seal by telephoning the accountant, and the accountant had informed the solicitor that Sturgess was a director and that Sturgess Jnr was the secretary.

Fortunately for the bank, the mortgage was under the Torrens system, so that registration of it gave the bank an indefeasible title as mortgagee. However, had the land been under common law or Old System title, it would have been invalid and accordingly, the first company was able to obtain compensation from the Registrar General.

The solicitors for the bank did not give any evidence. However, the Corporate Affairs Register showed two competing sets of documents, one which showed the accountant as the secretary, and one which showed Sturgess Jnr as the secretary. Both had been lodged by the accountants. The indoor management rule did not apply because where a lender knows that a company is providing its land for security for the borrowings of one of its directors or a company controlled by him, that fact alone would make any prudent lender make enquiries and satisfy himself that what was happening was indeed an authorised act of the company that was providing security.

Another problem occurs with groups of companies. This is exacerbated if the companies have like sounding names. A recent example is Pioneer Concrete Services Ltd v. Yelnah Pty Ltd (1986) 5 NSWLR 254. It is a disaster to take a security from a company in the group which is not the company which actually holds the assets. Some hints on recovery from this sort of disaster are given later in this paper.

Because a company under the Companies Code is the most usual form of corporation which seeks finance, those at grass roots level who do not always understand the niceties between a partnership, a company, a corporation, or an incorporated association sometimes assume quite incorrectly that the Companies Code is applicable. There are, of course, other sorts of corporations such as a corporation formed by its own Act of Parliament such as many of the companies formed last century to distribute gas, corporations formed under the Associations Incorporation Act or the Co-operation Act and corporations formed under certain special legislation such as in New South Wales the Anglican Church (Bodies Corporate) Act, 1938. Not only must one look at the relevant act to see the powers of the corporate body (and in the Co-operation Act, 1924 there is a different set of powers for each type of co-operative society), but it must also be borne in mind that ultra vires may still be in full force and that s.68A of the Companies Code has no application.

On a slightly different note, a warning must be given before leaving this "preventative law" section of the paper about witnessing documents. Under the Conveyancing Act, s.38 (similarly s.73 of the Victorian Property Law Act, 1958, s.45 of the Queensland Property Law Act, 1974 and s.9 of the Western Australian Property Law Act, 1969), a deed must be attested by at least one witness not being a party thereto. This does not prevent an officer or employee of a bank witnessing a document to which his bank is a party, see e.g. Bank of Victoria v. McMichael (1882) 8 VLR (L) 11. However, the attestation must be made by a person present at the time of execution who signs the deed for that purpose: Wickham v. Marquis of Bath (1865) LR 1 Eq 17, 24; Ellison v. Vukecevic (1985) 6 NSWLR.

Under the Torrens system, the various State Acts differ in degree but provide that the signatures of the parties must be witnessed by one of a special class of people including Justices of the Peace. If a bank officer ascribes his name as witness to a Torrens system dealing where he has not personally see the parties sign, that that has been held to be a fraud against the Registrar General which will make the document invalid even though registered. The fraud must be the fraud of an agent of the party so that if a solicitor is foolish enough to ascribe his signature as witness, then unless there is evidence to the contrary, the Court may find that the client did not authorise the solicitor to do such a foolish thing. See e.g. my decision in Peddie v. Stein - 26 March, 1987. However, if the person who signs as witness is a bank officer, then it will be virtually impossible to deny agency and the effect of the false certification by the witness may remove the document from the benefit of the indefeasibility provisions of the Real Property Act, see Australian Guarantee Corp Ltd v. De Jager [1984] VR 483, 497 and National Commercial Banking Corp of Aust Ltd v. Hedley (1984) NSW Conv R 55-211.

I should make the point also that in practice, courts tend to scrutinise transactions with different degrees of strictness. Where a transaction is purely commercial and a fortiori when it involves bills of exchange which are negotiable in the commercial community, the Court will not usually look too closely at equitable niceties. On the other hand, where, even though the transaction may, broadly speaking, be a commercial one, it involves ordinary people putting their houses up as security, the very often lack of commercial probity by the lender will disqualify it from relief, see e.g. Commercial Bank of Australia Ltd v. Amadio (1983) 151 CLR 447. In this area too, statutes such as the Contracts Review Act, 1980 (NSW) may have application and may even enable the borrower to circumvent the clause beloved of lenders making the certificate signed by its manager conclusive evidence in an appropriate case, see Cook v. Bank of New South Wales (1982) 2 BPR 9580, questioning the applicability of Dobbs v. National Bank of Australasia Ltd (1935) 53 CLR 643 where the Contracts Review Act is applicable.

I now turn from the practical to the strategies for recovering from disasters - at least partially.

The first strategy to bear in mind is what is known as warranty of authority. It is a principle of law that if A warrants to B that A has authority to do a certain act and A does not have that authority, then B can sue A on the warranty of authority for the damages he suffered: see Collen v. Wright (1857) 120 ER 241; Yonge v. Toynbee [1910] 1 KB 215; Leggo v. Brown & Dureau Ltd (1923) 32 CLR 95; Brownett v. Newton (1941) 64 CLR 439 and Black v. Smallwood (1966) 117 CLR 52, 64. Not only is an action against the director or officer of the company who warranted that he held the appropriate position a good claim in law, it also has the added advantage of either inducing an early settlement, or alternatively, making the defence by the company collapse because the individuals would far prefer a judgment against the company than against them personally.

Another aspect of warranting authority is indeed involved in the indoor management rule itself because as Wood J said in Barclays Financial Holdings Ltd v. Sturgess (1985) 3 ACLC 662, 670, the doctrine really depends on someone with actual or apparent authority warranting the authentication of execution of the relevant documentation by the company.

Another useful strategy is to rely on the doctrine of conventional estoppel. This doctrine was revivified by the English Court of Appeal in Amalgamated Investments & Property Co Ltd v. Texas Commerce International Bank Ltd [1982] QB 84. The doctrine is that if both parties to a transaction make a common assumption on a state of facts as the basis of their transaction, then as regards that transaction, each is estopped as against the other from questioning the truth of the statement of fact so assumed. Exactly how far the doctrine goes is still to be settled. In Coghlan v. SH Lock (Aust) Ltd (1985) 4 NSWLR 158, the facts were that the defendants gave guarantees of a company Colan Industries Pty Ltd. This company was one of nine in what might loosely be called the Colan group of companies. Three of the companies, but not Colan Industries Pty Ltd, traded as Colan Products. The banker drew 11 bills of exchange in favour of Colan Products which were dishonoured. The Court of Appeal held by virtue of the doctrine of conventional estoppel the guarantee covered the liability of Colan Products on the bills. The Court of Appeal's decision was not unanimous: the case went to the Privy council where the law lords closely questioned some of the statements made in the judgments of the Court of Appeal, but dismissed the appeal on a construction point so it was not necessary for them to rule on conventional estoppel. This places Australian lawyers in a state where New South Wales lawyers are bound by the majority of the Court of Appeal, yet there is a very convincing dissenting judgment by McHugh J which may yet be established as the law either by a subsequent decision of the NSW Court of Appeal or by the High Court of Australia or by the appellate courts in other States. Although the exact extent of the doctrine is unclear, the main purpose of this paper is to point out its usefulness as a strategy to avoid the consequences which may come about through careless paperwork or local executives spending too much time on the commercial aspects of the transaction and insufficient on getting the documentation correct.

May I now turn from strategies to two situations where obligations of companies to creditors have been tightened by court decisions in recent years.

The first of these is a recognition by the courts that directors of companies do owe obligations to creditors as well as shareholders. In Kinsela v. Russell Kinsela Pty Ltd (1986) 4 NSWLR 722, Street CJ (with whom Hope and McHugh JJA agreed), said at p.730:

> "In a solvent company the proprietary interests of 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."

Then after approving references to Walker v. Wimborne (1976) 137 CLR 1, 6-7 and Nicholson v. Permakraft (NZ) Ltd (1985) 3 ACLC 453, the Chief Justice said:

> "Once it is accepted, as in my view it must be, that the director's duty to a company as a whole extends in an insolvency context to not prejudicing the interests of creditors the shareholders do not have the power or authority to absolve the directors from that breach."

I followed this decision in Hooker Investments Pty Ltd v. Email Ltd on 24 April, 1986, and the Full Court of South Australia dealt with the problem in a similar way in Grove v. Flavel (1986) 11 ACLR 161.

The other development has been to protect creditors against trading trusts. There seems to be the idea amongst many of the commercial community that of one trades in the name of a company as trustee for say the Bloggs Family Trust, then as the company has no assets other than that which it holds as bare legal trustee, it can never be liable to pay any creditors that it does not feel like paying. The law up to 1981 was well discussed in the learned article by Professor Ford in (1981) 13 MULR 1. At pp.15-19, he discusses the right of a creditor to latch on to the trustee's right of exoneration out of the trust property, see e.g. Re Johnson (1880) 15 ChD 548. Professor Ford's article was quoted with approval by White J in South Australia in Re Pheon Pty Ltd (1986) 11 ACLR 142, which sets out a complicated trust and sub-trust scheme. Other developments have been that the courts are more ready now than they ever were to permit creditors to put in liquidators of the trustee company and for those liquidators to recover from the beneficiaries personally the appropriate indemnity. See e.g. Grime Carter & Co Pty Ltd v. Whyte's Furniture (Dubbo) Pty Ltd [1983] 1 NSWLR 158 and JW Broomhead (Vic) Pty Ltd v. JW Broomhead Pty Ltd & Ors (1985) 9 ACLR 593. Another alternative is to put the trust into general administration, see my decision in McLean v. Burns Philp Trustee Co Pty Ltd (1985) 2 NSWLR 623, 637. That decision does not go all the creditors' way, however, because at 640 I recognized that by an appropriate clause in the trust deed or contract a person might limit his liability to a specific fund subject to the Court's refusal to permit such clauses to be used as cloaks for fraud. See also the discussion on these cases in the 5th Edition of Jacobs on Trusts at pp.584-587. I should note that in Jacobs p.644, the learned authors indicate that my views in McLean's case on general administration "are more widely expressed than in other 20th century authorities".

Having reconsidered this paper, I am appalled by the number of references there are to my own decisions. I like to think that this is because I have become more acutely aware of the problems that were before the Court in those cases than I might otherwise have been and it is far more convenient to give a reference to my thinking about the matters dealt with in this paper where it appears already in the law reports rather than to set it out again here. Although those decisions have the authority of decisions of the NSW Supreme Court at first instance level, I am not yet sufficiently vain to think that they are the last word on the matter, and I would not be at all surprised if some of you when citing them to a court were merely to be told, "Oh really, we have noted that, but have you got any better arguments!".