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

QUESTIONS AND ANSWERS

Comment - Mark Sneddon (Monash University Law School):

Judge, I was following up on that thought that you had put, what would have happened in the **Qintex** case had the guarantees actually been executed? Would they have then been valid? My analysis, which is just in the last 15 minutes, is slightly different to yours, and so I would like to put it to you and get your comments on it.

First of all I agree with you that had the guarantees been given, ss160 to 162 of the Corporations Law would have solved the problem of corporate capacity. I think that is fairly clear, that the company would have had capacity to give the guarantees. But then I think you have to turn in your analysis to look at the question of the wider doctrine of ultra vires - abuse of power - giving the guarantees for an improper corporate purpose. And the analysis would then turn on the effect of s164, which allows an outsider to assume that the directors or the officers of the company have properly exercised their duties.

Now in that case, it would seem to me that if the guarantees had been given at a time when everybody was solvent within the group, there would not necessarily have been any actual knowledge, and nothing in the connection or relationship of the lender to those companies to put it on notice that there was any impropriety. Therefore the lender as a third party could have happily assumed that everything was all right and the transactions would therefore have been sound under s164.

On the other hand, had you been moving to a situation where the subsidiaries were insolvent, the nature of the connection of the relationship of the lender to the subsidiary might have been such as to put them on notice that there was some impropriety or abuse of power which would have vitiated the protection of the lender and the third party, under s164 and made the transaction voidable at the instance of the company, that is assuming that **Rolled Steel** applies in Australia.

Would you or Stephen like to comment on that if that line of thought is correct in your view.

Response - The Hon Mr Justice Paul deJersey (Speaker):

Yes. Well, I recognise the difficult financial circumstances of **Qintex**. I suppose what I was really trying to pose was the more basic situation of a company which in such a circumstance had given a guarantee of the subsidiary's obligations, and that had been accomplished where there was no benefit to the company at all giving the guarantee. But obviously the circumstances of the financial difficulty of the subsidiary raises the

connection and relationship point underneath the **Turquand** codification in the way that you mention, and I agree with you. I do not know what Stephen might like to say about that, if anything.

Response - Stephen Spargo (Commentator):

I would tend to agree. Section 161(3) I thought had been enacted to overcome **Rolled Steel** and that it makes it quite clear that the fact that there is some express restriction or prohibition does not protect the exercise by the company of the power. It seems to me from **Qintex** and in particular what the judge was saying that if the guarantees had been granted, then that would have been the end of that, subject of course to whether under s68A (now s164) there was some other basis for attacking the exercise of the power. This would include looking at the exercise by the directors of their management responsibilities under the articles in executing the guarantee - where there is something for them to protect.

Comment - The Hon Mr Justice Paul deJersey (Speaker):

Can I add something. The problem with power, I think, comes from the engrafted obligation to creditors which has arisen from **Qintex**, which may be seen, I think as an unfortunate derogation from all the powers of a natural person point made under the Corporations Law. I would have to think for a moment about the obligation of a natural person when giving away property to his creditors if he is facing bankruptcy. I suppose there is some comparable provision in that context.

Comment - Mark Sneddon (Monash University Law School

I have just one follow-up comment to what Stephen said and that is that the provisions in s161(3) I think from memory, I do not have the law in front of me, says that the failure of the directors to act in accordance with the best interests of the company does not affect the capacity of the company. Now it says in the Explanatory Memorandum that that was put in to abolish **Rolled Steel**, but it seems to me the wording of it is inadequate to do that because the provision only addresses the capacity of the company and not the doctrine of abuse of power. So there is an argument there that even though improper purpose does not affect capacity, that is really a restatement of current law and you are still left with the possibility that even though there was capacity to do the act, if there was an improper purpose the transaction is voidable at the instance of the company *a la* **Rolled Steel.** I just put that as an alternative interpretation of s161(3) which still leaves you with going back to s164 to try and solve it.

Comment - Tom Bostock (Mallesons Stephen Jaques, Melbourne):

I would just like to make a brief observation. It struck me listening to the discussion of three speakers this morning of the Australian and United Kingdom experience and then to Mark Sneddon's comment that the wisdom of Sir Owen Dixon when he noted the paragraph many years ago at the Australian Legal Conference that the most difficult problems in the law seem to arise out of attempts to reform it!

Question - Denis Clifford (Buddle Findlay, New Zealand):

The question I have got relates to cross-guarantees and cross-debentures, the totally typical practical situation where the group vehicle always bury the unsecured creditors of any one subsidiary - if it gives a debenture to secure the group debt supporting its guarantee, then the unsecured creditors in an insolvent winding up, which is the only one that really matters, will miss out. How do you answer the proposition that the giving

of the guarantee and the granting of the security can never be in the interests of the creditors of the subsidiary in question and therefore under this residual concern, no matter what reform to ultra vires we put in, that you can actually never answer the challenge from the unsecured creditors that that type of arrangement cannot be in their interests when it matters, which is when there is an insolvency.

Response - Francis Neate (Commentator):

I think that is an over-simplification of the situation of groups when they start getting into difficulties. The fact of the matter is that if the parent company goes, the subsidiaries are likely to have their lifeline cut, and they themselves are likely to immediately run into difficulties even if they can fund their own businesses out of their own cash flow. And you find that frequently happening in all big collapses. In our case, I suppose the British Commonwealth collapse was the best example of that. It turned out within six months that not a single business that that group owned was worth a bean. Yet, some of those businesses were really OK as long as there was confidence in them. I think you have to come back to the whole problem of confidence and this is why parent companies do have to prop their subsidiaries up. And we actually understand it might be quite difficult to explain that to a judge, but I think it is reality. Actually explaining a lot of realities to judges is quite difficult.

Response - The Hon Mr Justice Paul deJersey (Speaker):

Well the real problem is that judges are stubborn, self-important, power-drunk!!!

Comment - Professor Bob Baxt (Chairman):

Just one comment unrelated to the discussion that we have just had. I was very interested in the judge's remarks, in his paper and his oral remarks, about the injunctive power under s1324 of the Corporations Law which seems to me to be under-used. There is a very interesting statement of the width of that particular power - a couple of lines by Mr Justice Black, the present Chief Justice of the Federal Court - in recent litigation involving the power of the Takeover Panel, the **Precision Data** litigation which is worth looking at. That power under s1324 is potentially extraordinarily wide.

Ladies and gentlemen, we have been very privileged this morning. We have had a very detailed, learned paper by the judge that you have had an opportunity to read in advance of this oral presentation. We have had to excellent oral presentations from Stephen Spargo and Francis Neate and I am sure you would like to join with me in thanking them for contributing to the opening session.