CORPORATE AUTHORITY AND DEALINGS WITH OFFICERS AND AGENTS

Larelle Chapple
Senior Lecturer
TC Beirne School of Law
The University of Queensland

and

Phillip Lipton
Associate Professor
School of Accounting and Law
Royal Melbourne Institute of Technology University

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The Centre for Corporate Law and Securities Regulation
Faculty of Law
The University of Melbourne
Vic 3010
Australia

Phone: 61 3 8344 5281
Fax: 61 3 8344 5285
Email: cclsr@law.unimelb.edu.au
Website: http://cclsr.law.unimelb.edu.au

CCH Australia Limited
CAN 000 063 197
101 Waterloo Road
North Ryde NSW 2113
Australia

Phone: 61 2 9857 1300
Fax: 61 2 9857 1600

Chapple, Larelle
Lipton, Phillip
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The Centre's contact details are:

Tel: 61 3 8344 5281
Fax: 61 3 8344 5285
E-mail: cclsr@law.unimelb.edu.au
http://cclsr.law.unimelb.edu.au

Preface

This monograph was written with the purpose of bringing up to date an earlier monograph *The Authority of Agents and Officers to Act for a Company: Legal Principles* by Phillip Lipton. This was necessary due to several changes and developments in the law since the original monograph was written in 1996.

The Company Law Review Act 1998 came into effect on 1st July 1998 and while retaining the broad thrust of the previous legislation, introduced some significant differences in wording. It remains unclear to what extent these differences alter the meaning and operation of the legislation and previous common law however we believe that it is useful to revisit the legislation in the context of the history of the common law rules underpinning the statutory provisions and the policies these rules sought to implement. The various attempts to codify the common law are also important to consider in order to enhance the understanding of the objectives sought to be met by the current legislation.

In addition to these legislative amendments, there have also been several recent cases that cast light on the operation of the legislation and its purposes. This monograph compares and contrasts these cases so as to assess whether a preferred approach may be discernible which would enable the law to be applied in a consistent and commercially realistic manner.

The consideration of these issues has resulted in a work that departs significantly from the earlier monograph to the extent that it is substantially a new work rather than a revised edition.

We wish to thank Professor Ian Ramsay, Director of the Centre for Corporate Law and Securities Regulation, Faculty of Law, University of Melbourne for his encouragement for us to proceed with this work and agreeing to publish it.

Larelle's contribution to this monograph is derived substantially from material in her doctoral thesis as well as prior publications, which are referenced in this monograph. Accordingly, it is appropriate to express gratitude to her prior co-authors, Ms Janine Pascoe from Monash University and Dr David Morrison from the University of Queensland. Professor Bryan Horrigan (The University of Canberra) has provided valuable advice on the thesis version of the material and the Law School at Queensland University of Technology, Brisbane has graciously granted the use of facilities and resources. In this regard, the support of Professor Paul von Nessen is acknowledged.

Many of Larelle's colleagues at the University of Queensland have sustained and supported her endeavours, including Ms Brenda Marshall, Dr Pam Kent, Mr Scott Hirst, Professor Colin Ferguson and Dr Mary-Rose Cooney – to mention a few. Financial support from the Commerce Research Fund, School of Commerce, The University of Queensland, is gratefully acknowledged.

Last but not least, Larelle wishes to thank her family: Mark, Jeremy and Jack Chapple.

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List of Abbreviations

AC	English Law Reports, Appeals Cases
ACLC	Australian Company Law Cases
ACSR	Australian Corporations & Securities Reports
ALR	Australian Law Reports
All ER	All England Law Reports
App Cas	Law Reports, Appeal Cases, House of Lords
ASC	Australian Securities Commission
BCLC	Butterworth's Company Law Cases
Ch	English Law Reports, Chancery
Ch	App Law Reports, Chancery Appeals
ChD	English Law Reports, Chancery Division
CLERP	Corporate Law Economic Reform Program
CLR	Commonwealth Law Reports
DLR	Dominion Law Reports
ER	English Reports
HL	Cas Clark's Reports, House of Lords
HCA	High Court of Australia
KB	Law Reports, King's Bench Division
LR HL	Law Reports, English and Irish Appeals House of Lords
M&W	Meeson and Welsby's Reports, Exchequer
NSWLR	New South Wales Law Reports
NSWR	New South Wales Reports
NSWCA	New South Wales Court of Appeal
NZLR	New Zealand Law Reports
QB	Law Reports, Queen's Bench Division
QLS	Queensland Law Society
SASR	South Australian State Reports
SR(NSW)	State Reports, New South Wales
VLR	Victorian Law Reports
VR	Victorian Reports
WAR	Western Australian Reports
WLR	Weekly Law Reports

Chapter 1

Introduction

The legal fiction of the separate legal entity principles enables companies to be bound by contracts entered into with outside parties. However, for the company to be bound by the contract, several "internal" transactions must have occurred. These internal transactions are not necessarily observable to the outside party. First, as a result of registration of the company, the company has been granted contractual capacity, but the scope and limitations on its powers need to be identified. Second, the company will have appointed officers and agents to act on its behalf, but the scope of their authority must be identified. Third, regardless of the scope of authority expressly granted, the general law imposes inherent restrictions on the exercise of authority by corporate agents, for example, they must exercise the company's powers according to the fiduciary constraint to act in the best interests of the company.

If the scope of these internal transactions is exceeded or otherwise abused by corporate officers, it has consequences for the contracts entered into with outsiders. To minimise the risk of unenforceability for the outsider, the general law, followed by statutory codification, developed some principles to assist the outsider in enforcing contracts. Sections 128–129 of the *Corporations Act*[1] purport to comprise a statutory adoption of the common law rule known as the Rule in *Turquand's* case[2] or the "indoor management rule." This rule formed the common law basis of the application of agency principles to companies. Its essence was to allow outsiders dealing with a company to assume that the internal proceedings of a company were properly carried out.

The Rule in *Turquand's* case has traditionally struck a balance where officers of a company act without authority. It protects outsiders and enables them to enforce contracts against a company. At the same time the rule was subject to several exceptions that limited its protection to outsiders who act bona fide. In recent times this issue of corporate authority has most often arisen in the context of financial transactions where a company has contested the validity of a document executed under the seal of the company. From the point of view of lenders such as banks, the most important issue that has arisen is the scope of exceptions, that is, whether the lender was put on inquiry by the circumstances surrounding the formal execution of the contract.

Since 1983, the rule has been codified and set out in the *Corporations Act* in the form of assumptions representing the various aspects of the rule and limitations that correspond to the exceptions to the rule. These limitations are now contained in s 128(4) of the *Corporations Act*. Whilst there have been three iterations of the statutory indoor management rule since 1983, there remains uncertainty as to the scope of protection afforded to outsiders dealing with companies. In particular, the statutory limitations to some

1 See Appendix I, where the current and former provisions in the *Corporations Act* are reproduced.
2 *Royal British Bank v Turquand* (1856) 119 ER 886.

extent differ from the common law exceptions, especially as the *Corporations Act* does not explicitly provide for an inquiry exception. However, case law demonstrates that judges may be prepared to interpret the limitations in s 128(4) consistently with the policy behind the common law rules.

The most recent statutory reform to corporate contracts and authority of agents occurred with the *Company Law Review Act* 1998. Operational since 1 July 1998, the *Company Law Review Act* 1998 inserted new provisions relevant to corporate contracts and agents, dealing with:

1. the role of the corporate constitution and simplification of corporate powers and ultra vires;[3]
2. the procedures for companies entering into external contracts; and
3. the scope of protection conferred to third parties entering into these contracts.[4]

It is timely to re-examine the statutory rules for corporate contracts. The reforms superficially appear to be a mere simplification of the prior statutory regime, which itself was subject to some uncertainty in application. This monograph describes the common law rules surrounding the principles of agency law in their application to companies. Central to the common law position is the doctrine of constructive notice and the Rule in *Turquand's* case and its exceptions. One of the features of agency law in its application to companies was that an outsider dealing with a company was taken to have constructive notice of the company's public documents. In this context, the most important of these documents was the company's constitution, in particular where it contained a restriction on the authority of the company's officers or agents. This doctrine of constructive notice operated in favour of the company and against the outsider by deeming that the outsider was aware of the restriction of authority. Therefore the company as principal was not liable under a contract entered into by an officer or agent who exceeded the authority conferred by the constitution.

The Rule in *Turquand's* case recognised that in some cases, an agent may act without authority, however this would not be apparent to an outsider even after reading the constitution. The rule protected the outsider and operated against the company unless certain exceptions arose which resulted in the loss of this protection.

Of course, agents exercise authority within the context of the company as a separate legal entity, with its own contractual capacity. All companies' capacity to enter into contracts has been affected by developments in the doctrine of ultra vires. "Ultra vires" means "beyond power" and when used in company law, refers to corporate capacity, where transactions outside the formal objects and powers stated in a company's constitution were previously void.

The corporate debt or finance contract provides a compelling application of the rules of agency and the interaction with the statutory rule. This is due primarily to the prevalence of litigation. Litigation over the last decade shows that lenders, as outsiders, are involved in disputes with companies in enforcing corporate borrowing or securities trans-

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3 The *Company Law Review Act* 1998 inserted new Chapter 2A – Registering a company, and new Part 2B.1 – Company powers and how they are exercised.

4 The *Company Law Review Act* 1998 inserted new Part 2B.2 – Assumptions people dealing with companies are entitled to make.

actions. The magnitude of such contracts, the degree of formality that surrounds their formation and the degree of scrutiny that lenders are subjected to in relation to borrowers and security providers indicate a need for practical guidelines to maximise enforceability of these types of corporate contracts.

Within this framework, the principles of agency law with respect to implied actual authority and apparent authority are applicable to contracts with companies because an agency relationship arises as a result of the appointment of an officer or a holding out that such an appointment has been made. Accordingly, we commence this monograph by reviewing, in chapter 2, the general principles of agency as they apply to corporate contracts.

Following the analysis of the Rule in *Turquand's* case and its exceptions and limitations contained in chapters 3 and 4, chapter 5 discusses the history and background of statutory reform to the indoor management rule, and related doctrines, such as constructive notice and ultra vires. Chapter 6 analyses in detail the statutory assumptions in s 129. In a number of respects, these assumptions incorporate the common law agency principles. The primary focus is considering whether the statutory indoor management rule achieves its stated purpose of clarifying and codifying the Rule in *Turquand's* case. The purpose of the legislation was stated as being to "ensure that a person who deals in good faith with persons who can be reasonably supposed to have the authority of the company should be protected against later [claims] by the company that the persons purporting to act for it lacked authority".[5] Whilst chapter 7 briefly digresses to examine the common law rule against forgeries and the extent to which the *Corporations Act* now abrogates it, chapter 8 discusses the scope the limitations to the statutory rule contained in s 128(4). It is suggested that the current statutory limitations do not substantially depart from their common law derivation.

As borrowing and security contracts indicate a particular instance of vulnerability, chapter 9 sets out a number of practical implications for lenders arising from the analysis of both the common law and statutory provisions relating to corporate authority.

Finally, chapter 10 offers our summary and overall conclusions, detailing the scope of legislative reform and suggesting future reforms to the statutory rule and its limitations to reflect the policy of the Rule in *Turquand's* case with greater clarity than at present.

5 Explanatory Memorandum, *Companies and Securities Legislation (Miscelleneous Amendments) Act* 1983, [188].

Chapter 2

Actual and Apparent Authority of a Company's Agent

Company Contracts

As a company is an abstract entity, it can only enter into contracts through the actions of a natural person. Section 126 provides that a company's power to make a contract may be exercised by an individual acting with the express or implied authority of the company. A contract may also be made with or without a common seal. Section 127 prescribes how written contracts are to be executed, whether by seal or not.

Sections 126 and 127 indicate that a company may enter into a contract directly through one of its organs, usually the board of directors, or through a person who represents the mind and will of the company. The clearest way in which this occurs is by the affixing of the company seal. This type of situation is governed by the organic theory of company law that largely lies outside the law of agency but draws upon it.

A company may also enter into a contract indirectly through an agent. The agent may be an officer or employee of the company. Whether a company will be liable under a contract for the acts of an officer or agent is governed by the general law of agency. These agency principles have been modified by the *Corporations Act* so as to recognise the abstract nature of companies. The agency rules that are particularly applicable to companies are also affected by the common law rules known as the doctrine of constructive notice and the Rule in *Turquand's* case. *The Corporations Act* now governs these rules, in ss 128–130. This monograph is primarily concerned with these provisions but as they presuppose and are based on the above rules and general agency principles, it is first necessary to examine the common law rules. Accordingly, this chapter sets out the foundation principles of agency, whilst the following two chapters examine the scope of the Rule in *Turquand's* case and its limitations.

At common law, a particular feature of the applicability of agency principles to companies was that the acts of an agent could only bind the company if they were within the objects of the company as stated in its constitution.[1] Acts outside the scope of the company's objects are ultra vires ("beyond powers") and were once not binding on the company. Section 125(2), however, provides that a contract with a company is not invalid just because it is outside its object clause. Similarly, s 125(1) provides that if a company's constitution contains restrictions on powers, contracts are not invalid merely due to non-compliance with these restrictions. Ultra vires actions have no direct relevance under s

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1 Prior to the *Company Law Review Act 1998*, companies were required to have a memorandum of association and articles of association. This requirement has been abolished since 1 July 1998. In this monograph, we have adopted the current term 'constitution' when referring to the company's constituent documents, in preference to the former concepts of memorandum and articles. For those companies that may still have a memorandum and articles, s 1415 provides that these documents will become the company's constitution.

125, and may only be enforced as statutory contracts in the same way as other contraventions of the company's constitution, under s 140(1). Ultra vires actions may also be relevant indirectly, where they form part of an action involving breaches of duty by directors, oppression or applications for winding up by members.[2] These indirect effects of ultra vires generally involve proceedings of an internal nature. The main purpose for abolishing the ultra vires doctrine in relation to outsiders has been to afford additional protection to outsiders in their dealings with companies. Companies can generally no longer rely on restrictions contained in their constitutions to avoid contractual obligations.

A distinction is made between acts that are ultra vires the company because such acts are beyond the power of the company and acts that are within the company's power but outside the authority of the company's officers or agents when exercising the power. In the latter case the officer or agent is sometimes confusingly described as acting ultra vires. This confusion has been acknowledged in the past. For example, Slade J in *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*[3] stated:

> "Primarily [ultra vires] is used to describe acts which are beyond the capacity of a company ... [T]he phrase is also sometimes used to describe acts which are not beyond the capacity of the company but simply beyond the authority of either the board of directors or a majority of the shareholders. In many instances the sense in which the phrase is being used is far from clear...".

Corporate power exercised in the absence of, or in excess of authority, is sometimes referred to "inherent incapacity".[4] Understanding the effects of inherent incapacity involves applying the general law of agency to the corporate context, where the company is the principal, and its officers are the agents.

Identifying the grant of authority is through elimination: an agent may bind a principal where the agent has actual authority or apparent authority. (Apparent authority is also known as ostensible authority or authority by estoppel.) Further, in corporate law, certain positions on the company board automatically confer a certain grant of power, referred to as customary authority. Customary authority of particular officers assists in applying the general concepts of actual and apparent authority to companies. Each of these types of authority (actual, apparent and customary) is briefly discussed below, with pertinent examples involving companies and their officers.

Actual Authority

Actual authority arises where the principal has given consent to the agent to act for the principal.[5] This may derive from an express or implied conferral of authority (e.g in the corporate constitution) by the principal to the agent to do certain acts or enter into a particular transaction.

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2 See Explanatory Memorandum, *Company Law Review Act 1998*, [8.4]; S Woodward, 'Ultra Vires Oversimplified: Changes to Company Powers Under the Second Corporations Act Simplification Bill' (1997) 15 *Company and Securities Law Journal* 162, 169. The ultra vires reforms are discussed in chapter 5.

3 [1986] 2 Ch 246, 286. Approved of by *Advance Bank of Australia v FAI Insurances Ltd* (1987) 5 ACLC 725, 733 (Kirby P).

4 See for example K Dharmananda, 'Ultra Vires Goes Ultra Violet' (1997) 71 *Australian Law Journal* 622, 622;T Cain, 'Ultra Vires in 1984' (1985) 1 *Queensland Institute of Technology Law Journal* 31, 31.

5 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (10th ed, 2001) [13.030].

In a company context, an officer or agent will often have implied actual authority. A company will usually give consent to an agent to act for it by appointing the agent to a particular position. Generally, the constitution will confer a wide power of management on the board of directors.[6] In the usual case, the board is the organ of the company for the purposes of management so that its acts are the acts of the company itself. The authority of the board in this respect stems directly from the constitution. While the board is more than an agent as regards contracts between a company and an outsider, it has actual authority in the same way as an agent may have actual authority to act for the company.

Usually, outsiders do not deal directly with the board. Rather, they deal with a person to whom the board has delegated some or all of its functions. This person may be appointed as managing director of the company[7] upon whom the directors may confer any of the powers exercisable by them.

The appointment of a person as managing director results in that person having the implied actual authority usually associated with that position.[8] The implication arises from the fact of the appointment as managing director and the usual or customary authority of a managing director in the circumstances of the company and the nature of its business.

In several cases during the 1990s,[9] the phenomenon of the "de facto" managing director may be observed. An officer may not actually be appointed as managing director, but if they act in that capacity with the consent and acquiescence of the board, it is legitimate to find that they have the authority that goes with that position. It is common for boards to regard one of their number as the managing director with ultimate responsibility for the management of the company, however, the formal appointment contemplated by s 198C or similar provisions in the constitution has not been carried out. To facilitate transactions with third parties, the courts have conferred on dominant controllers with acquiescing boards the full authority of the company, most noticeably in cases involving corporate groups. This extension of actual authority creates a new category of officer that has been referred to as the de facto managing director.[10]

This result was achieved in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*,[11] where Mr Goldberg, a director was taken to have implied actual authority to act as the company in circumstances where he held a controlling shareholding and assumed the role of managing director with the acquiescence of the other directors. Transactions had generally been entered into without prior reference to the board and no attempt was made to interfere with his assertion of control over the company's affairs.

The acquiescence of members of the board to the conferral of actual authority requires "not merely the silent acquiescence of the individual members of the board, but

6 See s 198A set out in Appendix I (and former Table A art 66).

7 See s 198C set out in Appendix I (and former Table A art 79(1)).

8 *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549.

9 See for example discussed below: *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253, *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 11 ACLC 952.

10 See for example P Hanrahan, I Ramsay and G Stapledon, *Commercial Applications of Company Law* (2nd ed, 2001) [21–240].

11 (1992) 10 ACLC 253.

the communication by words or conduct of their respective consents to one another and to [the agent]."[12]

Normally, the appointment of a person as a director does not carry with it the implied actual authority to bind the company.[13] The power of management under the constitution is conferred on the board as a collegiate body.

The appointment of a person as secretary of a company confers implied actual authority to make contracts in connection with the internal administration of the company but not in relation to the management of the company in the sense of carrying on the company's business.[14]

Whether a director elected as chair has implied actual authority to bind a company is not entirely clear. The usual functions of a chairing director do not generally extend to conducting the company's business operations[15] and a he or she has no more authority to bind the company than has any other single director.[16] The authors of *Ford's Principles of Corporations Law* suggest that as officers who hold the chair commonly receive more remuneration than do other directors, there may be some things that the director elected as chair of a public company is impliedly authorised to do beyond the usual authority of a single director.[17] While the usual authority of a director elected as chair is unclear, the existence of implied actual authority may be determined from the circumstances and conduct of the company and its chair in the same way as occurred in the *Brick and Pipe* case.

This situation involving a director elected as a chair arose in *Equiticorp Finance Ltd v Bank of New Zealand*.[18] The Equiticorp Group was comprised of companies in its finance arm and other companies in an industrial arm. Hawkins was chair of the Group and director of a number of companies. A company in the industrial group borrowed money from a bank. The bank required early repayment and Hawkins applied assets of two member companies of the finance arm with the tacit approval of all but one of the directors of the finance arm companies. There was no formal approval from the boards of the finance arm companies for the transfer of assets. When the companies went into liquidation, the liquidator sought recovery of the assets on the ground (among others), that the payment of the assets was not authorised by the two companies. Clarke and Cripps JJA, in a majority judgment, held that the business of the various companies in the Equiticorp Group was conducted under the general authority of Hawkins who undertook all decisions of significance either with or without consultation with senior members of management. In these circumstances, Hawkins had implied actual authority to apply the assets of the finance companies in the manner in which he directed.

In a dissenting judgment, Kirby P held that no implied actual authority had been conferred on Hawkins. He stated:

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12 *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 501 (Diplock LJ).
13 *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 645 (Dawson J).
14 *Panorama Developments (Guilford) Ltd v Fidelis Furnishings Fabrics Ltd* [1971] 2 QB 711 and *Northside Developments*, 645 (Dawson J); *Re Tummon Investments Pty Ltd* (1993) 11 ACLC 1, 139.
15 *Hughes v NM Superannuation Pty Ltd* (1993) 11 ACLC 923.
16 *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549.
17 Supra n 5, [13.090].
18 (1993) 11 ACLC 952.

> "Where, however, actual authority is held to be implied, it remains vital to ask the question: 'authority for what?' It cannot be an authority at large to do anything at all. Relevantly, it must be authority to do something apparently in the best interests of the company."[19]

Kirby P also found that the other directors were either unaware of the disposal of the assets or were opposed to it. This did not amount to acquiescence at the time in the transfer of the assets. In his judgment, Kirby P noted that outsiders should be protected in their dealings with companies that operate in an irregular way and are dominated and effectively controlled by particular individuals. However as the bank knew of the structure of the Equiticorp Group, "it is to debase the integrity of company law, and the obligations of companies to operate according to law, to extend the protective principle to cloak Mr Hawkins with implied actual authority...The suggested imperative of 'realism' and the realpolitic of corporate control does not authorise courts to ride roughshod over the due observance of company law."[20]

This dissenting judgment emphasises the balance of interests that is at the heart of determining when a company is to be bound by the unauthorised acts of its officers. These considerations form the basis of the common law principles and the statutory assumptions and limitations contained in the statutory indoor management rule.

The implied actual authority of an officer may be restricted by the circumstances of the company. In *Bank of New Zealand v Fiberi Pty Ltd*[21] at first instance, it was held that one director had not acquiesced to giving the other director implied actual authority usual for a managing director, where the purpose of the company was to hold the title to the directors' family home. This limited function of the company meant that it was unnecessary for the company to appoint such an officer.

This case went on appeal and was dismissed by the Court of Appeal on other grounds.[22]

Apparent Authority

An agent's apparent or ostensible authority (the terms "apparent" and "ostensible" authority have the same meaning) creates the agency relationship because of the appearance of authority conferred on the agent. It does not depend on any agreement or relationship between principal and agent. It is often the case that an outsider does not know whether an agent has actual authority and the extent of that authority. Usually, all the outsider relies on is the appearance of authority. Depending on the circumstances, the extent of an agent's apparent authority may be the same as the agent's actual authority or it may exceed the scope of the agent's actual authority. In some situations a person may have apparent authority to do particular acts for the principal even though that person has been given no actual authority to contract. Thus actual and apparent authority rest upon entirely different bases but may often overlap.

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19 (1993) 11 ACLC 952, 978.
20 (1993) 11 ACLC 952, 979.
21 (1992) 10 ACLC 1557.
22 (1994) 12 ACLC 48. This case considered the statutory assumptions and limitations and is discussed in chapters 6, 7 and 8.

If an agent's apparent authority can be established, it creates an agency by estoppel. This means that as between principal and outsider, the principal is prevented or estopped from denying that the agent lacked authority. An exercise of agency by estoppel creates a valid contract between the principal and outsider in the same way as an agent with actual authority creates a contract.

The principal must make the representation of the agent's authority to the outsider. A principal is not liable merely on the representations of the agent. Where an outsider deals with a particular person, it may be difficult to determine whether the dealing is with the company or only with that person. In particular, is a representation made by a person acting as an officer to be taken as a representation by the company?

The principal may expressly make the representation to the outsider. It is more usual for the representation to arise by the principal's conduct. A representation by conduct may take either one of three forms:

1. It may arise when the principal permits the agent to occupy a particular position. In such cases the principal represents or holds out that the agent has the customary authority of a person in such a position. In this respect it is similar to an agent with implied actual authority resulting from the position occupied.[23]
2. It may arise when the principal's conduct permits the agent to carry out particular tasks on the principal's behalf that are beyond the scope of the agent's customary authority. For example, a single director may be permitted by the company to contract on its behalf in a number of previous transactions. This is a holding out that the director's authority is greater than would normally be the case.[24]
3. It may also arise where the agent holds no formal position in the company but the principal's conduct nevertheless leads the outsider to believe that the agent has authority.[25]

The most common situation is the second scenario, where a person is allowed by the board to act as a managing director even though not appointed to this position. Apparent authority may arise even though implied actual authority may not have been conferred because the board had not acquiesced to the particular person assuming the role of managing director.

In *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* there were two controllers of a company formed for the purpose of developing a property. Each held half of the issued shares and they comprised the board together with a nominee of each. One of the two controllers was absent for a long period, however the quorum for board meetings was four. The other controller acted as managing director with the approval of the board even though he had not been appointed. The constitution was of similar effect to s 198C and conferred a power on the board to appoint a managing director. The purported managing director entered into contracts related to the property development business of the company. One of these contracts was with a firm of architects, who sought to enforce the contract after the company refused to pay its fees. The Court of Appeal held that the company was bound by the acts of its purported managing director. It had represented

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23 See now the assumption in s 129(3), discussed in chapter 6.
24 See for example *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.
25 See for example *Mirimbiak Nations Aboriginal Corporation v Peninsula Prestige Cars Pty Ltd* [2000] VSC 556.

through its board that its agent was the managing director of the company. The contract was within the customary authority of a managing director and the outsider had relied on this apparent authority. Diplock LJ stated four conditions that must be met in order for a company to be bound by the acts of an agent where the agent had no actual authority to so act:

1. a representation must be made to the outsider that the agent had authority to enter into the kind of contract the outsider seeks to enforce;
2. the representation must be made by someone with actual authority to manage the company's business or at least authority in respect of the matters relating to the contract;
3. the outsider must be induced by the representation to enter into the contract and in fact relied upon the representation;
4. the memorandum or articles do not deprive the company of the capacity to either enter into the type of contract concerned or to delegate authority to enter into that kind of contract to the agent.

The last of these conditions refers to acts that are ultra vires the company in the sense of being outside the objects clause in the constitution. Ultra vires contracts are now governed separately under the *Corporations Act*. The policy behind this statutory reform is to abolish the doctrine of ultra vires in relation to contracts with outsiders.[26] Therefore under the *Corporations Act*, a company may be bound by an ultra vires contract entered into by an agent with apparent authority. The last condition also requires the constitution to authorise a delegation of authority to enter into the type of contract concerned. This power to delegate is usually conferred in a form similar to the replaceable rule s 198D.

The condition that has caused the most uncertainty from the outsider's point of view has been the second. This requires the representation to be made by someone with actual authority to manage the company's business or in respect of matters to which the contract relates. In the *Freeman and Lockyer* case, this did not present a problem to the outsider because the board through its acquiescence made the representation or holding out to the director assuming the role of managing director.

Usually, an outsider will be in contact with someone to whom the board has delegated authority. It will be difficult for the outsider to determine the nature and extent of this authority. This becomes critical where the board has represented that someone has apparent authority to bind the company and this person then purports to cloak another person with apparent authority. Such a situation does not meet the second of Diplock LJ's conditions.

This fact situation arose in the High Court case of *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd*[27] in which the court approved of the principles stated by Diplock L J in *Freeman and Lockyer*. A managing director was found to lack actual authority to enter into the contract in question because of limitations on his power. An employee had been held out by the managing director to have the necessary authority to enter into a contract on behalf of the company. The High Court applied the principles formulated by Diplock LJ and held that the employee had no actual authority.

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26 Section 125.
27 (1975) 133 CLR 72.

The employee also did not have apparent authority because the representation was made by someone who himself, as the managing director, only had apparent authority to carry on management of the company.

In order for the representation in this case to have been made by someone with actual authority, it would need to have been made by either the board or by a committee of directors which had been delegated the authority to carry on the business of the company. It seems curious that a managing director may bind the company through his apparent authority based on a representation by the company and yet, such a person is unable to represent that someone else has apparent authority. If a company can be bound by a contract, in circumstances such as arose in *Freeman and Lockyer*, it is hard to see why the company cannot be bound by a representation of the same person that holds out that someone else has authority to bind the company. This problematic result is avoided if the managing director is regarded as having implied actual authority because the board acquiesced to his assumption of broad powers.

Accordingly, the Australian cases, such as *Brick and Pipe*[28] and *Equiticorp*,[29] which have given rise to the concept of the "de facto" managing director, effectively sideline much of the apparent authority doctrine's difficulties by permitting outsiders the benefits that flow from dealing with officers who have actual authority. This is a realistic view of commercial situations where, like *Brick and Pipe*, a "Goldberg management style" is apparent.[30]

Cases decided subsequent to *Brick and Pipe* demonstrate however the point beyond which the principles of implied actual authority will not be flexibly applied. For example, in *Bank of New Zealand v Fiberi Pty Ltd*,[31] *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*,[32] *Pyramid Building Society v Scorpion Hotels Pty Ltd*,[33] *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*,[34] and *National Australia Bank v Sparrow Green Pty Ltd*,[35] the outsiders each asserted that the officer they dealt with, in relation to the provision of a third party security by the company, was the de facto managing director. In each case, the officer did not have the actual authority to bind the company. The critical factor in each case was the failure of the outsider to prove a substantial link between the officer, their assertion of authority, and the acquiescence of the board. De facto managing directors are not clothed with implied actual authority solely due to their own unilateral assertions. The results of these cases are summarised in Table 2.1 below. The facts and details of the cases are examined in more detail in chapters 5, 6 and 8.

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28 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253.
29 *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 11 ACLC 952.
30 L Law and D Morrison, 'The Brick & Pipe Appeal – Updating Ostensible Authority' (1992) 10 *Company and Securities Law Journa*l 330, 333.
31 (1994) 12 ACLC 48.
32 [1998] 3 VR 133.
33 (1996) 14 ACLC 679.
34 [1998] 3 VR 16.
35 (1999) 17 ACLC 1,665.

Table 2.1 Acquiescence by board as the critical factor in de facto managing director cases

CASE	PERSON ASSERTING AUTHORITY	ACTUAL DIRECTORS	ACQUIESCENCE BY BOARD	EXPLANATION
Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd (1992) 10 ACLC 253.	Goldberg representing Furst as secretary	Goldberg, Furst and Mrs Goldberg.	Yes	Goldberg was a de facto managing director and so could hold out Furst as secretary.
Equiticorp Finance Ltd v Bank of New Zealand (1993) 11 ACLC 952.	Hawkins	Hawkins was only a director of one of the appellant companies.[36]	Yes	Hawkins was a de facto managing director and so could make a binding management decision.
Bank of New Zealand v Fiberi Pty Ltd (1994) 12 ACLC 48.	Doyle	Doyle and Arnhold	No	Doyle did not have authority as managing director: Arnhold was not aware of his activities; no acquiescence.
Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd [1998] 3 VR 133.	Kandy	Dr and Mrs Taft	No	Kandy did not have authority as managing director: the Tafts were not aware of his activities; no acquiescence.
Pyramid Building Society v Scorpion Hotels Pty Ltd (1996) 14 ACLC 679.	Lewis	Lewis, Luscombe, Glasscock & Warfe	No	Lewis did not have authority as managing director: the others were not aware of his activities; no acquiescence.
Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd [1998] 3 VR 16.	Jeffries	Jeffries, S Ramsay and W Ramsay	No	Jeffries did not have authority as managing director: the Ramsays were not aware of his activities; no acquiescence.
National Australia Bank v Sparrow Green Pty Ltd (1999) 17 ACLC 1665.	Green	Green and Sparrow	Sparrow resigned from the board but this was not held to be acquiescence.	Green did not have actual authority as managing director and further, the Bank had actual knowledge that the company required a board of two.

36 "Giles J recorded some doubt about the exact constitution of the relevant boards of directors of the two appellant companies, EFL and EFSA. However, it appears that, at material times, there were some common directors. They comprised Mr David Adams, Mr Brian Fitzgerald, Mr Dennis Cowell, Mr David Crick, Mr Brian Chittenden and Mr Dennis Teroxy. At least, it was not seriously contested that they were directors. Mr Allan Hawkins was a director of EFSA. He held no office (including director) of EFL. Mr Cowell was the managing director of EFSA and EFL."(1993) 11 ACLC 952, 959 (Kirby P).

Where the de facto managing director assertion fails, the outsiders are left with apparent authority. The strict adherence to the conditions enunciated in the *Freeman and Lockyer* case produces considerable difficulties and uncertainty to an outsider. The outsider is required to ascertain the validity of a conferral of authority on the managing director in circumstances where the dealings are not with the board or a committee to whom authority has been delegated. To the outsider, the circumstances indicate a holding out by the company because it appears to have allowed the representation to be made. The application of agency law requires the representation to be made by an organ of the company, such as its board or a person or persons to whom authority has been delegated, such as a managing director or committee of directors. In the latter case, the outsider must hope that the authority was properly conferred on the committee so as to constitute actual authority. This places outsiders dealing with any person who does not possess actual authority in a potentially perilous position, yet it may be difficult or impossible for an outsider to ascertain the nature of the authority.

The operation of the Rule in *Turquand's* case and the statutory assumptions is significantly compromised if an outsider is expected to delve into the indoor management of a company in order to determine whether a particular person has actual or apparent authority. According to *Crabtree-Vickers* this distinction can be critical in determining whether a company is bound by a contract. The *Corporations Act* renders some assistance. For example, s 129(2) and s 129(3) allow the outsider to assume that the company's officers (identified from the public record, or from a holding out) are duly appointed and have the customary authority of that position. Further, s 201M provides that acts of officers are not invalid merely because of a defective appointment. However, s 201M applies to acts of an internal, administrative nature only. Outsiders enforcing contracts must rely on the s 129 assumptions, but reliance on the assumptions is subject to disqualifying circumstances.

National Australia Bank v Sparrow Green Pty Ltd[37] is a case involving the statutory rule and shows that the statutory assumptions were still not effective to overcome an absence of authority. In that case, one of the directors 'retired' from the business, but the ASIC register was not altered. The remaining director assumed the role of managing director, even though there was no formal appointment. The bank was precluded from enforcing a contract signed by the purported managing director for several reasons, relating to both the absence of authority, and the absence of the availability of the statutory assumptions, due to the knowledge exception applying.

Accordingly, the effect of actual authority and whether outsiders may rely on it depends upon the scope of protection provided by the assumptions in ss 128–129, and is analysed in chapter 6. As the statutory assumptions incorporate the concept of "customary authority", this is defined below.

37 (1999) 17 ACLC 1,665.

Customary Authority

Where an officer or agent of the company exercises authority that is not customary for someone in that position to normally have, the agent does not have implied actual authority or apparent authority to bind the company. The customary authority of particular officers is relevant in considering the limits of both implied actual authority and apparent authority.

Three matters affect the scope of customary authority of a company officer:

1. the size of the company;
2. the nature of its business; and
3. the position held in the company.

As for the first matter, the size of the company influences the size of the board. For example, a director of a small or closely held company would be expected to have more involvement in the company's business. They would be expected to have a wider customary authority than an officer of a large public company.[39]

As for the second matter, the nature of the company's business also affects the authority that would reasonably be expected, and reasonably required, of an officer managing that type of enterprise. To this extent, whilst the company's constitution does not affect the company's corporate power, it may limit indirectly the customary authority of its officers. Ford Austin and Ramsay give the example of a director of a charitable company being more restricted that an officer occupying a similar position in a commercial company. Charitable companies are required to have a constitution (s 150) requiring the company to pursue charitable purposes only. The authority of its officers would have to be restricted to be consistent with the company's object.

As to the third matter, the position occupied affects the scope of what an officer is entitled to do on behalf of the company. In this respect, it is convenient to look at the various positions and describe the customary authority.

Company director

While it is usual for the board as a whole or a managing director to be conferred with very wide powers of management, it is not usual for an individual, ordinary director to have such authority. In *Northside Developments Pty Ltd v Registrar-General*,[40] Dawson J considered the authority of an individual director:

> "The position of director does not carry with it an ostensible authority to act on behalf of the company. Directors can act only collectively as a board and the function of an individual director is to participate in decisions of the board. In the absence of some representation made by the company, a director has no ostensible authority to bind it."

It should be noted that while the customary authority of directors is limited, they may still be able to bind the company if there has been a representation or holding out by the company that greater than usual authority has been conferred.

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38 Ford, Austin and Ramsay, supra n 5, [13.390].
39 Ibid.
40 (1990) 8 ACLC 611, 645.

Company secretary

A company secretary may in certain circumstances act as an agent of the company. The implied actual authority or apparent authority of a company secretary extends to making contracts on behalf of a company that relate to the administration or internal workings of the company. In this respect, the customary authority of the company secretary has expanded substantially over the past century. Lord Denning MR considered this question in *Panorama Developments (Gilford) Ltd v Fidelis Furnishing Fabrics Ltd*.[41] A company secretary entered into a contract for the hire of cars for the purpose of carrying the company's major customers. The secretary then used the cars for his own purposes. The car hirer sued the company on the basis that its secretary had apparent authority to enter into that contract. Lord Denning stated:

> "A company secretary is a much more important person nowadays than he [sic] was in 1887. He is an officer of the company with extensive duties and responsibilities. This appears not only in the modern Companies Acts, but also by the role that he plays in the day-to-day business of companies. He is no longer a mere clerk. He regularly makes representations on behalf of the company and enters into contracts on its behalf that come within the day-to-day running of the company's business. So much so that he may be regarded as held out as having authority to do such things on behalf of the company. He is certainly entitled to sign contracts connected with the administrative side of a company's affairs, such as employing staff, and ordering cars and so forth. All such matters now come within the ostensible authority of a company's secretary."

The role of the secretary clearly does not extend as far as that of the directors. It is limited to matters of an administrative nature. Dawson J in the *Northside* case held that the office of secretary did not carry with it any apparent authority to affix the company seal and mortgage a company's land nor to enter into "commercial transactions upon his own decision which are not of an administrative kind required for the day-to-day running of the company's affairs."[42]

Where an outsider deals with a secretary or individual director who is acting outside the usual authority of an officer of the type concerned, the outsider loses the protection that arises from reliance on apparent authority. From the outsider's point of view this presents difficulties because it is rare for the outsider to deal directly with the board. Usually, the outsider deals with someone whom it may reasonably be assumed has been delegated to act on behalf of the board. It may be difficult for the outsider to determine whether the officer or agent is acting with actual or apparent authority and the extent of the authority conferred by the board.

Managing director

An outsider dealing with a company will usually be in a stronger position if dealings were conducted with a managing director. The constitution will usually empower the board to appoint a managing director to exercise such of the board's powers at it thinks fit.[43] A managing director has the customary authority to do almost all the things related to management that the board is empowered to do. The usual role of a managing direc-

41 [1971] 2 QB 711, 716–7. The distinction between managerial and administrative acts was also referred to in *Club Flotilla (Pacific Palms) Ltd v Isherwood* (1987) 5 ACLC 1,027.

42 (1990) 8 ACLC 611, 645.

43 See s 198C.

tor is "to deal with every day matters, to supervise the daily running of the company, to supervise the other managers and indeed, generally, be in charge of the business of the company."[44] This includes engaging persons to do work for the company[45] and borrowing money on the company's behalf.[46]

The limits on the customary authority of a managing director are not entirely clear. It does not extend to transactions that are outside ordinary trading transactions.[47] In *Re Tummon Investments Pty Ltd*[48] a person was named in ASIC records as the principal executive officer and secretary of a company. That person borrowed funds on behalf of the company but used the funds for his own purposes. At no time did the board of the company authorise the borrowing on behalf of the company. On the liquidation of the company, the lender lodged a proof of debt relating to the unsatisfied loans. It was held that the principal executive officer did not have implied actual authority or apparent authority to enter into the loan transaction because it was not one that formed part of his administrative functions and was not entered into in the ordinary course of business. The company had not made a representation to the other party that the agent had authority to enter, on behalf of the company, into the kind contract that was sought to be enforced.

The customary authority of a managing director probably does not extend to certain far-reaching decisions such as purporting to sell the entire business of the company. For example, in *Re Qintex Ltd*[49] it was held that the office of managing director did not carry with it the authority to make "critical" decisions after the filing of an application to wind up the company. In applying *Qintex*, Lehane J in *Nece Pty Ltd v Ritek Incorporation*[50] in obiter commented that a managing director may have customary authority where it is shown that the board consistently recognised the particular managing director's representation of the company in all matters to do with a particular debt and demand leading to the winding up application.

The chair of the board

The extent of the customary authority possessed by a director elected as chair is also unclear. In some cases, the courts have regarded the chair as having greater usual authority than ordinary directors and more akin to the usual authority of a managing director.[51] This approach was not adopted in *Hely-Hutchinson v Brayhead Ltd*[52] where it was held that a director elected as chair has the same customary authority as an ordinary director. In most cases the apparent authority of a chairing director will depend on the conduct of the company through its board, and in particular, the extent to which it allows the chair to conduct business of the company. The extent of authority of the chair would then arise independently of the occupation of the position. It would arise from the circumstances surrounding the consent or acquiescence of the company to the conduct of the chair.

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44 *Entwells Pty Ltd v National and General Insurance Co Ltd* (1991) 5 ACSR 424, 427 (Ipp J).
45 *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.
46 *British Thomson-Houston Co Ltd v Federated European Bank Ltd* [1932] 2 KB 176.
47 *Corpers (No 664) Pty Ltd v NZI Securities Australia Ltd* (1989) ASC 55–714.
48 (1993) 11 ACLC 1139.
49 (1990) 8 ACLC 811.
50 (1997) 15 ACLC 813, 815.
51 *British Thomson-Houston Co Ltd v Federated European Bank Ltd* [1932] 2 KB 176; *Clay Hill Brick Co v Rawlings* [1938] 4 All ER 100.
52 [1968] 1 QB 549.

Where an officer or agent of a company acts outside the customary authority of a person occupying the particular position concerned, the company may still be liable if it has held out that its officer or agent possesses greater authority than would be usual. This holding out must have been made by someone who has actual authority to make such a representation for the company. Where such a representation has been made, the outsider may still enforce the contract even though the agent of the company was not validly appointed or the agent acted outside the customary authority of a person occupying the particular position concerned.

The Effect of Agency Principles on Enforcing Contracts

If an 'agent' without authority enters into a contract, then the principal is not bound, unless it chooses to ratify the contract, otherwise, a contract entered into by an agent with no authority is completely void.[53]

As Table 2.1 above shows, recent cases illustrate that, particularly when the outsider has made an error in identifying company agents, the contracts are subject to the normal principles of agency law. If the person purporting to bind the company is not even an officer, then a finding of absence of authority is likely. There is no particular protection provided for this type of error. The common law has assisted the outsider to some extent by the recent trend of widening the concept of "actual authority" in the de facto managing director situations.

For the other error, that is, correctly identifying the company's officers, but incorrectly attributing authority to transact, the *Corporations Act* renders some assistance. For example, s 129(2) and s 129(3) allow an outsider to assume that the company's officers (identified from the public record, or from a holding out) are duly appointed and have the implied authority of that position. Further, s 201M provides that acts of officers are not invalid merely because of a defective appointment. Insofar as the outsider is dealing with an officer, we have already mentioned that the constitution and replaceable rules confer actual authority on officers.[54] However, at common law, the content of the constitution was of greater significance to outsiders due to the doctrine of constructive notice. "Constructive notice" means that the outsider was deemed to have knowledge of the constitution, which meant not only the grant of authority but also any express limitations on authority.

The interaction of the common law indoor management rule with the principles of agency is examined next in chapter 3, whilst chapter 4 considers the effect of exceptions and limitations on the rule, including opposing doctrines such as constructive notice.

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53 C Baxter, 'Ultra Vires and Agency Untwined' (1970) 28 *Cambridge Law Journal* 280.
54 For example, ss 198A and 198C.

Chapter 3

The Indoor Management Rule at Common Law

The Rule in Turquand's Case

Outsiders entering into transactions with companies have enjoyed limited protection ever since the decision in *Turquand's* case over 100 years ago. The rule provides that persons dealing with a company and contracting in good faith may assume that "acts within its constitution and powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular."[1]

The application of this rule gives rise to an irrebuttable presumption that prevents the company from avoiding a contract by relying on the fact that the proceedings were irregular and the person acting for the company was unauthorised to do so. This serves to protect persons "who are entitled to presume, just because they cannot know, that the person with whom they deal has the authority which he claims".[2]

At common law, the doctrine of constructive notice operated against outsiders dealing with companies. However, this doctrine did not operate where the directors or other agents of a company acted outside their authority but this was not apparent from the articles or other public documents of the company. The Rule in *Turquand's* case states that while persons dealing with a company are taken to have constructive notice of the contents of the company's public documents, they need not go further to ensure that the internal proceedings of the company have been properly carried out. In fact, the outsider can assume that these proceedings were properly carried out.

In *Royal British Bank v Turquand*,[3] the deed of settlement, the equivalent of the memorandum and articles of a company, empowered the board of directors to borrow amounts as authorised by a resolution of the general meeting of the shareholders. The company borrowed money from a bank on the authority of two of its directors who authenticated the company's common seal. There was no authority given by the general meeting. The company refused to repay the loan and argued that the bank had constructive notice of the articles and should have been aware of the lack of authority. It was held that an outsider need not inquire into whether such a resolution had in fact been passed. The company was bound to the bank because the passing of the resolution was a matter internal to the company.

Jervis CJ said: "... the party here, on reading the deed of settlement, would find, not a prohibition from borrowing, but a permission to do so on certain conditions. Finding

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1 *Halsbury's Laws of England* 4th ed 1988, Vol 7(1) para 980. This statement was approved by Lord Simonds in *Morris v Kanssen* [1946] AC 459, 474.

2 Lord Simonds in *Morris v Kanssen* [1946] AC 459, 474.

3 (1856) 6 E&B 327; 119 ER 886.

that the authority might be made complete by a resolution, he would have a right to infer the fact of a resolution authorising that which on the face of the document appeared to be legitimately done."[4]

The Rule in *Turquand's* case grew naturally as a response to the development of the doctrine of constructive notice. While outsiders had constructive notice of matters they could discover for themselves from public documents such as the articles, they could not reasonably be taken to have notice of matters concerning the indoor management of the company. The rule is primarily one of procedural convenience for the outsider, who cannot independently access the company's minute books to corroborate procedural compliance, and therefore should not be required to do so. Accordingly, the company itself cannot rely upon the rule: *Hughes v NM Superannuation Pty Ltd*.[5]

The types of procedural matters the rule applies to include the conduct of meetings of the company and the affixation of the common seal. For example, a quorum may not have been present, inadequate notice may have been given or a voting irregularity may have occurred. The rule also operates in situations where the common seal is not affixed in accordance with the constitution or the board is not properly constituted. In these cases, an outsider can generally hold the company liable, although protection is subject to exceptions.

The rule has been criticised because of uncertainty that has arisen from a large body of case law. Professor Gower observed: "Unhappily its obscurity increases in direct proportion to the literature upon it, and only its undoubted practical importance makes it essential to devote some space to it even at the risk of further obfuscation."[6] Gower commented that the history of the development of the rule saw an increase in the limitations to which the rule was subject. These limitations have become so extensive that the object of the rule has been obscured.

> "The result is that the law has become a jungle of irreconcilable decisions to the benefit of no one save the legal profession. If this branch of the law is ever codified the draftsman will be well advised to ignore all case-law of the present century and to go back to first principles and the judgements of the founding fathers of our modern company law. Unhappily a textbook writer has to try to state the law as he finds it and not as it ought to be."

The provisos and exceptions that defined the limits to the outsider's protection are listed below.

1. The outsider must act in good faith.
2. The outsider must not have actual knowledge to the contrary.[7]
3. The outsider "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."[8]
4. The outsider cannot assume matters that are inconsistent with public documents, as the doctrine of constructive notice presumes all outsiders have notice of the

4 (1856) E&B 327, 332.
5 (1993) 11 ACLC 923.
6 L C B Gower, *Modern Company Law* (2nd ed, 1957) 141. These comments do not appear in the current edition of this work because statutory reforms in England have largely replaced the common law principles in much the same way as occurred in Australia leaving only a "few ghostly relics...to haunt us". (5th ed, 1992) 198.
7 *Howard v Patent Ivory Manufacturing Co* (1888) 38 Ch D 156.
8 *Morris v Kanssen* [1946] AC 459, 475 (Lord Simmonds).

contents of the public documents. (Referred to as the "doctrine of constructive notice").[9]

5. The rule does not apply where the corporate signature is forged. (Referred to as the "forgery exception").[10]

These provisos and exceptions to the common law rule are discussed in detail in later chapters. This chapter continues by examining the more recent application of the common law rule in Australia, in *Northside Developments Pty Ltd v Registrar-General*,[11] where the High Court considered the operation of the Rule in *Turquand's* case.

The Northside case

The judgment and its significance

The High Court's decision in *Northside* represents in Australia the most authoritative Australian judicial analysis of the common law formulation of the indoor management rule. The case involved the disputed execution of a third party mortgage document. Sturgess, a director and shareholder of Northside affixed the common seal of Northside to a mortgage document that secured a loan from Barclays to a company controlled by Sturgess. The mortgage was over land owned by Northside and was its only major asset. The common seal was affixed and signed by Sturgess as director and by his son who purported to sign as the company secretary. The son had not been appointed under the articles although a statutory return filed with the Commission named him as the company secretary. The other two directors, who were also the remaining shareholders, did not know of or authorise the execution of the mortgage, nor did they know of the purported appointment of secretary. They had no interest in the borrowing company and Northside derived no benefit from the transactions.

The transaction only came to the other officers' notice after Barclays exercised its power of sale under the mortgage. Hence the involvement of the New South Wales Registrar of Titles, as there were also statutory issues to resolve under the regularity and compensation provisions of the *Real Property Act* 1900 (NSW). This aspect of the case is not substantially pursued. The crux of the dispute was to examine the legal regularity of the contract and its execution.

The High Court considered the validity of the mortgage. This depended upon whether it had been executed by Northside. The case was decided under the common law rules because the mortgage was purportedly executed in 1979 prior to the 1983 amendments that inserted the statutory rule into the legislation. The High Court held that Northside was not bound by the mortgage because the affixing of the common seal was invalid. Although the Rule in *Turquand's* case enabled Barclays to assume that the common seal was properly affixed and the internal proceedings of the company had been properly carried out in accordance with its memorandum and articles, the circumstances

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9 *Ernest v Nicholls* (1857) 6 HL Cas 401. For the history of the interaction between constructive notice and the indoor management rule, see I Campbell, 'Contracts with Companies' (1960) 76 *Law Quarterly Review* 115, 120 and K E Lindgren, 'History of the Rule in Royal British Bank v Turquand' (1975) 2 *Monash University Law Review* 13, 34–35.

10 *Ruben v Great Fingall Consolidated* [1906] AC 439.

11 (1990) 8 ACLC 611.

of the case should have put Barclays upon inquiry. Because Barclays failed to make further inquiries as to whether the common seal was properly affixed, it was unable to rely on the Rule in *Turquand's* case and Northside was not bound by the mortgage.

The circumstances that put Barclays upon inquiry were that the mortgage secured Northside's major asset where the transactions were outside its usual business and not for its benefit. Barclays was prevented from relying on the Rule in *Turquand's* case because it ought to have suspected an irregularity. Although Barclays did not have to have actual knowledge of the lack of authority of Sturgess and his son to affix the company seal, it had constructive knowledge. These various attributes of knowledge are examined in more detail when examining the ambit of the rule's exceptions in chapter 4.

All five justices comprising the High Court agreed with this result. However, each judge delivered a separate judgment, with detailed analysis as to the basis and operation of the indoor management rule. A brief summary of the High Court's analysis is useful to rationalise the scope of the indoor management rule.

The High Court's contribution to the development of the common law rule may be summarised according to four main points:

1. articulation of the theoretical justification for the rule, including its interaction with principles of agency;
2. discussion of the interaction between the rule, and the constraints imposed on companies to comply with their mandatory constitutions (i.e the doctrine of ultra vires, which rendered void contracts beyond the scope of the company's stated objects or powers);
3. confirmation that the rules relating to contracts void for forgery involve separate principles and not part of the rule itself; and
4. clarification of the various aspects of the knowledge exceptions to the rule.

The first two points are discussed below, whilst the knowledge and forgery exceptions are discussed in later chapters.

The basis of the indoor management rule

We discussed earlier that the rule balances between the company's obligation to comply with its mandatory rules, and the outsider's inability to check the extent of that compliance. Either the outsiders must incur the search costs to resolve these issues for each transaction; or, take a commercial risk on each transaction; or expect the law to provide some resolution between these two extremes.[12] Mason CJ in *Northside* articulated this balancing exercise, by stating the policy behind the Rule in *Turquand's* case in this way:

> "What is important is that the principle and the criterion which the rule in Turquand's case presents for application give sufficient protection to innocent lenders and other persons dealing with companies, thereby promoting business convenience and leading to just outcomes. The precise formulation and application of that rule calls for a fine balance between competing interests. On the one

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12 A comprehensive analysis of the concepts of "risk" and "cost" associated with corporate transactions is provided by M Whincop, 'Nexuses of Contracts, the Authority of Corporate Agents and Doctrinal Indeterminacy: From Formalism To Law and Economics' (1997) 20 *University of New South Wales Law Journal* 274. Whincop uses game theory to describe the costs incurred by both parties to the corporate contract, linking costs to the degree of incomplete information. There is a high degree of incomplete information for the external party as to whether the person they are dealing with has authority of the company to act or not. Whincop argues that the cost allocation solution is not a simple one, but that the legal rules should attempt to minimise the joint costs of unauthorised transactions.

> hand, the rule has been developed to protect and promote business convenience which would be at hazard if persons dealing with companies were under the necessity of investigating their internal proceedings in order to satisfy themselves about the actual authority of officers and the validity of instruments. On the other hand, an over-extensive application of the rule may facilitate the commission of fraud and unjustly favour those who deal with companies at the expense of innocent creditors and shareholders who are the victims of unscrupulous persons acting or purporting to act on behalf of companies."[13]

Although the reason for the rule is relatively clear, its theoretical foundation is subject to some debate. The High Court's judgment typifies this diverse approach. The basic distinction in approaches in whether the rule is an "organic" manifestation of the corporate structure and separate legal entity principle, or is simply an application of established legal rules, such as agency or estoppel. This debate is briefly described below. The significance of this debate has ongoing relevance, particularly regarding the interpretation of statutory reform subsequent to *Northside's* case. The statutory provisions are analysed in later chapters.

The rule and agency principles

The general principles of agency law in their application to companies operate in conjunction with the Rule in *Turquand's* case. The rule facilitates the outsider's ability to presume that the company has consented to the transaction, and, particularly where a company enters into a contract directly itself, that the officers who acted for the company were properly authorised to do so. This is particularly relevant where the common seal of the company was affixed by persons purporting to act as directors or secretary with authority to affix the company seal. We highlighted above the obscurity surrounding the Rule in *Turquand's* case, which has resulted in significant differences of opinion in attempts to express the basis of the rule and its inter-relationship with agency principles.

In the *Northside* case the High Court judges analysed the relation between the Rule in *Turquand's* case and the general agency principles in different terms. However, a major point of agreement in the five judgments was that the indoor management rule does not create authority; it merely entitles the outsider, in the absence of anything putting them on inquiry, to assume procedural regularity in the transaction.[14]

The first of the three positions, which closely aligns the rule and agency principles, was represented by Dawson and Toohey JJ.[15] Dawson J considered that the rule depends on the operation of agency law. The person who purports to act on behalf of the company must act within his or her actual or apparent authority.

Toohey J stated that the rule originally evolved in relation to irregularities in the internal management of companies, such as failure to hold proper meetings or pass regular resolutions. The issues that arise where officers of a company act without authority are resolved by application of agency rules rather than indoor management rule in the strict sense. While the rule protects outsiders where there is an irregularity, it does not extend to confer authority on an officer where that authority does not otherwise exist. This is apparent from the *Freeman and Lockyer*[16] and *Crabtree-Vickers*[17]cases.

13 (1990) 8 ACLC 611, 621-2 (Mason CJ).
14 (1990) 8 ACLC 611, 626, 641 (Dawson J); 646 (Toohey J).
15 (1990) 8 ACLC 611, 626 (Brennan J), 641(Dawson J).
16 *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.
17 *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising Co Pty Ltd* (1976) 50 ALJR 203.

Brennan and Gaudron JJ represented the second approach, relying on estoppel. Brennan J considered that the rule comes within the framework of apparent authority which itself is based upon estoppel. The company is prevented from denying the representation of authority that it has made. There is no material distinction between acts of natural persons in affixing the common seal (which are acts of the company itself) or acts of an agent of the company. For example, the principles of apparent authority established in *Freeman and Lockyer* and *Crabtree-Vickers* cases will resolve issues of the identity of purported officers, not the Rule in Turquand's case. Gaudron J thought that the principles of apparent authority represent an example of estoppel. The Rule in *Turquand's* case is also based on principles that provide the foundation of estoppel.

Mason CJ took the third approach, distinguishing between contracts entered into directly by the company under its common seal, and those entered into by agents. As a company could contract directly, categorising the rule as merely grounded in agency was an insufficient explanation for the reliance placed upon the use of the seal and the protection afforded to outsiders in the case of a sealed document. Mason CJ held that the "principle applicable to instruments executed under the common seal of a company is an organic principle of company law".[18]

The 'organic' theory of the rule and estoppel

1. The organic theory

The organic theory is an extension of agency rules, recognising that a company may manifest its consent to be bound as a separate and distinct entity. It attributes certain acts to be the acts of the company itself. In this way, a distinction is drawn between the acts of an agent that are binding on a company as a principal and acts which are directly those of the company. The affixing of the company seal has historically been regarded as a direct act of the company, generally through its board of directors and is analogous to the signature of a natural person.[19] This theory also finds expression in relation to a company's liability in tort, criminal liability and the division of powers between the board and general meeting of members.

A company will only be bound by its own act where the persons acting as the company do so within their actual or apparent authority. The organic theory merely extends the scope of the capacity of an agent to bind the company directly. It does not enable a person who acts without authority to bind the company. This includes the situation where the company seal is affixed. Effectively, the organic principle recognises two separate issues: the officers' authority to exercise corporate power, and the officers' authority to provide the company's assent in the proper form. This distinction has been identified as the difference between "substantive authority" and "formal authority",[20] where:

18 (1990) 8 ACLC 611, 620.

19 See K E Lindgren, 'The Positive Corporate Seal Rule and Exceptions Thereto and the Rule in Turquand's Case' (1973) 9 *Melbourne University Law Review* 192; K E Lindgren, 'The Negative Corporate Seal Rule and Exceptions Thereto' (1974) 9 *Melbourne University Law Review* 411. Professor Lindgren discusses the nature of the common seal and describes how it represents the true expression of the company's assent that operates independently of the exercise of the power.

20 I Ramsay, G Stapledon and K Fong, 'Affixing of the Company Seal and the Effect of the Statutory Assumption in the Corporations Law' (1999) 10 *Journal of Banking and Finance Law and Practice* 38, 39.

1. "substantive authority" is the existence and scope of the officers' authority to enter into the contract; and
2. "formal authority" is the officers' authority to signify, in the proper form, the company's assent.

2. The estoppel approach

Campbell suggests that the principle of estoppel is not an adequate explanation of the rule.[21] While a company may make a representation by means of its articles, if the articles state that the authority of an agent is subject to a condition, this does not constitute a representation that the condition has been fulfilled. Therefore, if the articles empower the board to delegate some or all of its functions, the company does not thereby represent that a delegation was in fact made.

Campbell was of the view that the Rule in *Turquand's* case goes far beyond the principle of estoppel as its effect is to hold a company bound by a contract even in the absence of actual or apparent authority. This view is at odds with that expressed by Brennan and Gaudron JJ in the *Northside* case. Campbell does not cite any examples of where a company was bound by a contract where an agent lacked actual and apparent authority.

Although the High Court judges in the *Northside* case adopted different approaches, they all suggested that in agency situations, the rule did not apply in the absence of authority. This view has been adopted by the statutory assumptions, particularly s 129(2) and (3), which rely on agency principles.

Whilst Campbell acknowledges an alternative theory as the basis of the rule, he also rejects it as inadequate. This theory is expressed by the maxim *omnia praesumuntur rite esse acta* –"the presumption that things are in order."[22] This is a rule of evidence which is rebuttable and shifts the burden of proof. Campbell rejects this theory as the basis of the Rule in *Turquand's* case because the rule gives rise to an irrebuttable presumption. The company is prevented from giving evidence to show that a transaction was in fact irregular or unauthorised.[23]

The authors of *Ford's Principles of Corporations Law*[24] suggest another theoretical basis behind the Rule in *Turquand's* case which they consider to be the best supported by weight of authority. This is referred to as the "closed door rationale" for the rule, which is designed to allow outsiders to make protective assumptions just because they cannot know that the person with whom they deal has the authority which they claim.[25]

In the context of a transaction entered into by a company and a bank, Kirby P of the New South Wales Court of Appeal in *Registrar-General v Northside Developments Pty Ltd*[26] expressed reservations on this justification of the rule. Outsiders such as banks are generally in a very strong commercial position to insist on detailed scrutiny of the internal workings of a company.

21 Campbell (1960), supra n 9, 115. See also A Thompson, 'Company Law Doctrines and Authority to Contract' (1956) 11 *Univ of Toronto* LJ 248, 254.
22 Lord Simonds referred to this maxim in *Morris v Kanssen* [1946] AC 459, 474.
23 Campbell (1960), supra n 9, 116.
24 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (10th ed, 2001) [13.160].
25 See *Morris v Kanssen* [1946] AC 459, 475 (Lord Simonds).
26 (1989) 7 ACLC 52.

The Significance of the Northside Case

It will be unlikely to find the opportunity for any future judicial contribution on the theoretical basis of the common law rule, given statutory reform has been in place since 1984. *Northside* represents the most authoritative source, although the judgments leave a legacy of divergent views.

Brennan J, by insisting that the basis of the rule is estoppel, emphasises the relevance of the awareness and conduct of the outsider in raising the estoppel. The discussion by Dawson J contributes and assists the development of the rule and its relation to agency. The judgment of Mason CJ, insofar as His Honour proposes an "organic principle of company law" regarding the company seal, continues to provoke commentary.[27]

In any event, *Northside* still stands for the proposition that the rule is a simple one of procedural regularity. The differences in theoretical approach serve to highlight different uncertainties in the boundaries in the application of the rule. For example, the agency approach emphasises the role of authority as a pre-condition to accessing the rule, whereas the estoppel approach emphasises the role of the authority principles in alerting the outsider to the limitations in reliance. The organic view of the corporate seal focuses on one aspect of the corporate transaction, the significance of the sealed document. None of the theoretical approaches alter the residual concerns of the outsider as to the scope of protection afforded to corporate dealings. Campbell acknowledged that:

> "The rule is, indeed, unique, having affinities in other legal principles, but having no precise analogy in the law applicable to transactions between natural persons."[28]

The next chapter looks at the development of the exceptions and qualifications to the common law rule. In the following chapters, we examine the contribution of the statutory reforms to the operation of the rule.

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27 R Grantham, 'Attributing Responsibility to Corporate Entities: A Doctrinal Approach' (2001) 19 *Company and Securities Law Journal* 168; Ramsay, Stapledon and Fong, supra n 20.
28 Campbell (1960), supra n 9, 116.

Chapter 4

Exceptions to the Rule in Turquand's Case

Introduction

As we foreshadowed in chapter 1, the Rule in *Turquand's* case did not extend to protect outsiders in all circumstances, such that the scope of the exceptions under the current statutory version of the rule continues to be a controversial issue. The common law rule did not apply where the outsider did not act innocently or reasonably in the light of the circumstances. The common law principles withheld protection to the outsider where certain exceptions arose. The circumstances excluding the rule may be distinguished as exceptions relating directly from the rule's development, and impediments to the rule's operation sourced from conflicting common law doctrine.

In the first category, the full exposition of the rule and its exceptions was proposed by the House of Lords in 1946 in *Morris v Kanssen*[1] as:

> "persons dealing with a company in good faith may assume that acts within its constitution and powers have been properly and duly performed and are not bound to inquire whether acts of internal management have been regular.[2]

This emphasises that the rule is primarily one of procedural convenience: the outsider cannot independently access the company's minute books to corroborate procedural compliance, and therefore should not be required to do so. However, Lord Simmonds qualified the rule by stating that:

> "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 which he claims. This is clearly shown by the fact that the rule cannot be invoked if the condition is no longer satisfied, that is, if he who would invoke it is put upon his inquiry. 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." [3]

This leads to two major propositions precluding reliance on the rule:

1. The precondition or supposition of the Rule in *Turquand's* case is that outsiders accessing the rule were acting in "good faith"; and
2. That the degree of knowledge, from subjective (actual) knowledge, objective (reasonably expected to know) to presumed (constructive notice) affects the availability of the assumptions as to internal regularity.

In addition, it is recognised that the application of the rule in cases since *Turquand* has had a varied and not entirely consistent history. This is attributed to the intersection of other related doctrines that override a rule of mere procedural convenience. For example, the scope of protection of the common law was eroded by:

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1 [1946] AC 459.

2 Lord Simonds in *Morris v Kanssen* [1946] AC 459, 474 , citing *Halsbury's Laws of England* (2nd ed, 1942) vol v, 423 and approved by Brennan J in *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 626 referring to *Halsbury's* (4th ed, 1988), vol. 7(1), [980].

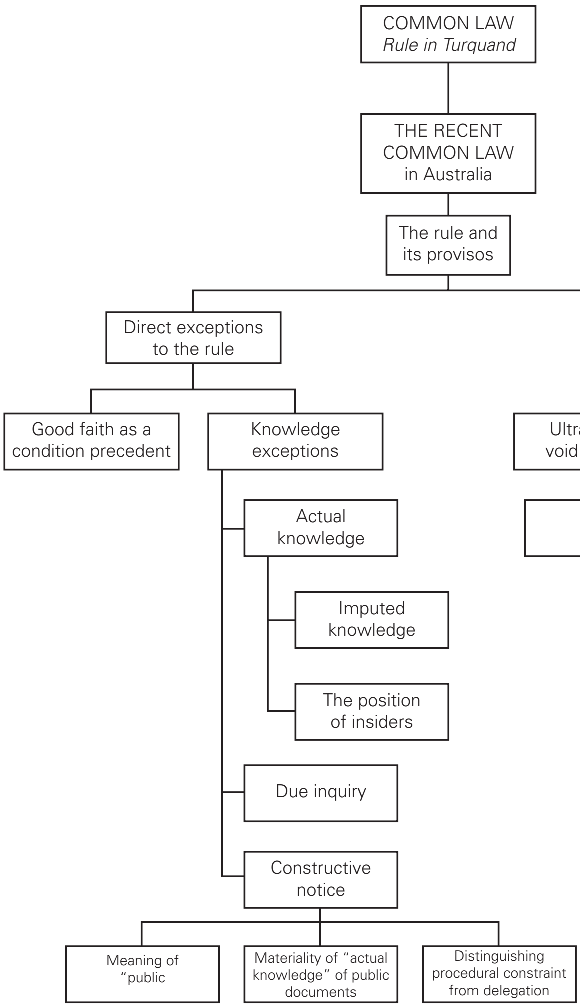
3 *Morris v Kanssen* [1946] AC 459, 475 (Lord Simmonds).

1. The operation of the rule against forgery, that rendered any contract tainted by forgery void, despite the Rule in *Turquand's* case; and
2. The operation of the doctrine of ultra vires, that rendered any contract beyond the company's mandatory constitution void, despite the rule.

In both of these instances, the rule was not effective, as forgeries or ultra vires transactions were rendered void due to an absence of corporate capacity or consent. Corporate capacity was not a matter of mere procedural convenience that could be assumed. These doctrines are explained below, to describe the fetters on the common law rule. Their effect due to statutory reform is analysed in chapter 5 and the rule as to forgeries is specifically examined in chapter 7.

This chapter summarises the direct exceptions to the common law rule. The interaction of the other provisos is dealt with in subsequent chapters. The structure of this discussion is presented in Figure 4.1 below. This exercise is necessary to analyse and interpret the scope of statutory reform that occupies the later chapters.

Figure 4.1 The common law rule and its provisos



Good Faith

Although "good faith" is mentioned by the House of Lords in *Morris v Kanssen*[4] in connection with the indoor management rule, it does not appear to be considered, or applied, as a separate substantive element. Early literature on the indoor management rule's evolution does not elaborate upon good faith.[5] Good faith commonly invokes standards of fairness, loyalty and cooperation.[6] As an example in company law, creditors against whom a voidable preference action has been taken may rely on 'good faith' as a defence.[7] Where good faith is typically applied, it has dual requirement of acting honestly (subjectively) as well as reasonably (objectively). As the indoor management rule has developed in Australia, good faith more manifests itself in the degrees of knowledge that preclude reliance on the assumptions, rather than as a precondition. This is certainly evident from the statutory version, which makes no reference to "good faith" as an element of reliance, although the legislature refers to the adoption of the common law rule and "good faith" in dealings.[8]

Lord Alverstone CJ alluded to the connection between any "requirement" of good faith and the common law rule in *Duck v Tower Galvanizing Co*,[9] stating:

> "it has always been held that it is not incumbent on the holder of such a document purporting to be issued by a company to inquire whether those persons pretending to sign as directors have been duly appointed … so that there has been ample authority to show that no informality will alter rights possessed by a bona fide holder for value upon a document that purports to be in order."

The connection with the good faith element relies on the recognition that the common law rule is subject to the remedies in equity for the principal to avoid the contract where the agent has breached their authority, subject to the rights of the bona fide purchaser. The adoption of "good faith" is not really a separate element of the rule, but a gloss that recognises the other claims under the contract to which the outsider may become subject, for example, the equitable defence of the bona fide purchaser for value without notice.

The Knowledge Exceptions

The types of knowledge

A person who has actual knowledge of an irregularity cannot rely on the Rule in *Turquand's* case.[10] "Actual knowledge" refers to subjective knowledge and also may be inferred where the outsider wilfully turns a blind eye. An outsider is also unable to gain the protection of the rule where they ought to make inquiry. One way of distinguishing

4 [1946] AC 459.

5 For example, I Campbell, 'Contracts With Companies' (1960) 76 *Law Quarterly Review* 115; K E Lindgren, 'History of the Rule in Royal British Bank v Turquand' (1975) 2 *Monash University Law Review* 13.

6 J M Paterson, 'Limits on a Lender's Right to Repayment on Demand: Construction, Implication and Good Faith?' (1998) 26 *Australian Business Law Review* 258, 261.

7 Section 588FG.

8 Explanatory Memorandum, *Corporations Bill 1988*, [568]. This is discussed further under the statutory rule, in chapter 5.

9 [1901] 2 KB 314, 318.

10 *Howard v Patent Ivory Manufacturing Co* (1888) 38 Ch D 156. See also H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (10th ed, 2001) [13.190], who assert actual knowledge refers to subjective knowledge, or an inference that can be drawn that the person knew, such as where eyes are wilfully shut.

between the actual knowledge and the inquiry exceptions is to categorise the latter as a type of constructive knowledge. The distinction, however, is not clear cut. For example, the failure to make inquiries may be due to recklessness or wilful blindness. This may be captured as actual knowledge, rather than constructive knowledge. The effect of a person being put on inquiry here is that a failure to make reasonable inquiries results in the inference of actual knowledge. Lord Esher MR expressed this inferred actual knowledge in *English and Scottish Mercantile Investment Co Ltd v Brunton*:[11]

> "When a man has statements made to him, or has knowledge of facts, which do not expressly tell him of something which is against him, and he abstains from making further inquiry because he knows what the result would be – or, as the phrase is, he 'wilfully shuts his eyes' – then judges are in the habit of telling juries that they may infer that he did know what was against him. It is an inference of fact drawn because you cannot look into a man's mind, but you can infer from his conduct whether he is speaking truly or not when he says that he did not know of particular facts."

"Constructive knowledge" picks up a wider spectrum of "knowledge" and requires, as its threshold, the outsider knowing of certain facts that prompt the obligation to inquire further. The point at which the prompt cuts in divides the definition of "actual" from "constructive" knowledge. A useful way to describe this intersection is the cut off between subjective knowledge and objective knowledge. Objectivity is based on a reasonableness test. The definition of constructive knowledge resolves the point of intersection: if the outsider knows certain facts, when is it is reasonable to expect them to make inquiries?

This vague distinction of actual from constructive knowledge is all that may be retrieved from the common law cases on the rule. However, this distinction has been the subject of more detailed discussion in the case law dealing with constructive trusts, than in the company law cases. Constructive trust liability imposed on an outsider depends on the degree of knowledge of the outsider in participating in another's breach of duty or breach of trust. In the constructive trust cases, knowledge is described according to a five point scale, from actual to constructive.

When discussing the knowledge requirement, the usual starting point is to note the contribution by Peter Gibson J in the English *Baden* case,[12] in identifying five categories of "knowledge":

- (i) actual knowledge;
- (ii) a wilful shutting of one's eyes to the obvious;
- (iii) a wilful and reckless failure to make inquiries that an honest or reasonable person would have made;
- (iv) knowledge of circumstances which would have indicated the facts to an honest and reasonable person; and
- (v) knowledge of circumstances which would have put an honest and reasonable person on inquiry.

Category (v) knowledge is most controversial, because it imports an objective standard similar to negligence, which has a profound effect on the company's liability to outsiders. If category (v) triggers the rule's knowledge exception, then it places an active

11 [1892] 2 QB 700, 707–8.
12 *Baden, Delvaux and Lecuit v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA* [1983] BCLC 325.

duty on outsiders to enquire into the possibility of internal non-compliance in entering into the corporate transaction. This approaches the undesirable effect rendering the indoor management rule's protection less effective.

Examples of actual knowledge and due inquiry are examined below.

Actual knowledge: the insider exception

A major rationale behind the Rule in *Turquand's* case is that it protects outsiders who have no means of knowing whether the internal proceedings of a company have been properly carried out. This prevents an insider such as a director from gaining the protection of the rule. In *Morris v Kanssen*[13] a director was denied the protection of the rule where shares were issued to the director at a board meeting that he attended.

Where a director purports to act on behalf of a company in a self-interested transaction, it is generally unreasonable for the director to gain the protection of the rule by claiming a lack of knowledge of an irregularity. A director is presumed to be under a duty to know the correct procedures.

In unusual circumstances a director may seek the protection of the rule where the director did not act for the company in relation to the transaction in which he or she was involved as the other party: *Hely-Hutchinson v Brayhead Ltd*.[14] In such a case, the director may be considered as an outsider for the purposes of the rule. An insider may also include controlling shareholders and perhaps employees and professional advisers. Such a person who has a "connection or relationship" with the company may be put on inquiry or be deemed to have actual knowledge in cases where strict actual knowledge cannot be shown. This appears to have been picked up by the statutory exceptions to the rule, discussed in chapter 8.

Constructive knowledge and due inquiry

In *Northside Developments Pty Ltd v Registrar-General*[15] all five judges of the High Court held that a bank was put on inquiry where it sought to enforce a mortgage against a company. It was put on inquiry as to the authority of the persons who affixed the company seal to the mortgage document. This was because of the nature of the transaction, which was of no benefit to the company and appeared unrelated to its business. The mortgage secured debts of companies controlled by the person who signed as director but these companies had no association with Northside, against which the bank sought to enforce the mortgage. The inquiry exception was triggered because the bank took no steps to establish that the company's officers had authority to affix the company seal.

The more specific features of the circumstances giving rise to due inquiry (although not conclusive), were set out by Mason CJ[16] as:

- the powers of the company (if relevant);
- the nature of the company's business;
- a reasonable apprehension that the transaction is entered into for purposes unrelated to the company's business;

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13 [1946] AC 459.
14 [1968] 1 QB 549.
15 (1990) 8 ACLC 611.
16 (1990) 8 ACLC 611, 619–622.

- reliance on the purported actual or apparent authority of those acting or purporting to act on behalf of the company;
- any representations made to the outsider by those acting or purporting to act on behalf of the company;
- the existence or otherwise of any prior connection or association between the outsider and the company;
- whether the outsider conducted any search of the public record.

The *Northside* case represents what may be considered a "high water" mark for due inquiry, involving a fairly rigorous degree of reasonable conduct imposed on the lender.

The *Northside* decision is the final chapter on the common law knowledge exceptions, although there was pre-existing Australian case law to reconcile with its findings. Previous Australian authorities involving the due inquiry exception to the rule include:

- *Re Efron's Tie & Knitting Mills Pty Ltd*,[17]
- *Re Hapytoz Pty Ltd*,[18]
- *Re Scottish Loan Finance Co Ltd*,[19]
- *Albert Gardens (Manly) Pty Ltd v Mercantile Credits Ltd*,[20] and
- *Custom Credit Holdings Ltd v Creighton Investments Pty Ltd*.[21]

As *Efron's Tie, Scottish Loan* and *Hapytoz* involved third party securities, it is particularly useful to examine whether they are consistent with *Northside*.

In *Efron's Tie*, the rule was unavailable to a creditor who was seeking to enforce a third party guarantee. Cussen ACJ, foreshadowing Mason CJ in *Northside*, held that as the guarantee was provided to secure the director's personal liability, the bank had constructive knowledge that the guarantee was not in the interests of the company and was bound to inquire into the circumstances of its execution. The guarantee was signed under common seal.

Hapytoz and *Scottish Loan* involved a different form of execution of the written contract, as the guarantees were signed under the personal signature of the respective managing directors. In *Hapytoz*, the third party guarantee was provided to secure the debts of another company, and as there were no circumstances to put the creditor on inquiry, the rule applied. The managing director signed the guarantee. Although not cited, *Hapytoz* is similar in facts and outcome in *Scottish Loan*.[22]

The different forms of execution mean that the relevant assumptions under the rule to be made by the creditor are different. In *Hapytoz* and *Scottish Loan*, the managing director signed the respective guarantees, so the creditor could assume that the managing director had authority to sign. The potential conflict between the corporate security providers and the third party debtor was not was not obvious enough to provoke inquiry, as in neither case was the signatory to the guarantee the principal debtor (unlike *Efron's Tie*). Even in *Hapytoz*, the guarantor company shared common directors and common shareholders to the debtor company.

17 [1932] VLR 8.
18 [1937] VR 40.
19 (1944) 44 SR(NSW) 461.
20 (1973) 131 CLR 60.
21 (1985) 3 ACLC 248.
22 In *Scottish Loan*, a guarantee was signed purportedly by the managing director Levitus, in favour of the Commissioner of Taxation, in respect of another party's (Forbes') tax debt.

This is the point of distinction between the personal signature cases with the common seal cases that is not necessarily highlighted by *Northside* (a seal case). As the result in *Northside* shows, where the seal is affixed, the creditor has stronger evidence from the face of the document whether there is a conflict by a principal debtor committing corporate assets to a third party guarantee in their favour. For example, in *Northside*, the lender failed to distinguish between Sturgess' personal interests and his other corporate interests. Although the method of execution seems to be a compelling point of distinction between the creditors' constructive knowledge in these cases, caution must be exercised in extrapolating this to more modern cases. Brennan J in *Northside* commented that "had it been found that the creditor [in *Hapytoz*] was put on inquiry, that result would not have been surprising."[23]

It may not only be the manner of execution that provides objective facts from which an outsider may need to inquire further. In *Custom Credit Holdings Ltd v Creighton Investments Pty Ltd*,[24] the financier was told by one director that the company's solicitor had doubts as to the validity of the execution of the documents. Having this fact revealed gave rise to the reasonable obligation on the financier to inquire further.

Accordingly, the common law exception of due inquiry arises when either:

- the person dealing with the company has a particular relationship with the company and *is in a position to know* about the company's internal management (regardless of their actual knowledge);[25]
- the actual knowledge (by subjective knowledge or reckless indifference) possessed by the outsider would lead a reasonable person to doubt the efficacy of the assumption.[26]

The matters of knowledge that trigger the doubt include:

1. the circumstances of the company.[27]
2. The nature of the transaction itself. As alluded to by Mason CJ in *Northside*: "A person, even one who has no special relationship with the company concerned, may be put upon inquiry by the very nature of the transaction...".[28] Further, in *Northside Developments Pty Ltd v Registrar-General* at first instance, Young J distinguished between conveyancing transactions and ordinary commercial transactions in holding that "in a conveyancing transaction, especially one involving a large amount of money or very valuable land, a court would very easily come to the conclusion that a reasonable person, acting in such a transaction, would make inquiries."[29] This refers to the standard beyond constructive knowledge into constructive notice.
3. The identity of its officers.[30]

23 (1990) 8 ACLC 611, 633.
24 (1985) 3 ACLC 248.
25 *Morris v Kanssen* [1946] AC 459.
26 *Custom Credit Holdings Ltd v Creighton Investments Pty Ltd* (1985) 3 ACLC 248.
27 The word "circumstances" captures all the indicia from Mason CJ's judgment in *Northside*, above.
28 (1990) 8 ACLC 611, 617.
29 (1987) 5 ACLC 642, 649. The abolition of constructive notice is discussed in the next chapter.
30 Although not a common law case, *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48 followed *Northside*. As the identity of officers is a matter of public record, a reasonable and prudent lender would, as a matter of routine, obtain this information: per Priestley JA in *Fiberi*. Referring to the cases decided under the statutory rule (discussed in chapters 5–8), there is a consistent correlation between failure to search and rely on the public record and the unsuccessful lender.

4. The conflicting interests of those officers.[31]
5. The assets being offered as third party security are trust assets. The significance of the borrower/security provider being a trustee did not arise from *Northside* or any previous common law cases. This factor is added as a result of developments since *Northside*. Based on the result in *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*[32] and *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*,[33] the outsider would always need to inquire about the trust deed to ensure that a third party security is permitted.[34]

Imputed knowledge

Both actual and constructive knowledge requires evidence of some accumulation of facts by the outsider. A practical issue that affects corporate or institutional outsiders is the question of the acquisition of knowledge. To be more precise, where the outsider is a corporation, how does the court ascertain a corporation's knowledge? The issue of imputed knowledge has arisen in the more recent cases on the statutory rule, although it relies on underlying common law authorities.

In a commercial transaction, there are several layers of responsibility within the institution to bring the contract to fruition. A typical chain of command, as represented by the recent cases *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*[35] and *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*,[36] involves the bank's officers dealing face to face with the company's officers, and those officers in either case may be different from the actual decision makers in the corporation. The knowledge of the bank officer with responsibility for the account is imputed to the bank.[37] The bank also engages professional legal and valuation services. The chain of command is such that the bank accumulates disparate pieces of information about the transaction and the parties to it. Essentially, it is a question of fact for the court to ascertain the nature and effect of the accumulation of knowledge. In *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*,[38] counsel for the bank argued that the communication breakdown evident from the bank records and witness' recollections amounted to honest confusion, not knowledge about the transaction. Hansen J confirmed that a company has the knowledge of its officers. His Honour extended this to the situation of a solicitor who has been engaged by the outsider to investigate a particular transaction. As a question of fact, Hansen J resolved that the bank's actual knowledge of some matters (that Koorootang was a trustee company) lead to constructive knowledge of others (e.g. that the officer of Koorootang misapplied the trust assets for his personal interests).

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31 *Re Efron's Tie & Knitting Mills Pty Ltd* [1932] VLR 8. *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* provides a post-*Northside* example. Once the bank knew that the director who represented the borrower also represented the third party security provider, and that there was no business connection between the two, then the bank ought to have made further enquiries of the other directors or beneficiaries of the trust, represented by the security provider.

32 [1998] 3 VR 16.

33 [1998] 3 VR 16

34 These cases are discussed in chapters 5 to 8.

35 [1998] 3 VLR 16.

36 [1998] 3 VR 133.

37 *Re Chisum Services Pty Ltd* (1982) 1 ACLC 292.

38 [1998] 3 VR 16.

This accumulation of knowledge has limits, for example, in *Sixty-Fourth Throne,* Tadgell JA declined to find that the aggregation of all the knowledge of a corporation was sufficient to find a fraudulent state of mind of the corporation.[39] Also, where the director is acting in fraud of the company, or in breach of duty, then their knowledge of their own breach will not be imputed to the company.[40]

However, where there is evidence that both parties to the contract have common directors, then the knowledge of the director about a breach of duty will be imputed to the company taking the benefit of the breach of duty. This is the case provided the common director is acting within the scope of their authority as director of the benefiting company, to enter into the contract.[41] In such a case, the company benefiting from the breach of duty will have actual knowledge of the breach.

Constructive Notice

Common law development

At common law, an outsider dealing with a company was deemed to have notice of the public documents of the company. This is known as the doctrine of constructive notice and is a modification of the general rules of agency as applied to companies. The application of this doctrine meant that where the authority of an agent was limited by a company's constitution, an outsider dealing with the company was taken to have read and understood these documents and to be aware of the agent's lack of authority. The outsider could not then hold the company liable despite any representations to the contrary made by the company. This doctrine was also applicable in cases where a company acted outside its objects as stated in the constitution. The doctrine corresponded to the situation in agency law where the third party is aware that the agent has exceeded their authority and is unable to bind the principal.

The doctrine of constructive notice was well established by 1857. Lord Wensleydale said:

> "The stipulations of the deed, which restrict and regulate [the directors'] authority, are obligatory on those who deal with the company; and the directors can make no contract so as to bind the whole body of shareholders, for whose protection the rules are made, unless they are strictly complied with".[42]

This doctrine enabled a company to rely, as against an outsider, on any limitations imposed on the powers of its organs, as disclosed in the constitution or other public documents. Thus a company was not bound by a contract with an outsider, if its constitution showed that the person who purported to act as agent, did not have the requisite author-

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39 [1998] 3 VR 133, 145–6.

40 *Re Hampshire Land Co* [1896] 2 Ch 743, *JC Houghton & Co v Northard Lowe & Wills Ltd* [1928] AC 1. Followed in Australia in *The Duke Group Ltd v Pilmer* (1999) 17 ACLC 1, 329 (first instance, not mentioned in the High Court appeal [2001] HCA 31) and *Beach Petroleum NL v Johnson* (1993) 115 ALR 411.

41 *Farrow Finance Company Ltd v Farrow Properties Pty Ltd* (1998) 16 ACLC 897, 931 (Hansen J); *Linter Group Ltd v Goldberg* (1992) 10 ACLC 739; *Southern Cross Commodities Pty Ltd v Ewing* (No 2) (1988) 6 ACLC 647. See R Grantham, 'Corporate Knowledge: Identification or Attribution?' (1996) 56 *Modern Law Review* 732. Grantham reviews and criticises New Zealand developments, particularly *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 2 AC 500, on knowledge attribution to companies.

42 *Ernest v Nicholls* (1857) 6 HLC 401, 41.

ity or exceeded authority. For example, former Table A, art 66(2) empowered the directors to borrow money and to charge any property of the company as security. This power may, in the constitution of some companies, be subject to certain limitations. Under the doctrine of constructive notice, outsiders were taken to be aware of the existence of any such limitations contained in the constitution. If the directors gave security on a loan that was in excess of their specified borrowing powers, the outsider could not hold the company to be bound by the act of the directors because the outsider was taken to know of the limitation on the directors' authority. This was so, even in the absence of actual knowledge of the limitation.

The doctrine of constructive notice applied to public documents such as the constitution, and notices of special resolutions.[43] The doctrine operates against the outsider and in favour of the company.[44]

The doctrine of constructive notice is unfair because it precludes any examination of the state of actual knowledge of both parties to the contract. For example, the company itself may rely on restrictions in its constitution to preclude enforceability of a transaction, even where the company may have misrepresented its capacity.[45] The doctrine of constructive notice routinely caused confusion to outsiders and attracted criticism. For example, Professor Ford in 1978 noted that:

> "Most contracts are made with companies without inspection of their memoranda for the reason that the insistence on inspection would slow down commerce intolerably. ... But the doctrine of constructive notice operates regardless of the nature of the transaction and it served no useful purpose when it enabled a company … to avoid liability on a contract entered into in circumstances where no reasonable person would ask to see the memorandum."[46]

It is difficult to find support for the doctrine: Campbell[47] suggests that the function of public documents, in particular the memorandum and articles was to restrict powers which would otherwise exist at common law. Montrose[48] thought that this doctrine differentiated companies from partnerships because restrictions in partnership agreements did not affect third parties.

Constructive notice and the indoor management rule

In particular, the doctrine of constructive notice complicated the indoor management rule's efficient operation. The rule's interaction with constructive notice has been described[49] as both:

- a "modification" of constructive notice, as it allows the outsider to make assumptions consistent with the public documents; and
- the "converse" of constructive notice, as the rule may operate in favour of the outsider, whereas constructive notice operates in favour of the company.[50]

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43 *Irvine v Union Bank of Australia Ltd* (1877) 2 App Cas 366.
44 *Houghton & Co v Nothard Lowe and Wills Ltd* [1928] AC 1 and *Rama Corporation Ltd v Proved Tin and General Investments Ltd* [1952] 2 QB 147.
45 *Re Jon Beauforte (London) Ltd* [1953] 2 WLR 465.
46 H A J Ford, *Principles of Company Law* (2nd ed, 1978) 90.
47 I Campbell, 'Contracts with Companies' (1959) 75 *Law Quarterly Review* 469, 476.
48 J L Montrose, 'Apparent Authority of an Agent of a Company' (1934) 50 *Law Quarterly Review* 224, 237.
49 I Campbell, 'Contracts with Companies' (1960) 76 *Law Quarterly Review* 115, 117.
50 *Rama Corporation Ltd v Proved Tin & General Investments Ltd* [1952] 2 QB 147, 149.

The operation of the indoor management rule as a protection for outsiders is adversely affected by the doctrine of constructive notice, for four reasons:

1. the doctrine demands notice of "public documents", so there is an issue as to the meaning of what constitutes public documents;
2. There is confusion caused by some common law cases as to whether the outsider's actual knowledge of the public documents overrides constructive notice;
3. the distinction between procedural regularity and substantive limitations on powers, as revealed in the public documents; and
4. the continuing role of "notice".

1. The meaning of "public documents"

All companies legislation has required the filing of documents at regular intervals (e.g. annual returns), and upon the happening of certain events, all of which inform outsiders, including:

- incorporation or registration;
- changes of officers;
- allotment of shares;
- notices of special resolutions, which generally by their very nature relate to changes in the constituent documents;
- notices relating to external administration.

If we assume that all documents filed with the regulator are "public documents", constructive notice is counterproductive to the simple rule of procedural regularity. If documentary evidence of a company's decision is required for the public record, then constructive notice necessarily imposes the proviso that the assumption may only be made if it is consistent with the content of the public record. For example, if a matter ought to be decided by special resolution, then the indoor management rule allows the outsider to assume that the procedure has been carried out. However, the doctrine of constructive notice fixes the outsider with notice of documents lodged, or not lodged. The outsider cannot assume that the special resolution has been held when that assumption is inconsistent with the public record. In this sense, constructive notice interferes with procedural regularity assumptions in cases where the irregularity is apparent on the face of the constitution or other public document.

Notification of external administration and routine changes of officer both alert outsiders to a change in the identity of officers authorised to exercise corporate power. In this way, the interaction between the public record and the outsider can be positive, as it allows the outsider to confirm the officers' identity.

The rule is enhanced if the negative aspects of constructive notice are minimised and the positive aspects retained. This can be seen with the statutory version of the rule. For example, the public record as to the identity of officers is necessary and conclusive to the making of certain statutory assumptions, although the outsider does not have to prove that they actually checked and relied on the public record at the time of entering into the transaction. The statutory version of the rule and the statutory abolition of constructive notice, are discussed in chapters 5 and 6.

2. The materiality of the outsider's actual knowledge of the public documents

Constructive notice disregards the outsider's actual knowledge. However, common law indoor management rule cases unnecessarily complicated the operation of the rule by emphasising the outsider's actual knowledge of the public documents compared with the actual content of the public documents.

For example, in *Rama Corporation Ltd v Proved Tin and General Investments Ltd*,[51] the outsider's failure to read the articles but subsequent reliance on the wide powers of delegation permitted, was one factor that precluded reliance on the rule. That is, constructive notice of the articles could not be used in favour of the outsider to argue for the rule's application. Whether the *Rama* case is also authority for the corollary, that is, at common law, a person with actual knowledge of a power in the company's articles to delegate is entitled to assume that the board has delegated its powers, is an open question. Slade J in *Rama* approved of earlier authority[52] to the effect that an outsider might rely on their actual knowledge of the articles that delegation might take place, as part of the circumstances for a person dealing with that officer, bona fide, to rely on the rule.[53] Slade J declined to follow contrary dicta in cases such as *British Thomson-Houston Co v Federated European Bank Ltd*[54] that a person need not know of the articles at all or inquire as to delegation.

Antipodean cases have, perhaps more correctly, placed less emphasis on whether the outsider read the constitution prior to entering into the transaction. In *Re Hapytoz Pty Ltd*,[55] the creditor accepted a guarantee executed by the managing director. The creditor was entitled to accept that the managing director had the authority to do this, without checking that the constitution actually permitted the appointment and delegation of powers to a managing director. Similarly, in *Re Scottish Loan Finance Co Ltd*[56] Nicholas CJ held that the outsider did not have to know that the company had a power to appoint a particular person as managing director to rely on the power of appointment in the constitution.

These Australian cases bear some similarity to the *British Thomson-Houston* case, as all three involved guarantees signed on behalf of the company by the managing director.[57] Knowledge of the constitution should not matter in cases that may be decided on the grounds of actual implied authority,[58] as in all three cases, it was not disputed that the signatory was managing director. Cases such as *Rama* and the case it followed *Houghton & Co v Nothard Lowe & Wills Ltd* have different outcomes as they involved dealings by

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51 [1952] 2 QB 147.

52 *Biggerstaff v Rowatt's Wharf Ltd* [1896] 2 Ch 93, 102 (Lindley LJ); *Kreditbank Cassel GmbH v Schenkers* [1927] 1 KB 826, 832–833 (Bankes LJ); *Houghton & Co v Nothard Lowe & Wills Ltd* [1927] 1 KB 246 (Bankes LJ, Atkin LJ, Sargant LJ).

53 There was a short-lived attempt made in 1984 to overcome this debate from *Rama*. Section 68B, repealed in 1986, provided that a person could not assume that an officer or agent had authority, merely because the memorandum or articles of the company provided authority could be delegated to an officer or agent.

54 [1932] 2 KB 176, 182.

55 [1937] VLR 40.

56 (1944) 44 SR (NSW) 461.

57 In *British Thomson-Houston Co v Federated European Bank Ltd* [1932] 2 KB 176, Pal signed as "Chairman" but it was assumed that this was equivalent to the position of managing director.

58 *Northside Developments Pty Ltd v Registrar-General* (1990) 11 ACLC 611, 640 (Dawson J): "knowledge of such an article [of delegation] is not essential for the application of the indoor management rule where apparent authority can be established without reliance upon it."

the outsider with a single director only. Ultimately, Sargant LJ in *Houghton* held that the outsider could not assume that the director they were dealing with had more than the customary authority of a director. The rule did not apply, even if the outsider had actual knowledge and not merely constructive notice of the power of delegation in the constitution.

Dawson J in *Northside* concludes the debate by arguing that:

> " … the notion that potential authority under an article might, without more, be treated as actual authority by an outsider to the company who knows of the article was something which obviously went beyond the reasonable requirements of business convenience and was difficult to sustain upon principle."[59]

3. Distinguishing procedural requirements in the public documents from substantive provisions affecting exercises of power

As the discussion on actual knowledge above indicates, some English cases have distinguished between a requirement in the constitution that is merely procedural, from an assumption that a more substantive matter has occurred, such as a power of delegation. This indicates that common law cases applying the rule may be separated into two categories: first, those that have been decided as procedural exercises of power, in which case the rule has generally been successful in enabling the outsider to enforce their contract. For example, in *Turquand*, Jervis CJ contributed an important precedent by noting that the constitution did not prohibit borrowing, but amounted to a permission to do so upon certain procedural conditions.[60]

The second type of case are those that have been argued as an attempt by the outsider to assume something more than a procedural regularity, namely, that a delegation of power has occurred. As we saw in the *Rama* case,[61] the rule generally cannot be used to assume that a particular delegation has taken place. Although the distinction between procedural constraint and substantive delegation may be identified, it is not consistently applied in the common law cases. For example, in *Mahoney v East Holyford Mining Co*,[62] the constitution permitted the shareholders to appoint directors to exercise the management powers of the company. The bank was enforcing cheques signed by directors where the company argued that the directors were not properly appointed. Due to a representation, the bank could assume appointment. That is, the delegation of the power to the board was treated as a procedural matter relating to the manner of their appointment, not a matter of delegation.

Constructive notice highlights the procedural regularity, and so defines the scope of the assumption allowed to be made by the outsider.[63] Should the rule also apply to exercises of power subject to more substantive requirements, such as an express power of delegation, or an explicit limitation on its exercise? The constitution in *Turquand* could have been interpreted as a substantive limitation, and not a procedural condition. The common law cases demonstrate the difficulty of categorising a requirement in the constitution as

59 (1990) 11 ACLC 611, 640 (Dawson J).
60 (1856) 119 ER 886, 888.
61 *Rama Corporation Ltd v Proved Tin and General Investments Ltd* [1952] 2 QB 147.
62 (1875) LR 7 HL 869.
63 Campbell (1960), supra n 49, 117: "The officials in the company cannot be assumed to have greater capacity that the articles permit."

a mere procedural constraint, and the results in the Australian common law cases suggest that this is a largely unnecessary exercise. Australian cases on the common law rule highlight two features of the rule's application:

1. Even where the constitution imposes merely a procedural restraint, constructive notice of the public documents will not allow the outsider to assume compliance if the manner of execution is inconsistent with the constitution. In *Equity Nominees Ltd v Tucker*, the company's constitution required the seal to be signed by at least two directors and the secretary. Two directors only signed the third party guarantee signed under seal. Windeyer J held that the rule did not apply where the articles "apparently or in fact" were not complied with.[64]
2. In Australia, unlike the English decisions,[65] the delegation problem has been overcome by essentially treating a substantive power of delegation as a procedural requirement. For example, *Re Scottish Loan Finance Co Ltd*[66] and *Re Hapytoz Pty Ltd*[67] are cases involving the positive exercise of an appointment provided in the constitution, but were treated as merely procedural, so the rule applied. The existence of the power was enough, despite the absence of any representation as to its exercise.[68]

4. The continuing role of constructive notice

Although constructive notice of public corporate documents is now abolished in s 130 (except for registered charges), the concept of notice remains relevant to the doctrine of the bona fide purchaser for value without notice. Issues of the outsider's title may still be challenged if the transaction occurred with actual or constructive knowledge, or notice of a prior equity. In the corporate transaction, the prior equity may refer to the company's right to avoid the contract due to directors acting without authority. In a transaction involving land, an outsider is still expected to conduct the normal searches as to title in land registers, hence the reference to notice.

The effect of the doctrine of the bona fide purchaser for value without notice, in land transactions, is affected by the Torrens system of indefeasibility of registration, but this conveyancing practice aspect of legislative intervention by the states' various land titles legislation is not pursued here.

64 (1967) 116 CLR 518, 526.

65 For example, in *South London Greyhound Racecourses Ltd v Wake* [1931] 1 Ch 496, the sealing clause was incorrectly treated as a substantive matter of delegation, so the rule did not apply to assume that the delegation had in fact occurred In *Northside* (1990) 11 ACLC 611, 631, Brennan J said that in *Wake*, the person dealing with the company in good faith might have assumed that the board had given its authority to the fixing of the seal. However, the result of the case is correct if confined to the "put on inquiry exception". In *Wake's* case, the share certificate was not issued for the purposes of the company's business as in *Turquand* but for the benefit of an unrelated debtor company.

66 (1944) 44 SR (NSW) 461.

67 [1937] VLR 40.

68 See also *Albert Gardens (Manly) Pty Ltd v Mercantile Credits Ltd* (1973) 131 CLR 60, where directors had to have a share qualification for a valid appointment. The matter of their share qualification was a procedural matter that the rule applied to, not a matter that related to delegation of power.

Conclusion on the Current Relevance of the Rule in Turquand's Case

The rule and its exceptions: ongoing development?

The cases analysed on the application of the common law indoor management rule show some inconsistency in result. This is primarily due to the rule applying subject to other common law doctrines such as classic ultra vires and constructive notice. The efficacy of the rule was therefore affected by complexity in operation, attributed to:

1. Determining whether the constitution sets out a procedural constraint or a substantive power of delegation or appointment. If there is a procedural constraint, then the outsider may assume that the procedure is complied with, regardless of whether they had actual knowledge of the articles. The Rule in *Turquand's* case requires that the assumption made is consistent with the terms of the constitution, not necessarily with actual knowledge of it.
2. If it seems that the outsider is actually seeking to assume the exercise of a power of delegation, then the existence of the power in the constitution is not enough to assume procedural regularity, regardless whether the outsider read it. If they did not read it anyway, constructive notice does not operate in their favour. Even if they did read it, actual knowledge of the power still requires some representation that it was exercised.
3. The debate as to the true nature of the seal,[69] and determining the extent to which the rule covers all steps in the execution, from the board resolution to actual physical execution.
4. Whether the "forgery" preventing the rule from operating is true fraud, or also applies to defects in the exercise of the power.

The statutory reform process that commenced in 1983 accordingly addresses these points of confusion directly by codifying the rule and making explicit the assumptions that are available, and indirectly by removing the need for a constitution (discussed in chapter 2) and abolishing constructive notice (discussed in chapter 5).

Continuing relevance of the common law rule

Although the *Northside* case is essentially the final statement on the common law principles applicable to the indoor management rule, these principles are relevant for three reasons.

1. The common law will still apply to a situation that arises outside the statutory formulation.
2. The common law background forms the foundation for the subsequent statutory intervention.
3. The common law provides a standard or basis to inform the debate as to the ambit of the statutory rule and to measure the effectiveness of the statutory intervention.

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69 See K E Lindgren, 'The Positive Corporate Seal Rule and Exceptions Thereto and the Rule in Turquand's Case' (1973) 9 Melbourne University Law Review 192; K E Lindgren, 'The Negative Corporate Seal Rule and Exceptions Thereto' (1974) 9 *Melbourne University Law Review* 411. Professor Lindgren discusses the nature of the common seal and describes how it represents the true expression of the company's assent that operates independently of the exercise of the power.

1. Circumstance outside of the statute

A dealing may occur that arises outside of the *Corporations Act*. Examples include:

- dealings with an entity not subject to *Corporations Act* regulation; or
- the transaction occurred before statutory intervention (unlikely); or
- based on some technical interpretation, the statute does not apply to the circumstances of the transaction.

As the statutory rule is set out as a code, there are obviously elements or conditions to be cumulatively satisfied, discussed in chapter 5 as the "qualifying circumstances". Gummow J in *Australian Capital Television Pty Ltd v Minister for Transport & Communications*[70] comprehensively discusses the types of situations that may be excluded from the statute. His Honour identified the qualifying circumstances of the former statutory version of the rule as:

1. any person had dealings with the company, and
2. in proceedings in relation to those dealings,
3. the company sought to assert that the matters the person was entitled to assume were not correct.

For example in that case, the applicant sought to dispute the sealing of certificates of lodgement submitted to the Minister by other parties. The statute could not apply, as the applicant was not engaged in "dealings" with the companies concerned; nor were the companies making assertions to the contrary about the execution of the certificates. Gummow J provided a further example of where the statute may not apply, in an action for inducing breach of contract, where the plaintiff may first need to establish the validity of the contract in question.

In *Bell Resources Holdings Pty Ltd v Commissioner for ACT Revenue Collections*,[71] von Doussa J held that the statute did not apply because the first and second qualifying circumstances had not been met. The case involved an appeal from the Administrative Appeals Tribunal, by the applicant (a holding company) against the Commissioner in relation to a share transfer signed by a subsidiary in favour of a third party.

There is limited scope for ongoing development of the common law indoor management rule, as well as its relevance to establish the foundation for statutory modifications.[72]

2. Common law foundation for statutory intervention

The first round of statutory intervention commenced in 1984, and the case law indicates some debate as to the status of the statutory rules against their common law foundation. The argument that the statute operates as a complete code to replace the common law has not been sustained. Instead, Australian judges acknowledge that the statute codifies and clarifies the common law, to overcome some of its problems such as forgery,[73] but operates not as a comprehensive code.[74] Kirby P in *Bank of New Zealand v Fiberi Pty Ltd* said

70 (1989) 7 ACLC 525.

71 (1990) 8 ACLC 533.

72 *Australian Capital Television Pty Ltd v Minister for Transport & Communications* (1989) 7 ACLC 525, 535 (Gummow J). See also D Morrison, 'The Continued Role of the Common Law Indoor management Rule Due Inquiry Exception' (1996) 12 *Queensland University of Technology Law Journal* 28.

73 *Barclays Finance Holdings Ltd v Sturgess* (1985) 3 ACLC 662, 667 (Wood J). See chapter 7.

that the statutory rule does not operate in a "legal social and economic vacuum."[75] The statute does not override existing common law principles on the rule, as expressed in *Northside*, nor did it provide unconditional protection to outsiders, nor does it preclude reference to other competing considerations (such as good faith).

3. Common law background relevant for statutory interpretation

The Explanatory Memorandum to the statutory reform that introduced the indoor management rule into the companies legislation kept *Turquand's* case on the agenda by specifically referring to the intention to clarify the rule's operation.[76] Any academic exercise in tracing the rule's development and application, and resolving remaining ambiguities, inevitably requires comparison with the common law principles. Defining the scope of the statutory versions of the actual or constructive knowledge exceptions is one of the important contributions of the common law principles in shaping the debate as to statutory interpretation. As discussed later in chapter 8 there was initial judicial agreement that the statute departed from the common law constructive knowledge exception of "put on inquiry". However, the New South Wales Court of Appeal in *Bank of New Zealand v Fiberi Pty Ltd*[77] narrowed the perceived gap between the common law and the statute. The debate continues as to the meaning of the newly drafted statutory exception, its connection with constructive knowledge, and the role of common law principles.

Once the surrounding factors of ultra vires, forgeries and constructive notice have been specifically reformed, the issues for statutory reform of the rule itself include:

1. Resolving the ambit of the exceptions;
2. Specifically, clarifying the open-ended obligation of reasonable conduct imposed by constructive knowledge and its formulation into the "due inquiry" exception;
3. Clarifying whether the rule provides an assumption of delegation of authority;
4. Stating the role of the corporate seal and the extent of the assumption regarding its use; and
5. Confirming the role of agency principles and the types of authority, particularly to confirm the implied authority that company officers possess by virtue of their position.

Chapters 5 to 8 now examine in detail these issues within the context of statutory reform.

74 *Australian Capital Television Pty Ltd v Minister for Transport & Communications* (1989) 7 ACLC 525, 535 (Gummow J).
75 (1994) 12 ACLC 48, 51.
76 Explanatory Memorandum, *Corporations Bill* 1988, [567].
77 (1994) 12 ACLC 48.

Chapter 5

The Statutory Reformulation of the Indoor Management Rule

Statutory Intervention

The common law principles surrounding the operation and development of the indoor management rule discussed in earlier chapters have now been affected by reform to the *Corporations Act* in ss 125–130. The statutory version of the rule itself is based around seven protective assumptions set out in s 129 and are subject to the limitations in s 128. It was necessary to consider in the earlier chapters the Rule in *Turquand's* case, its exceptions and the rules of agency law in their application to companies because the statutory provisions are based upon the common law principles. This chapter will consider the extent to which the statutory provisions represent a departure from the traditional rules. In particular, it is unclear to what extent the inquiry exception to the Rule in *Turquand's* case has been incorporated into the legislation. Recent case law has indicated that the common law rules provide necessary background in the interpretation of the provisions.

Accordingly, there continues to be uncertainty in formulating the scope of the indoor management rule due to several factors:

1. the continuing relevance of the common law rule in modern circumstances in Australia since *Northside Developments Pty Ltd v Registrar-General*;[1]
2. whether the common law is simply mirrored, as opposed to reformulated, by statutory revisions of the rule;
3. the effect of the recent "simplification" of the rule by the *Company Law Review Act* 1998;
4. the extent of the exceptions precluding the rule's operation; and
5. in promoting business contracts, the rule must balance the business convenience of the outsider with commercial morality factors to prevent fraud, mentioned in chapter 3, under the discussion of the significance of the *Northside* case.

Aligned with reform to the Rule in *Turquand's* case, the *Company Law Review Act* 1998 also continued the legislative goal of abolishing ultra vires and the doctrine of constructive notice. In tandem with the statutory rule's reform, this chapter examines these related reforms.

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1 (1990) 8 ACLC 611.

Recent Litigation

The application of the indoor management rule for the protection of outsiders dealing with corporate borrowers and mortgagors is particularly dynamic and has attracted considerable academic commentary[2] and practitioner focus.[3] The cluster of 1990s cases applying the statutory rule primarily concern financing transactions.[4] Much of the recent judicial and academic comment on the indoor management rule is relevant, because it has arisen in the context of finance and security transactions.

Table 5.1 below nominates the important Australian cases and Table 5.2 provides a comparative overview. As these tables show, the cases have mixed results for the lenders involved. As Table 5.2 demonstrates, the selection of the comparative features is designed to identify "up front" the critical factors that affected the outcomes. These factors are based on both the standards of conduct imposed on the outsiders and the context of the transaction, such as the identity and characteristics of the corporate borrower/security provider. The factors featured in Table 5.2 are referred to in more detail in chapter 8 (the statutory exceptions) as contributing to the factual matrix triggering the exceptions to the statutory rule.

Collectively, these cases illustrate a combination of common features that the courts have been required to balance between protecting the outsider and enhancing commercial integrity, in situations involving contested authority. Significant factors throughout these cases include:

1. Securities transactions: the disputes involve the validity of loan and securities transactions.
2. Third party mortgages: the corporate security provider disputed the security granted in respect of loans made available to other (related and unrelated) borrowers.

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2 Notably but not exhaustively: I Ramsay, G Stapledon and K Fong, 'Affixing of the Company Seal and the Effect of the Statutory Assumption in the Corporations Law' (1999) 10 *Journal of Banking and Finance Law and Practice* 38;
D Loxton, 'One Step Forward, One Step Back: The Effect of Corporate Law Reform on Procedures in Dealing with Companies Borrowing or Giving Guarantees' (1999) 10 *Journal of Banking and Finance Law and Practice* 24;
C Hammond, 'Section 164(4)(b) of the Corporations Law: 'To be Put Upon Inquiry or Not to be Put Upon Inquiry: Is that the Question?' A Problem of Statutory Interpretation'(1998) 16 *Company and Securities Law Journal* 93;
B Horrigan, 'Busting Guarantees!' [1998] *National Law Review* 7;
J Lambrick, 'Corporate Benefit in Financial Transactions: A Policy Perspective' (1997) 8 *Journal of Banking and Finance Law and Practice* 212;
J O'Donovan, 'Corporate Benefit in Relation to Guarantees and Third Party Mortgages' (1996) 24 *Australian Business Law Review* 126;
B Horrigan, 'Third Party Securities – Theory, Law and Practice' in J Greig and B Horrigan (eds), *Enforcing Securities* (1994);
D Morrison, 'The Indoor Management Rule – A Review' (1994) 4 *Australian Journal of Corporate Law* 264.

3 For example, The Honourable Justice Paul de Jersey, 'A Question of Notice', Paper presented at QLS *Securities Intensive V Seminar*, Royal Pines, Gold Coast, October 1991, 115–136;
The Honourable Justice Paul de Jersey, 'Lending to Company Groups – The Problems of Corporate Power and Directors' Authority', Paper presented at the 9th Annual Banking Law and Practice Conference, Gold Coast, April 1992;
The Honourable Justice Ken Handley, 'When are Outsiders on Notice that Corporate Agents Lack Authority?', Paper presented at QLS *Securities Intensive VII Seminar*, Coolum, October 1993, 20–34;
J Story, 'Authority of Corporate Officers: The Northside Case and Section 164', Paper presented at QLS *Securities Intensive VII Seminar*, Coolum, October 1993, 35–64;
J Gallimore, 'The Authority of Companies to Enter into Transactions – a New Twist' (1994) 14 (8) *Proctor* 10;
The Honourable Chief Justice Paul de Jersey, 'Securities Case Law – The Year in Review', Paper presented at QLS *Banking and Finance Law Intensive Seminar*, Brisbane, October 2000.

4 Only the Australian decisions, including *Northside* and later cases, are emphasised. Australian cases dealing with other applications of the statutory provisions of the indoor management rule are only referred to incidentally.

3. Invalid execution: the security documents were executed under common seal with later claims of invalid execution. The dispute involves the authority of those "officers" who purported to attest the deal. In several situations, the attesting signatories were not even officers. In *Story v Advance Bank Australia Ltd*,[5] the signatory was an officer, but their signature was forged.
4. Corporate benefit: claims made by the corporate security provider that it received no direct benefit from the loan transaction.[6]
5. Corporate control: one person whose personality dominated the management of the corporate security provider (either with or without the acquiescence or direct sanction of other board members).

6. Corporate personality: the inability or unwillingness by outsiders to distinguish between the dominant individual and the corporate personality. Similarly, where "groups" were involved, the inability or unwillingness to distinguish between individual companies and the "group" entity.

7. Public information: the extent to which outsiders resorted to and relied on public information held by the ASIC.

8. Lack of shareholder involvement: there is no evidence that formal shareholder approval to the transaction was sought.

9. Other basic information errors: failure by the outsider to follow through when basic information was requested or supplied, or failure to reconcile conflicting information, or failure to rely on or act on professional advice.

Technically, the lenders in the cases outlined in Table 5.2 who were unsuccessful in enforcing their contracts were unable to rely on the indoor management rule due to the scope of the exceptions. Although the analysis of the exceptions is addressed in more detail in chapter 8, some preliminary reconciliation of the outcomes is appropriate. The inability to access indoor management rule protection is directly attributable to two factors within the lenders' control:

- failure to meet a threshold of familiarity with the corporate borrower/security provider and other parties to the transaction (including access to basic publicly available information); and
- failure to identify the "officers" of the company purporting to have the authority to exercise corporate power (the authority of officers was discussed in chapter 2).

5 (1993) 11 ACLC 629.

6 "Benefit" here is used in the sense of commercial benefit or advantage, and is one of the components of the 'due inquiry' exception identified in chapter 4.

Table 5.1 Indoor Management Rule cases involving banks and financiers as outsiders

Case name in full	Referred to as:	Court	Appeal history
Northside Developments Pty Ltd v Registrar-General (1990) 8 ACLC 611.	*Northside*	High Court Mason CJ, Brennan, Dawson, Toohey & Gaudron JJ	NSW Sup Ct, Young J (1987) 5 ACLC 642; NSW CA, Kirby P, McHugh & Samuels JJA (1989) 7 ACLC 52
Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd (1992) 10 ACLC 253.	*Brick & Pipe*	Vic Supreme Ct FC McGarvie, Marks & Beach JJ	Vic Sup Ct, Ormiston J (1991) 9 ACLC 324
Story v Advance Bank Australia Ltd (1993) 11 ACLC 629.	*Story*	NSW CA Gleeson CJ, Mahoney & Cripps JJA	NSW Sup Ct, Studdert J, *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* (1992) 10 ACLC 703
Equiticorp Finance Ltd v Bank of New Zealand (1993) 11 ACLC 952.	*Equiticorp*	NSW CA Kirby P, Clarke & Cripps JJA	NSW Sup Ct, Giles J, *Bank of New Zealand v Equiticorp Finance Ltd* (1993) 11 ACLC 84
Bank of New Zealand v Fiberi Pty Ltd (1994) 12 ACLC 48.	*Fiberi*	NSW CA Kirby P, Priestley & Clarke JJA	NSW Sup Ct, Allen J (1992) 8 ACSR 790 leave to appeal to the High Court was refused on 11 February 1994 (1994) 12 ACLC 232.
Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd [1998] 3 VR 133.	*Sixty-Fourth Throne*	Vic CA Winneke P, Tadgell JA & Ashley AJA	Vic Sup Ct, Hedigan J (1996) 14 ACLC 670. Special leave to appeal to the High Court was refused on 19 May 1998.
Pyramid Building Society v Scorpion Hotels Pty Ltd (1996) 14 ACLC 679.	*Scorpion*	Vic Sup Ct Nathan J	
Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd [1998] 3 VR 16.	*Koorootang*	Sup Ct Vic Hansen J	
NAB v Sparrow Green Pty Ltd (1999) 17 ACLC 1665.	*Sparrow Green; Perkins* (first instance)	SA CA Olsson, Mullighan & Nyland JJ	SA Sup Ct Debelle J *Perkins v NAB* (1999) 30 ACSR 256.
Myers v Aquarell Pty Ltd [2000] VSC 429.	*Myers*	Sup Ct Vic Gillard J	

Table 5.2 Major similarities and differences of significance in Indoor Management Rule cases

	Northside	Brick & Pipe	Story	Equiticorp	Fiberi
COMMON LAW	x				
STATUTE: PRE CLR ACT		x	x	x	x
STATUTE: POST CLR ACT					
LENDER SUCCESSFUL IN ENFORCING SECURITY?	NO	YES	YES	YES	NO
REASON?	put on inquiry	Statutory rule applied	Statutory rule applied	Statutory rule applied	Statutory exception applied OUGHT TO KNOW
TRANSACTION ENTERED INTO WITH BOARD AUTHORITY?	NO	NO	NO	YES	NO
TRANSACTION ENTERED INTO WITH SOME OTHER ACTUAL AUTHORITY?	NO	YES (Goldberg was de facto MD)	NO	YES (Hawkins was de facto MD)	NO
SEAL AFFIXED BY ALL PARTIES WHO WERE OFFICERS?	NO	YES	YES, but forgery involved	YES	NO
FORGED SIGNATURE?	NO	NO	YES	NO	NO
CORPORATE BENEFIT?	NO	NO	YES	YES: group welfare	NO
SOLE ASSET MORTGAGED?	YES	NO	NO	NO	YES
CORPORATE GROUP?	NO	YES	YES	YES	NO
DOMINANT MANAGER?	NO	YES (Goldberg)	YES (Story)	YES (Hawkins)	NO
DOMINANT BY ACQUIESCENCE	NO	YES	NO	YES	NO
TRADING COY?	NO	YES	YES	YES	NO
TRUST ASSETS?	NO	NO	NO	NO	NO
SHAREHOLDER RATIFICATION?	NO	NO	NO	NO	NO
LENDER CONSTRUCTIVE TRUSTEE?	NO	NO	NO	NO: but Kirby P in dissent	NO
DUTY OF CARE TO BORROWER/ SECURITY PROVIDER?	NOT ARGUED	NOT ARGUED	NOT ARGUED	NOT ARGUED	NOT ARGUED
LENDER DID ASIC SEARCH?	NO	YES	YES	YES	NO
LENDER /SOLICITOR FOLLOWED UP REQUESTS FOR INFORMATION	N/A	YES: confirmation of Furst's appointment as secretary sought	N/A	N/A	N/A

	Sixty-Fourth Throne	**Scorpion**	**Koorootang**	**Sparrow Green**	**Myers**
COMMON LAW					
STATUTE PRE CLR ACT	x	x	x	x	x
STATUTE POST CLR ACT					x
LENDER SUCCESSFUL?	NO	NO	NO	NO	YES
REASON?	Statutory exception applied OUGHT TO KNOW	Statutory exception applied OUGHT TO KNOW	Statutory exception applied OUGHT TO KNOW	Statutory exception applied OUGHT TO KNOW	Statutory rule applied
TRANSACTION ENTERED INTO WITH BOARD AUTHORITY?	NO	NO	NO	NO	YES (McCardel was sole director)
TRANSACTION ENTERED INTO WITH SOME OTHER ACTUAL AUTHORITY?	NO	NO	NO	NO	YES
SEAL AFFIXED BY ALL PARTIES WHO WERE OFFICERS?	NO	NO	YES, but forgery involved	NO, only one officer signed	YES
FORGED SIGNATURE	NO	NO	YES	NO	NO
CORPORATE BENEFIT?	NO	NO	NO	YES	YES
SOLE ASSET MORTGAGED?	YES	YES	SUBSTANT -IAL ASSETS	YES	NOT KNOWN
CORPORATE GROUP?	NO	NO	NO	NO	NO
DOMINANT MANAGER?	YES (Mr & Mrs Kandy)	YES (Lewis)	YES (Jeffries)	YES (Green)	YES (McCardel)
DOMINANT BY ACQUIESCENCE	NO	NO	NO, although his advice was sought	NO	YES, sole director
TRADING COY?	Trustee	YES	Trustee	YES	Trustee
TRUST ASSETS?	YES	NO	YES	NO	YES
SHAREHOLDER RATIFICATION?	NO	NO	NO	NO	NO
LENDER CONSTRUCTIVE TRUSTEE?	NO: but Ashley AJA in dissent	NO	YES	NO	NO
DUTY OF CARE TO CORPORATE BORROWER/SECURITY PROVIDER	NOT ARGUED	NOT	YES ARGUED	NOT ARGUED	NOT ARGUED
LENDER /SOLICITOR FOLLOWED UP REQUESTS FOR INFORMATION	NO: bank did not request the results of solicitor's searches	NO	NO: bank did not act on legal advice	NO: did not obtain a director's resignation as it required.	NOT KNOWN (lender did not have solicitors)
LENDER DID ASIC SEARCH?	YES	YES	YES	YES	NOT KNOWN

The cases in Table 5.2 show that the lender was successful in relying on the indoor management rule in only four out of the ten cases listed. In the unsuccessful cases, protection was denied because of the ambit of the constructive knowledge of the lender (although *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* also involved actual knowledge of certain factors). The facts of the cases are discussed in more detail in chapters 6, 7 and 8 when the statutory provisions are analysed.

The results from the cases formulate the guidelines to indoor management rule reliance set out in chapter 10. In the meantime, the ambit of the rule and its exceptions are analysed to arrive at the scope of protection afforded to finance contracts.

The Statutory Rule: Sections 128–129

The statutory indoor management rule was first inserted as a reform to the former *Companies Codes*, operational from 1 January 1984. Table 5.3 below summarises the statutory versions of the indoor management rule. The *Corporations Act*, when first enacted in 1991 (as the *Corporations Law*) replicated the former Code provisions, then was subject to extensive revision in the *Company Law Review Act* 1998. For convenience, this chapter will reference former s 164 and current ss 128–129 only.

Table 5.3 The history of the statutory indoor management rule

Description of statutory provision	Uniform Companies Act 1961 1 July 1962	Companies Codes 1 January 1984 (as amended 1985)	Corporations Law 1 January 1991	Company Law Review Act 1 July 1998 & Corporations Act 14 July 2001
Companies granted the legal capacity of natural persons	No statute	s 67(1)	s 161(1)	s 124(1)
Company's legal capacity not affected if its interests are not served by atransaction[7]	No statute	s 67(3)	s 161(3)	s 124(2)
Abolished constructive notice of the constitution (but still applies for charges)	No statute, only common law rule[8]	s 68C	s 165	s 130
Statutory assumptions that outsidersdealing with companies may make[9]	No statute, only common law rule	s 68A(1)–(3)	s 164(1)–(3)	s 128–s 129
Statutory exceptions to the assumptions[10]	No statute, only common law rule	s 68A(4)	s 164(4)	s 128(4)
Effect of fraud or forgery in dealings	No statute, only common law rule[11]	s 68D	s 166	s 128(3)

The purpose for statutory intervention, as stated by the legislature, is to:

> "ensure that a person who deals in good faith with persons who can be reasonably supposed to have the authority of the company should be protected against later claims by the company that the persons purporting to act for it lacked authority. This involves clarifying and codifying the so-called 'indoor management rule' which has developed from the decision in *Royal British Bank v Turquand* (1856) 119 ER 886."[12]

The Attorney-General's Explanatory Memorandum considered that the state of case law was not entirely clear or satisfactory despite the considerable amount of litigation revolving around the Rule in *Turquand's* case. With the benefit of hindsight since statutory intervention, it is an interesting question to consider whether the statutory provisions have been successful in clarifying the "indoor management rule." It is surprising to note that despite the practical importance of this area, it had been the subject of relatively little explanatory case law until the last decade.

7 This provision was first inserted in 1985 by the *Companies and Securities (Miscellaneous Amendment) Act* 1985.
8 The common law rule of constructive notice (i.e. deemed notice by outsiders of the corporate constitution) and its application to the common law indoor management rule was discussed in chapter 4.
9 The former versions of the statutory rule comprised six assumptions. There are seven assumptions in the current rule. This is discussed in the next chapter.
10 The statutory wording of the exceptions was changed from the common law expressed in *Northside*, then changed again in the 1998 amendments. This is discussed in chapter 8.
11 The common law rule of forgery (i.e. that a forgery is a nullity) and its effect on the common law indoor management rule is discussed in chapter 7.
12 Explanatory Memorandum, *Companies and Securities Legislation (Miscellaneous Amendments) Act* 1983, [188].

It is clear from the Attorney-General's Explanatory Memorandum quoted above, that the dominant policy consideration behind the statutory rule is to protect outsiders acting in good faith. As will be seen in this and the following chapters, most of the cases interpreting this legislation have concerned the issue of whether the outsider ought to be excluded from the benefit of the protective assumptions.

Although good faith is expressly articulated as legislative policy, and is always an aspect of the common law, it has not been explicitly inserted into any of the statutory versions of the rule. As discussed under the common law rule in chapter 3, "good faith" includes notions of honesty and reasonableness. Rather than imposing good faith as part of the statutory rule, instead, it becomes relevant when the conduct of the outsider is examined under the exceptions, discussed in chapter 8.

The assumptions seek to codify and clarify the Rule in *Turquand's* case. Gummow J in *Australian Capital Television Pty Ltd v Minister for Transport and Communications*,[13] considered that former s 164 was not a "comprehensive code" but designed to repair the failings of the common law. Kirby P in *Bank of New Zealand v Fiberi Pty Ltd* said that former s 164 does not appear in a legal, social and economic vacuum. It does not override the principles and policies of the common law unless this is plainly the result intended by the legislation.[14] Kirby P did not think that it was a universal and unconditional objective of the legislation to protect persons dealing with a company at the expense of all other competing considerations. Its purpose is to protect such persons who deal in good faith and innocently. Kirby P thought that the competing policy considerations behind the Rule in *Turquand's* case as stated by Mason CJ in *Northside Developments Pty Ltd v Registrar-General*,[15] are also applicable in the interpretation of the statutory rule.

As Table 5.3 above, summarising the statutory provisions suggests, there are four main elements in relation to the outsider accessing the rule:

1. the outsider must meet the "qualifying circumstances" set out in s 128(1)–(3), which includes having "dealings" with the company, and in the past has included other elements such as whether the outsider was involved in proceedings in which the company asserted that the assumption was incorrect.
2. The relevant assumption accessed must fall within the scope of those listed in s 129.
3. The outsider has not triggered the statutory exceptions in s 128(4).
4. The events must have taken place since the statute was enacted. (The significance of the common law rule was discussed in chapter 4).

The *Company Law Review Act* 1998 signals the most significant change in the statutory rule. The main uncertainty created by the *Company Law Review Act* 1998 is the differences in the former and current exceptions. The exceptions are examined in chapter 8, whilst the content of the assumptions are discussed in chapter 6. The remainder of this chapter briefly canvasses the role of s 128 is establishing the "qualifying circumstances" for outsiders to access the assumptions in s 129, as well as briefly noting important related reforms.

13 (1989) 7 ACLC 525.
14 (1994) 12 ACLC 48, 51.
15 (1990) 8 ACLC 611, 627.

The qualifying circumstances in s 128(1)

The statutory version of the rule is more specific in two respects than the common law: s 128 sets out qualifying circumstances, such as requiring the outsider to have "dealings" with the company and exceptions; and s 129 specifies the actual assumptions allowed.

Section 128(1) provides:

> "A person is entitled to make the assumptions in section 129 in relation to dealings with a company. The company is not entitled to assert in proceedings in relation to the dealings that any of the assumptions are incorrect."

The new simplified version of the indoor management rule contained in s 128(1) suggests only one qualifying circumstances for the outsider to prove: that there are "dealings" with the company.[16] Further, the wording of s 128(4) still seems to require some direct connection between the person, the company and the dealing by using the phrase: "if at the time of the dealings they knew or suspected that the assumption was incorrect." The company is not entitled to assert that the assumption is incorrect in proceedings, but there is not the same imperative (as appeared in former s 164(1)) that the outsider may only rely on the assumptions if they bring "proceedings".

The word "dealings" was also used in former s 164(1) and is discussed in the case law. However, in former s 164(1), the outsider was linked directly to the dealings by the phrase "a person having dealings with a company". There was some danger that this would not appear appropriate to cover the types of agency questions contemplated by the assumptions. A strict interpretation of the expression would remove the benefit of the assumptions from an outsider who is unable to show the existence of an actual pre-existing legal relationship with the company.

The term "dealings" was given a broad meaning in *Story v Advance Bank Australia Ltd*.[17] In this case, a bank dealt with a managing director who was permitted de facto control of the conduct of a company's business by the other director. It was held that the concept of having dealings with a company extends beyond dealing with someone who has actual authority and includes situations where a document is forged. It extends to purported dealings.

The authors of *Ford's Principles of Corporations Law* concur that s 128(1) and (2) allow the assumptions to apply where the outsider deals with a person who purports to represent the company, or who purports to have acquired title from a company.[18] This interpretation enables an outsider to be protected in cases where the outsider is unable to show that the company's agent possessed authority so as to bind the company. The company would then be unable to argue that the outsider did not have dealings "with a company" but only with persons purporting to be its officers or agents.

While not deciding the issue, Kirby P in *Bank of New Zealand v Fiberi Pty Ltd*[19] suggested that it was arguable that a person is not "dealing with a company" if the circumstances of that person's relationship with the company or the dealings themselves, should have put the person on inquiry. The failure to make inquiry as to whether the dealings

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16 Although Loxton, supra n 2, 30, suggests that the ambit is even wider and a person does not have to be dealing with the company to exploit the assumption.
17 (1993) 11 ACLC 629.
18 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (10th ed, 2001) [13.281]–[13.290].
19 (1994) 12 ACLC 48.

were with the company or with the particular individuals would result in the outsider losing the entitlement to make the assumptions. This interpretation creates difficulties because it results in the introduction of a further inquiry exception to the assumptions.

There is no significance to be attached to the use of the plural: it was held previously that "dealings" does not require multiplicity of transactions.[20]

The requirement in s 128(2) that the outsider may also have acquired title through another in relation to dealings, to be entitled to make the assumptions, remains unchanged from former s 164(1).

As the qualifying circumstances have been reduced, this suggests that the assumptions may be available to a wider range of situations that under the former provisions. However, the assumptions are personal to each particular outsider. For example, provided a person has had dealings with a company, then they can assume that directors have been appointed, but the assumption must relate to *their* dealings. In *ASIC v Hallmark Gold NL*,[21] a person sought to assume that a company validly appointed directors, in order to resist an application made against them by the regulator. ASIC, after receiving a complaint by the company's shareholders, sought an order that three directors were not validly appointed. Two directors were purportedly appointed at the annual general meeting, whilst the board subsequently appointed the third director. The third director argued that at the time of his appointment, he had dealings with the company and could assume that the directors currently on the board were validly appointed. Lee J held it was "unnecessary to consider" whether ss 128–129 applied because they do not apply *in rem* by making valid acts of a company that are invalid.[22] This was not a case where the company was making an assertion against the outsider.

The Abolition of Constructive Notice

At common law, an outsider dealing with a company was deemed to have notice of the public documents of the company. The effect this had on the rule's operation has been criticised in chapter 4.

Addressing the arguments as to the lack of merit in the common law doctrine, the legislature has stepped in to abolish constructive notice for most purposes. The position of the outsider has been greatly improved by s 130 which has the effect of abolishing the doctrine of constructive notice. The doctrine has been retained only with respect to documents relating to company charges: s 130(2). Section 130(1) provides:

> "A person is not taken to have information about a company merely because the information is available to the public from ASIC."

(Former s 165(1) was substantially similar: a person shall not be taken to have knowledge of the memorandum or articles of a company or any other document or particulars by reason only that they have been lodged with the Commission.) This means that a company can no longer rely, as against an outsider, on any limitations of authority imposed on the organs or agents of the company by the constitution.

20 *Brick & Pipe* (1991) 9 ACLC 324, 345–6 (Ormiston J); *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* (1992) 10 ACLC 703, 710 (Studdert J).
21 (1999) 30 ACSR 688 (Lee J).
22 (1999) 30 ACSR 688, 395.

Section 130 operates together with the assumptions an outsider is entitled to make under s 129. For example, under s 129(2), an outsider may assume that an officer has authority to exercise the powers and perform the duties customarily exercised or performed by an officer of a similar company. The outsider need not be concerned with restrictions on the authority of the officer or agent imposed by the constitution.

The Abolition of Ultra Vires

The unresolved issues of statutory reform

Literature and case law universally agree[23] that the first round of legislative reform effected by the 1984 amendments abolished ultra vires in the classic sense. A breach of the company's constitution no longer has any direct effect on the enforcement of contracts: s 125. Legislative attempts to abolish ultra vires, however, have not entirely dispelled reservations regarding the degree of overall protection to outsiders from disputes regarding a company's capacity, powers and the exercise of its powers. The scope of reform still raises the following issues:

1. The recurring debate whether the doctrine of ultra vires ought to be abolished.
2. Amendments to the legislation give rise to varying degrees of perceived transitional difficulties for all pre-reform companies that have existing constitutions.[24] The main difficulty is in identifying the form of the constitution, to determine whether the company has any self-imposed restrictions on powers.
3. Identifying the direct and indirect consequences of a breach by the company of its constitution. Even though the void effect of ultra vires is overcome, there is concern as to the extent that the outsider's rights could be indirectly affected by internal enforcement action of the constitution, for example, if the shareholders were successful in applying for an injunction, or to have the company wound up for breach of the constitution.[25]
4. The limitation, if any, on a company's contractual capacity and the significance of the statement in s 124(2) (and its predecessors) that the company's legal capacity is not affected if an action is not in its interests.

These issues are examined below.

Should ultra vires have been abolished?

Although at the various stages of the reform there has been criticism of the drafting of the provisions, the overwhelming consensus supports the view that abolishing ultra vires is a desirable legislative goal. Outsiders were subject to harsh and inconsistent results when the common law doctrine operated. For example, in *Re Introductions Ltd*,[26] a nor-

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23 For example, T Cain, 'Ultra Vires in 1984' 1 *Queensland Institute of Technology Law Journal* 31, 39; M Sneddon, 'Protection From Ultra Vires and Related Defences' (1992) 66 *Law Institute Journal* 70; *Duke Ltd v Pilmer* (1998) 16 ACLC 567, 731 (Mullighan J, at first instance); *Advance Bank of Australia Ltd v FAI Insurances Ltd* (1987) 2 NSWLR 464, 475 (Kirby P); *Darvall v North Sydney Brick & Tile Company Ltd* (No 4) (1988) 6 ACLC 1095, 1104 (Bryson J).

24 As in *Re Edward Love & Co Pty Ltd* [1969] VR 230.

25 "There is a remote possibility that non-observance of the restriction or prohibition could be part of a case for having the company wound up and that might be inconvenient to the outside contractor ." H A J Ford, *Outline of Companies and Securities Law* (1988) 54.

26 [1970] 1 Ch 199.

mal commercial loan transaction was held to be void by ultra vires. Although the company had the power to borrow, the loan was to fund a business activity that was outside the company's constitution, and the bank knew this. By contrast, Re *David Payne & Co Ltd*[27] held that as long as the company had a power to borrow in its memorandum, the lender does not have to ensure that the directors apply the loan for an intra vires purpose.

To balance these criticisms, three points may be made in defence of ultra vires:

1. The doctrine of ultra vires was developed in the early cases during the nineteenth century primarily to protect shareholders and members from unauthorised use of corporate funds.[28] This protection to shareholders was subverted during the twentieth century by such strategies as widely drafted objects and powers clauses. Consequently, protection to shareholders was eroded, the process of incorporation was seriously encumbered and created pitfalls for third parties.[29]
2. As mentioned in chapter 3, the doctrine of constructive notice, in conjunction with ultra vires, seriously undermined the position of third parties. Traditionally, the doctrine of constructive notice was developed to counterbalance the protection to shareholders by ultra vires, that is, it was developed to ensure that shareholders invested on the basis that they were assumed to have knowledge of the company's constituent documents. It was a doctrine developed to constrain the actions of insiders, that, when applied to outsiders, operated harshly.[30]
3. Although companies (or more usually, their liquidators[31]) could invoke ultra vires and its void affect, so too could outsiders invoke a company's ultra vires actions to defend a claim brought by the company against them.[32]

Adopting the view of the outsider, such as a lender, the reforms minimise the risk of invalid corporate dealings and minimise the transaction costs. The company's constitution, if there is one, operates from the shareholders' point of view as an expression of the collective expectation regarding the company's activities and managers' powers. Watson[33] and Grantham[34] have argued that the balance may be too far in favour of outsiders at the expense of shareholders' interests. Although we do not wish to vigorously debate the chosen legislative path, any criticism of the legislative policy is at least consistent with the High Court in *Northside* (noted in chapter 3), that corporate law principles must balance between facilitating business transactions with companies against preventing corporate fraud. This "balancing" test is useful to moderate competing views as to the scope of the outsider's protection.

It is also worth observing the expectation gap left by the legislature in the latest round of reform. Although the *Corporations Act* still contemplates, and in some cases, requires, the corporate constitution, there is equivocal signalling of the purpose of such regulation.

27 [1904] 2 Ch 608.

28 *Re KL Tractors Ltd* (1961) 106 CLR 318, 338 (Fullagar J).

29 United Kingdom, *Report of the Committee on Company Law Amendment*, (Cmnd 6659, 1945), 12.

30 'The real focus of complaint by an outside party against whom the doctrine of ultra vires is invoked, is therefore, the doctrine of constructive notice.': W Paterson and H Ednie, *Australian Company Law vol 1* (2nd ed, 1971) [20/10] .

31 For example, *Re Edward Love & Co Pty Ltd* [1969] VR 230 and *Jon Beauforte (London) Ltd* [1953] 2 WLR 465.

32 For example, *City of Camberwell v Cooper* [1930] VLR 289.

33 B Watson, 'Corporate Collapses – Time to Reintroduce the Ultra Vires Rule?' (1990) 8 *Company and Securities Law Journal* 240.

34 R Grantham, 'Contracting with Companies: Rule of Law or Business Rules' (1996) 17 *New Zealand Universities Law Review* 39.

If there is no direct consequence for non-compliance of the constitution, this disappoints the expectations of shareholders and creates unnecessary confusion as to the legal effect of the constitution. The absence of explicit consequences, or at least explicit cross-referencing to indirect effects,[35] is counter-productive to the simplification goal. This is still an issue for companies created for a particular purpose, for example, joint venture companies or not for profit companies.

Transitional difficulties in identifying the corporate constitution

The *Company Law Review Act 1998* resulted in more simplified legislation but this is the fourth major legislative stage in forty years.[36] This means that there are companies currently operating that were incorporated according to different regulatory regimes. Although it is possible to state above in simplistic terms the constitutional options for companies before or after 1 July 1998, to reverse the issue is more complicated. That is, there are a number of steps involved in answering the question: "For any given company, what is its constitution?"[37]

From the point of view of an outsider,[38] there are three steps:[39]

1. Was the company incorporated after 1 January 1998?

   The only constituent document required to register the company is the application for registration. A check of the ASIC records ensures that no constitution was registered with the company and that no subsequent special resolutions have been lodged to rescind or modify the replaceable rules. If the check is negative, then the company has no constitution, and the replaceable rules apply as the company's constitution: s 134. A useful strategy for companies in this situation, if requested to produce a "hard copy" its constitution, is to access the summary of the replaceable rules from the ASIC webpage.[40]

   Also, if a post-July 1998 company is a public company, three other complications are noted:

   (i) a public company is bound by certain mandatory rules that are not replaceable (s 141);

   (ii) if it is a No Liability company, then it must be registered with a constitution limiting its objects to mining (s 112(2)); and

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35 S Woodward, 'Ultra Vires Oversimplified: Changes to Company Powers Under the Second Corporations Act Simplification Bill' (1997) 15 *Company and Securities Law Journal* 162, 172.

36 In summary:
Pre 1961 *Uniform Companies Acts*, (UCA) that relied on mandatory objects and powers in memoranda, backed up by the common law ultra vires void effect;
UCA to the 31 December 1983 version of the *Companies Codes*, with the first expression that transactions were not void merely because of a restriction in or absence of powers or objects in the memorandum;
Companies Codes to 30 June 1998 *Corporations Law*, expressly abolishing ultra vires and making memoranda optional;
Current *Corporations Act* with the ultra vires provisions simplified as a result of the *Company Law Review Act* 1998 changes.

37 The 'what' question is posed as the threshold question. The 'why do you need to know' question is dealt with next.

38 Shareholders have a right to request a copy of the constitution: s 139.

39 Elsewhere, the process of identifying a company's constitution since 1 July 1998 has been presented as a complex flowchart: see for example I Ramsay, *The New Corporations Law* (1998) 39–40; S Woodward, H Bird and S Sievers, *Corporations Law in Principle* (5th ed, 2001) 74–75.

40 The ASIC webpage contains a useful summary of the replaceable rules, which is attached as Appendix II. See http://www.asic.gov.au/.

(iii) if it omits the word "Limited" from its name, it must have objects limiting its activities to "charitable" (s 150).

If there are any special resolutions, the most likely effect is to modify the replaceable rules, in which case the replaceable rules as modified will govern the company.

2. Was the company incorporated between 1 January 1984 and 30 June 1998?
   These companies were required to have a memorandum, although stated objects and powers were optional. The ASIC records will reveal whether the company passed a special resolution to repeal its former constitution (s 136). If so, then the company has no constitution, and the replaceable rules apply, subject to the same three complications for public companies. If the company still has its memorandum and articles, then these documents will remain as the company's constitution (s 1415). Similarly, if there are any special resolutions, they may either repeal the existing constitution or modify the replaceable rules, in which case the replaceable rules as modified will govern the company.
3. Was the company incorporated before 1 January 1984?
   These companies were required to have a memorandum, with stated objects and powers. The ASIC records will reveal whether the company has passed a special resolution to repeal its former constitution (s 136). If so, then the company has no constitution, and the replaceable rules apply, subject to the same three complications for public companies. If the company still has its memorandum and articles, then this will remain the company's constitution (s 1415). Similarly, if there are any special resolutions, they may either repeal the existing constitution, or modify the replaceable rules, in which case the replaceable rules as modified will govern the company.

The difficulty is that the constitution may not necessarily comprise the one document that was submitted for incorporation, but now must be "recreated" from the special resolutions filed on the public record. In summary, if the company records indicate that it once had a memorandum, the record must be checked to ensure that it has not been repealed. If the company never had a constitution, or repealed it, the record must be checked to ensure that the replaceable rules apply unmodified, or that a constitution has not subsequently been reinstated.

Identifying the format of the constitution enables any stakeholder, whether outsider, insider or the regulator, to ascertain whether the company has any self-imposed objects or restriction on powers. The significance of the existence and contents of the constitution, in terms of its effects and indeed whether the outsider needs to know any details of the company's constitution, is considered in the next part that examines the direct and indirect effects of breaching the constitution.

The Explanatory Memorandum rather unhelpfully suggests that:

> "Acts which are contrary to restrictions on the company's exercise of powers will now be treated in the same way as any other breach of a company's constitution."[41]

There is no explanation of these effects.

41 Explanatory Memorandum, *Company Law Review Act* 1998, [8.5].

The consequences of breaching the constitution

1. The effects of the statutory provisions on classic ultra vires

The *Company Law Review Act 1998* effects four main changes to bring about the abolition of ultra vires. First, constructive knowledge of the constitution is abolished (s 130(1)). Section 130 is structured in the legislation as part of the rules relating to the availability of statutory assumptions to outsiders. This reform has already been discussed in chapter 3. The result is that cases such as *Re Jon Beauforte (London) Ltd*,[42] where the company's constitution confined its objects to carrying on the business of costumiers and tailors, would not affect its capacity to deal with outsiders, regardless of the company carrying on some other business.

Second, a company cannot plead its constitution to avoid a contract. However, the residual effect of *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd*[43] is still possible, as to whether a court would order specific performance of a contract where the company refused to complete it if it breached the express restrictions and objects in the constitution. *Qintex* may still override s 125 as regards executory transactions that contravene the constitution.

Third, as s 125 covers both stated objects and express restrictions, the technical distinctions under the common law between objects and powers are no longer relevant.

Fourth, s 124(2) confirms that corporate purpose is not relevant to the company's capacity. This was the effect of the common law as decided by Pennycuick J in *Charterbridge Corporation Ltd v Lloyds Bank*[44] particularly as His Honour emphasised that non-corporate purpose transactions may still be voidable due to defects in agents authority, but not void due to ultra vires.

2. The residual effect of the former provisions on s 125

Section 125 confirms that a company may still have stated objects, or impose restrictions on its powers, in its constitution. A failure to observe an express restriction or prohibition or an object in a constitution does not invalidate the transaction. Section 125 merely retrieves the essence of the corporate constitution captured in former s 162(1) and (5) by acknowledging that companies may have limitations imposed by their constitution, but that it does not affect transactions if power is exercised not in accordance with such limitations.

The balance of the provisions in former s 162 are not necessary to achieve the object of abolishing ultra vires. In a substantial departure from former s 162, the ultra vires provisions no longer explicitly:

- state that a contravention of the constitution is a contravention of the Law (former s 162(2)); nor
- refer to any non-effects of an ultra vires action, such as contravention of the constitution is not an offence (former s 162(4)); nor
- provide direct consequences flowing from a breach of constitution (former s 162(7)(8)).

The simplified "anti-ultra vires" rules suggest that there is no direct consequence flowing from a breach of the corporate constitution.

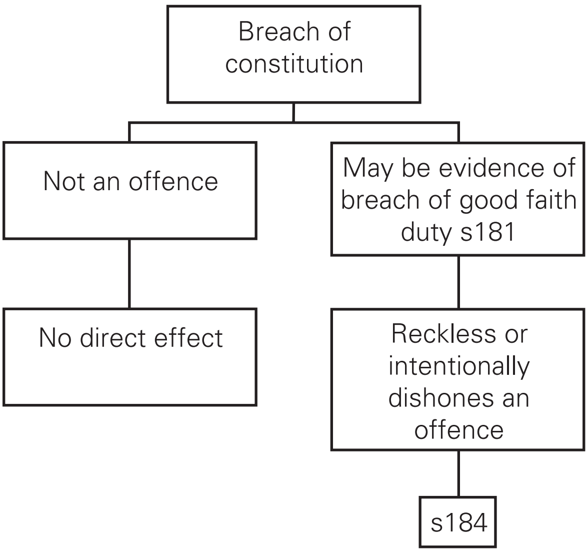
42 [1953] 2 WLR 465.
43 [1991] 2 Qd R 360.
44 [1970] Ch 62.

To test the effectiveness of the repeal of s 162(7) and (8), the direct consequences formerly listed in those sections were itemised as set out below.[45]

Under former s 162(7), the fact that a company contravened its constitution, or that an officer was involved in the contravention, could only be asserted in the following situations:

1. In a prosecution of a person for an offence against the legislation (s 162(7)(c)): although no longer explicit, it is intuitive that such a general effect survives. Depending upon the nature of the offence, a director's disregard of the constitution may be relevant to the elements of that offence, as shown in Figure 5.1 below. Woodward's example of the breach of the statutory duty of good faith,[46] remains valid under the current provision in s 181 that requires directors to act in good faith and exercise powers for a proper purpose. The constitution contains an expression of corporate purpose, so that a breach of the constitution may evidence lack of good faith, or improper purpose. A contravention of this provision is an offence if accompanied by recklessness or intentional dishonesty: s184(1).

Figure 5.1 Breach of constitution and offences for breach of statutory duties

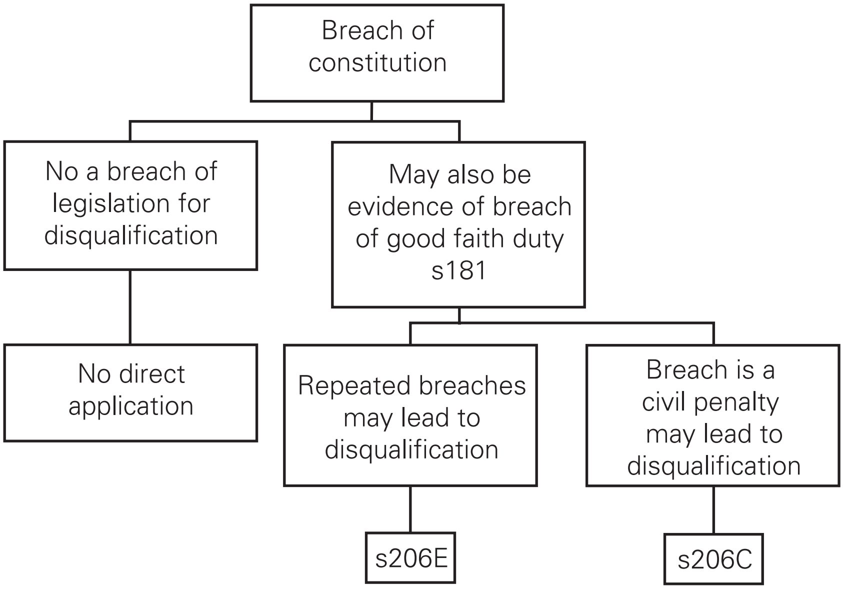


2. In an application for a management banning order under s 230 (s 162(7)(d)): former s 230 allowed the court to make an order prohibiting a person from managing a corporation where there were "repeated breaches of the legislation." Section 230 has been replaced, as a result of changes effected by the *Corporate Law Economic Reform Program Act* 1999, with Part 2D.6 – Disqualification from managing corporations. Part 2D.6 still contains a power by the court to disqualify for repeated breaches of the legislation: s 206E. Woodward concluded that the effect of the repeal of s 162 is to render irrelevant breaches of the consti-

45 See Woodward , supra n 35.
46 Ibid 166, see also Explanatory Memorandum, *Company Law Review Act* 1998, [8.4].

tution for the purpose of a disqualification order.[47] However, s 206C confirms that the court may also make an order consequent upon a civil penalty order. Breach of directors' duties also involves a civil penalty order, so a disqualification order remains an indirect effect, as shown in Figure 5.2 below.

Figure 5.2 Breach of constitution and disqualification orders



3. An application for an oppression remedy (s 162(7)(e)): the court's discretion under s 232 and s 233 to consider the conduct of the "affairs of the company" would appear to be wide enough to contemplate contraventions of the constitution.[48] Woodward[49] argues that a member must be able to rely on such a factor as evidence of oppression or prejudicial conduct. The court can make any order, for oppressive conduct, including winding up, appointment of a receiver, a share purchase order, etc.
   There is no direct power for the court to affect contracts entered into with outsiders, although the court may make "any order". The oppression remedy refers to the possibility of an injunction as a remedy that indirectly may affect pending contracts, although the risk to outsiders being affected is minimal. The appointment of a receiver may affect a lender if it triggers default under a floating charge, but this does not affect enforceability of the underlying contract.
4. An application for an injunction under s 1324 to restrain the company from entering into an agreement (s 162(7)(f)): "the abolition of s 168(7)(f) has the effect of putting a statutory injunction entirely out of the reach of a member (or

47 Ibid 166.
48 Contemplated, but not decided, by Young J in *Strong v J Brough & Son (Strathfield) Pty Ltd* (1991) 9 ACLC 1,018, 1,023.
49 Supra n 35, 167. See also Explanatory Memorandum, *Company Law Review Act* 1998, [8.4].

other person) who is aware that directors are proposing to act in breach of objects or restrictions in the company's constitution…".[50] The courts' express jurisdiction in the *Corporations Act* to grant an injunction is not available, as s 1324 provides that the remedy is available only for contraventions of the legislation. The passive wording of s 125, combined with the absence of any explicit outcome, suggests that a breach of the corporate constitution does not, of itself, contravene the legislation. However, this does not preclude the possibility that a breach of the constitution will have relevance in other matters, leading to an injunction for other contraventions, such as discussed above, breach of duty[51] or as an oppression remedy.

5. Proceedings by the company or by a member against present or former directors (s 162(7)(g)): the Explanatory Memorandum asserts that this provision related to "the common law doctrine that a director of a company who causes the company to act outside its powers is automatically liable to the company for any loss resulting from the breach."[52] No authority for this assertion is provided, and it gives rise to two separate issues: first, was the effect of s 162(7)(g) confined to the common law doctrine as identified, and secondly, in any event, the deletion of s 162(7)(g) does not automatically repeal the operation of the common law damages doctrine.

As to the first point, there may be some confusion generated by the Explanatory Memorandum as to the relation between s 162(7)(g) and s 162(8). Former s 162(8) was more explicit as to the damages effect. It provided:

> "Where, if subsection (7) had not been enacted, the Court would have power under section 1324 to grant … an injunction restraining a company, or an officer of a company, from engaging in particular conduct constituting a contravention [of the constitution]… the Court may, order the … company, or the officer, as the case may be to pay damages …".

The terms of s 162(7)(g) are more general, permitting ultra vires actions to be asserted in *any* proceedings against directors by *either* the company or a member. There is nothing to suggest that the proceedings are limited to damages. Referring to the directors' duties example, if the ultra vires action of directors is being used as evidence of a breach of the duty of good faith, or breach of the duty of care,[53] then a whole range of civil remedies, including damages, is available to the company. This remedy may be pursued by the company, or by a member on behalf of the company under Part 2F.1A (the statutory derivative action). Further, members may sue in their own right if they are seeking to enforce the constitution as a contract (discussed below). Repeal of s 162(7)(g) does not preclude ultra vires actions being raised indirectly if this relates to enforcement of some other provision or duty on directors.

As to the second point, the Explanatory Memorandum is probably incorrect in attributing the common law doctrine of damages for breach of constitution solely to s 162(7)(g), as s 162(8) had a similar effect. As a breach of the constitution is no longer a contravention of the Act, and as a contravention of the Act is a prerequisite to seeking

50 Woodward, supra n 35, 168.
51 Ibid.
52 Explanatory Memorandum, *Company Law Review Act* 1998, [8.5].
53 H A J Ford, *Outline of Companies and Securities Law* (1988) 54.

an injunction under s 1324, a damages provision tied to injunctive relief is redundant. In any event, Professor Ramsay suggests that former s 162(7)(g) does not overcome the common law rule.[54] Based on the usual requirements of statutory interpretation, if the legislature intends to specifically override common law, some express provision is required. The simplified anti-ultra vires provisions, merely by repealing the former provisions, and in the absence of express statutory override, suggest that the common law liability of directors is intact. Woodward supports the view, on policy grounds, that directors ought to retain some accountability for breaching the constitution.[55]

6. An application for winding up (s 167(7)(h)): deletion of the direct effect may not have any substantial change, as the ultra vires act could be raised simply because it is relevant to the court's determination of the winding up application.[56]

To summarise the effects of the repeal of s 162(7), the Explanatory Memorandum confirms that actions contrary to stated restrictions on powers or stated objects will still be able to be asserted in other sections, and three examples are provided:

1. Action for breach of statutory duty of honesty (now good faith in s 180);
2. Action for oppression; or
3. Action for winding up under s 461(1)(k).[57]

Members have several grounds available under s 461 to seek winding up. It may be that the directors' actions contravening the constitution may be relevant evidence in proving, for example, that directors have acted for a non-corporate purpose for s 461(1)(e), or the just and equitable ground in s 461(1)(k). The history of ultra vires reform and its effect on winding up creates some uncertainty, as demonstrated by Menhennitt J in *Re Tivoli Freeholds Ltd*.[58]

In *Re Tivoli Freeholds Ltd*, the company's stated objects were to carry on an entertainment business. Industrial Equity Ltd gained control of the company and sold off its assets, using the proceeds to fund the group's share trading activities. The minority shareholders applied for compulsory winding up on the just and equitable ground. Menhennitt J granted the application on the basis that the company's departure from the general intention and common understanding of the activities of the company when they became members meant that it was just and equitable to wind it up. His Honour emphasised that although this is a different test to ultra vires, the prime source for ascertaining the general intention and common understanding of the members was the constitution.[59] The winding up application was decided on the provisions in the *Uniform Companies Act 1961*. As the original s 20 provided an exclusive code for the ultra vires effects, only allowing members to seek an injunction, Menhennitt J held that "lack of capacity or power is not a ground for winding up by a member."[60]

54 I Ramsay, *The New Corporations Law* (1998) 35.
55 Supra n 35, 169.
56 Ibid. See also Explanatory Memorandum, *Company Law Review Act* 1998, [8.4].
57 Explanatory Memorandum, *Company Law Review Act* 1998, [8.4].
58 [1972] VR 445.
59 See also *Strong v J Brough & Son (Strathfield) Pty Ltd* (1991) 9 ACLC 1,018, 1022 (Young J) that confirms that members can seek winding up for loss of substratum, although that case involved identifying the corporators' purpose in the absence of stated objects. See also R Grantham, 'Ultra Vires: Gone But Not Forgotten' (1993) 3 *Australian Bar Review* 243.
60 *Re Tivoli Freeholds Ltd* [1972] VR 445, 465.

Given the restructured ultra vires provisions that now provide no direct consequence for the breach of the constitution, the reference in the Explanatory Memorandum to the relevance of winding up may be valid on two alternative bases, either by confining Menhennitt J's finding to the context of the statutory provision then in place, (so that in the absence of specified effects, lack of capacity or power may be a ground of winding up), or by applying the substance of the judgment that loss of substratum is different to ultra vires, but confirming the role of the constitution in identifying the general intention and common understanding of the members.

Added to this list, also, must be the effects from former s 162(7)(g), that directors acting for non-constitutional purpose may still be raised in proceedings against directors, for example, an action for damages for breaching the constitution, or for breaching their general law duties.

These effects are predominantly of an internal nature, and are unlikely to affect the validity of an external contract entered into in breach of the constitution. The remedy of winding up obviously has consequences for an outsider regarding the long-term effectiveness of any transaction. Similarly, the appointment of a receiver as a remedy for oppression would usually trigger default and crystalisation under a floating charge. For any other discretionary oppression remedy under s 233, presumably, the court would limit the exercise of its discretionary power to situations of threatened or proposed breaches of a company's constitution. Otherwise, an attack on executed contracts would jeopardize the rights of third parties and reinstate a form of *ultra vires*.[61] An outsider may be directly affected by allegations of directors' breach of fiduciary duty flowing from a non-constitutional transaction, if they have participated in the breach of duty. The outsider's participatory liability is determined according to the law of constructive trusts. (Discussed in Chapter 6).

The only immediate relevance of a contravention of the constitution is that it results in a breach of the corporate contract. Section 140 confirms that the constitution applies as the terms of a contract between:

- the company and each member; and
- the company and each officer; and
- a member and each other member.

Further, as a restriction on the company's powers to amend its constitution, any amendment that increases a member's liability to the company is not valid unless they agree in writing to be bound: s 140(2)(b).

Members may seek a remedy against the company under the general law in the form of a declaration or injunction (but not damages)[62] to enforce the constitution. Bryson J in *Darvall v North Sydney Brick & Tile Co Ltd* (No. 4)[63] confirmed that the former "anti-ultra vires" provisions (ss 67–68 *Companies Codes*) "operate to diminish the enforceability among the members and the company of the contractual obligations among them arising out of" the constitution.

61 Supported by Australian Corporations and Securities Commentary [¶33–140].

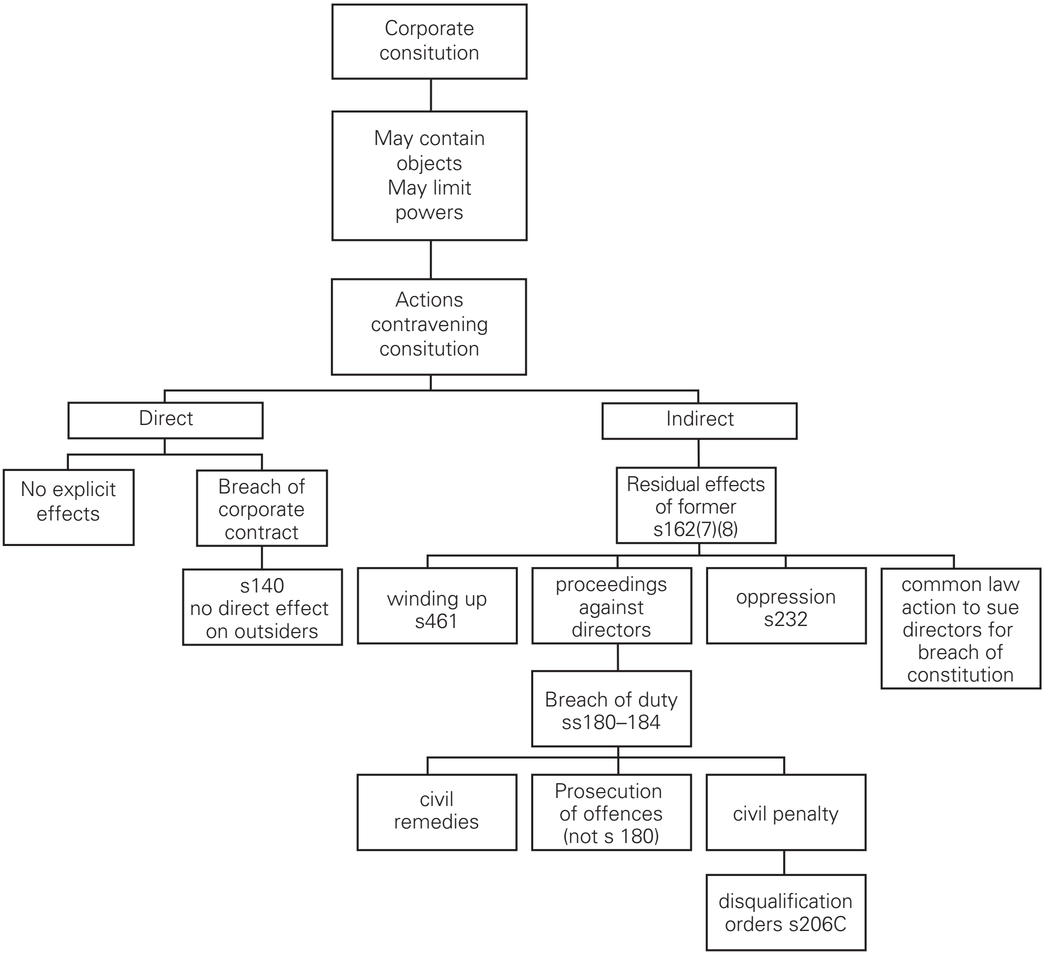
62 *Webb Distributors (Aust) Pty Ltd v Victoria* (1993) 179 CLR 15.

63 (1988) 6 ACLC 1,095, 1104. A member was successful in having a dividend declaration declared invalid, on the basis that the articles did not authorise a dividend in the form of assets (shares in a wholly owned subsidiary). Also, Austin J in *Ding v Sylvania Waterways Ltd* (1999) 17 ACLC 531 declared that an alteration to the constitution to impose a new levy was not binding under s 140(2). None of these disputes affected the rights of outsiders.

It is not accurate to describe a breach of the constitution, which only affects the internal contract between the company and members (s 140), as a "direct" effect. In the absence of any explicit direct effects, and due to the repeal of former s 162, it is concluded that there are no direct consequences if a company contravenes its constitution.

The rewording of s 125 does not prevent enquiry as to possible indirect effects of the breach of the corporate constitution. Figure 5.3 below summarises possible direct and indirect effects. Whether the effects of the breach of the corporate constitution are direct and indirect, they primarily have significance for internal parties only. The extent of the risk to outsiders is assessed as minimal.

Figure 5.3 Comparison between direct effects and indirect effects of breach of the company's constitution



The balance of the effects of a breach of the constitution would now have to be considered as indirect effects.

The regulatory effects of a breach of the constitution: company type

A constitution is now optional for most companies, but the only exceptions are No Liability companies, and any charitable company that wishes to delete the word "Limited" from its name. Such companies must have constitutions that restrict their purposes. A problem for outsiders is whether they will be bound by the restrictions in objects that these companies must have, and that are automatically signalled by the company's name.

To address this issue for No Liability companies, s 112(5) specifically provides that an act or transaction is not invalid merely because the company engages in activities that are outside its mining purposes objects. This confirms the effect of s 125(2), so that contacts are not invalid. This effect though would be limited to classic ultra vires,[64] but there are two problems dealings with No Liability companies create:

1. Are outsiders automatically on notice that such companies have restricted constitutions when dealing with No Liability companies? This is mitigated if notice is confined to actual knowledge:

   > "…since there may be considerable awareness in the business community that a no liability company is restricted to engaging only in activities directed to mining purposes."[65]

2. Dealing with No Liability companies that breach their stated objects adds another layer of compliance, so s 125(2) is not enough to protect outsiders from all effects of a breach of the Act, particularly an injunction. It would seem that a member or any other person whose interests are affected could seek an injunction under s 1324 for a breach of s 112(3), as this subsection specifically prohibits a No Liability company from breaching its constitution.
   To the extent that s 112(4)[66] only precludes letting contacts over the mining land without a special resolution, breach of this restriction would not amount to a breach of the constitution, but would be a procedural matter for the outsider to assume under the statutory assumptions.

Corporate capacity: s 124

1. Section 124(1) and its limitations

Although s 124 (former s 161(1)) is necessary in abolishing the doctrine of ultra vires, it must be recognised that corporate capacity still has some limits. Companies have the powers of an individual, but there are limits on individuals' contractual freedom. Any principles under general contract law may still invalidate a financing transaction, so lenders must still be alert to these "usual" problems.[67]

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64 Confirmed in *Duke Group Ltd v Pilmer* (1998) 16 ACLC 567, 731–733 (Mullighan J, at first instance), in dealing with the defendants' arguments about the plaintiff's dealings, where the plaintiff was a No Liability company. The defendants raised a preliminary issue that the negligence action against the defendants could not be sustained, as it arose out of a transaction (a takeover) that was not for the company's express purposes.

65 Ford, Austin and Ramsay, supra n 18, [12.190]. A similar issue arises for charitable companies that delete 'Limited' from their name (s 150) as the company's name would signal this particular restriction.

66 Section 112(4) [Letting or contract] The directors of a no liability company must not:
(a) let the whole or proportion of a mine or claim on tribute; or
(b) make any contract for working any land on tribute;
unless:
(c) the letting or contract is approved by a special resolution; or
(d) no such letting or contract has been made within the period of 2 years immediately preceding the proposed letting or contract.

67 For example, absence of consideration: *Re Edward Love & Co Pty Ltd* [1969] VR 230.

Section 124(1) is a pivotal section to corporate contracts. It states:

> "A company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate …"

A company cannot be equated with an individual for all purposes, so some ad hoc distinctions have been made with respect to corporate capacity, for example:

- A company cannot act maliciously against its members. In *Rogers v The Royal College of Ophthalmologists*,[68] Young J posed the question that "if a company has all the powers of a natural person, and a natural person has the power to gossip about a friend, why does the company not have the power to do what this company, unless restrained, intends to do?" Ultimately, His Honour did not quite answer this question, as he granted the injunction based on the finding that it would be a fraud on the power for the board to exercise its powers maliciously.
- Section 124 does not abrogate any restriction that a company cannot "represent" itself in legal proceedings other than by a practitioner: *Bay Marine Pty Ltd v Clayton Country Properties Pty Ltd* (No 2).[69]

It has been held under the common law that the doctrine of maintenance of share capital operates as a restriction on corporate capacity. For example, a company had no power to:

- Purchase its own shares: *Trevor v Whitworth*;[70]
- Issue shares for less than their nominal value: *Ooregum Gold Mining Company of India v Roper*;[71]
- Issue shares in breach of the fundraising provisions: *Australian Breeders Co-operative Society Ltd v Jones*.[72]

These effects have now largely been overcome by the recent reforms. However, these effects may be of little continuing relevance in any case, as s 124(1) is different to former s 161(1) in one significant respect. Former s 161(1) had effect "subject to the Corporations Law" (former s 161(2)(a)); whereas this qualification to s 124(1) was deleted by the *Company Law Review Act 1998*. Although this "simplification" is not referred to in the Explanatory Memorandum, the effect of this change is arguably more than just simplification. Where certain contracts are illegal for companies, whether under the *Corporations Act* itself, or due to some other statute or due to general law principles, the outsider could not enforce them. In the case of the first category, contracts illegal under the corporations legislation, former s 162(2)(a) operated as a limitation on a company's capacity. A contract invalid by some other provision in the *Corporations Law* was not "saved" by the grant of power in former s 161. For example, in *Collingridge v Sontor Pty Ltd*,[73] a contract had the effect of an unauthorised reduction of capital. Young J held the contract was still void, despite former s 161:

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68 (1991) 9 ACLC 1,497, 1,499.

69 (1987) 5 ACLC 38, 41 (Samuels JA). In that case, the Supreme Court Rules required companies to be represented by a solicitor. The Court of Appeal (majority, Kirby P dissenting) held that the amendments to the *Companies Codes* affecting capacity did not alter this rule.

70 (1887) 12 App Cas 409.

71 [1892] AC 125.

72 (1998) 16 ACLC 100.

73 *Collingridge v Sontor Pty Ltd* (1997) 16 ACLC 1,681.

> "In any event, s 161 does not appear to authorize the company to do something which under the Corporations Law it cannot do. Thus, even after ss 160–162, if a company purports to make an agreement which involves an unauthorized reduction of capital the agreement is ultra vires and void."

Contracts that contravene the Act are arguably no longer void since the *Company Law Review Act 1998* changes for two reasons:

1. s 124 is no longer expressly "subject to" the Act; and
2. the combined effect of the *Company Law Review Act 1998* and the *Corporate Law Economic Reform Program Act* 1999 simplifies many of the procedural limitations on companies in relation to share dealings, so that the procedures are no longer required,[74] and the provisions expressly preclude any void effect.[75]

2. Section 124(2): capacity not affected by the company's interests not being served

The drafting of s 124(2) has been simplified compared to its former equivalent, s 161(3). A significant change is that instead of the company's capacity being unaffected by "the fact that the doing of an act by a company would not be, or is not, in its best interests", s 124(2) now only refers to the "company's interests are not … served". The previous use of the qualifier "best" suggests a connection with the fiduciary formulation of the "best interests of the company as a whole". The deletion of "best" relieves any future concerns that s 124 is confined to precluding the void effect for transactions entered into in breach of fiduciary duties. The more generic, unqualified "interests" denotes that all transactions tainted by a non-corporate purpose, whether that be identified as a breach of the constitutional constraints, or identified by the fiduciary constraint, are not void. Accordingly, the redrafted format of s 124(2) is more explicit in recognising "abuse of power" in all its forms, and that such transactions are not to be treated as void. Hence, the former s 161(3) did not affect the outcome in *ANZ Executors & Trustee Company Ltd v Qintex Australia Ltd*,[76] nor would the redrafted s 124(2), as the case involved the issue of specific performance (i.e. court's discretion), not the issue of whether the transaction was void ab initio.

The Effect of Statutory Reform

Although this chapter has discussed the history of legislative reform to ultra vires and the statutory indoor management rule, of primary interest is the comparison between *Company Law Review Act* 1998 and former legislation. The *Company Law Review Act* 1998 significantly restructured and redrafted the provisions dealing with corporate constitutions, registration and ultra vires. Notable features of reform that affect outsiders' perception of capacity issues are:

Constitution optional

If outsiders are dealing with a company, it is unnecessary for the outsider to access the company's constitution. For those who may still insist on this information, it may be a frustrating task to identify the company's constitution. Companies registered after 1 July

74 For example, capital reductions, unlike in Collingridge, no longer require court authorisation to be valid, only shareholder approval: s 256B, s 256C.

75 For example, a capital reduction in breach of s 256B and s 256C does not affect the validity of any transactions: s 256D.

76 [1991] 2 Qd R 360.

1998 do not need a constitution, unless they are No Liability or charitable companies. Table A articles have been repealed and the replaceable rules operate as the default rules for all companies. Existing companies are able to repeal former memoranda and articles.

Constitutions may state objects and powers, but there are no explicit effects

The effect of s 125 is similar to former s 162 by expressly providing that the exercise of a power is not invalid merely because it contravenes the constitution. However, the streamlined s 125 may cause confusion as it no longer makes transparent the indirect, or internal effects, of a breach of the constitution. Contravention of the constitution may still be raised in related actions such as prosecutions of directors, actions for damages against directors, oppression proceedings and winding up applications. Section 125 may be misleading as it no longer recognises these effects, but they still exist.

Grant of corporate power: s 124(1)

Section 124(1) is differently worded form former s 161 in two respects. First, the grant of power to the company is "the legal capacity and powers of an individual" whereas previously it was "legal capacity of a natural person". No significance is attributed to this change. However, former s 161(2) made the grant of power "subject to the Law". This qualification has been deleted, with the result that breach of any provision of the *Corporations Act* cannot affect the company's legal capacity. This effect is important, and overcomes any past arguments as to the effect of illegal transactions.

Company's "best" interests

The new provision s 124(2) is arguably stronger in overcoming the effect of corporate purpose on corporate capacity, as it has been simply reworded from "best interests" to:

> "A company's legal capacity to do something is not affected by the fact that the company's interests are not, or would not be, served by doing it."

The use of best interests in the former provision is too restricting, due to the strong association between "best interests" of the company and directors' fiduciary duty. The new provision makes it clearer that capacity is not affected by any non-corporate purpose, not just directors' breach of fiduciary duty.

Express intention to abolish ultra vires

The legislation no longer contains this express intention. This is not significant because the Explanatory Memorandum refers to that intention anyway; and the use and misuse of the term "ultra vires" in the past renders such intention of fairly unsatisfactory assistance. It is not clear that either the intention or effect of the *Corporations Act* is to protect lenders from the effects of "ultra vires" as used in the sense of officers' abuse of power. This is the issue that consumes much of the current literature; "although ss 160–162 have abolished the old narrow ultra vires doctrine the wide doctrine appears to be alive and kicking."[77] Specifically, the *Company Law Review Act 1998* does not resolve the following vulnerabilities of debt or security contracts, relating to the authority of officers to enter into them:

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77 K Robson, *Annotated Corporations Law*, (2nd ed, 1997) 163.

- the lender still has to identify the officers of the company and ascertain their position.
- The existence of a non-corporate purpose still operates as an inherent limitation on officers' authority. However, with optional constitutions, it is more difficult to define "non-corporate" purpose. The judgment of McPherson J in *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd* assists to some extent in defining "non-corporate" purpose. His Honour said:

> "We cannot order a shareholder to require the company to execute the instrument of guarantee if to do so would involve infringing the 'essential principle' that corporate powers and funds may be used only for corporate purposes. For a commercial or trading company confronting insolvency to make a gift of its assets in derogation of the interests of creditors is not to use powers or purposes for their corporate but to do so for a non-corporate purpose. For a subsidiary now to execute an instrument rendering it liable for an indebtedness in the order of $110 million cannot possibly be for its benefit."[78]

- Similarly, a transaction entered into by directors in breach of their fiduciary duties still gives rise to disputes about officers' authority and company's remedies that may be exercised.

Finally, to address these concerns, we have formulated some guidelines below, to assist lenders in avoiding issues of corporate capacity, or the abuse of corporate power by officers.

The Scope of Protection: Practical Guidelines and Ultra Vires

In terms of practical guidelines, the only threat to outsiders enforcing transactions against companies lies in the uncertainty surrounding the effect of abuse of power by the company's officers. We address the following scenarios:

1. If the abuse of power relates to a contravention of express objects or powers in a constitution, this has no direct effect on outsiders. However, contravention of the constitution may arise as evidence to support a limitation on directors' authority, or that directors have breached their fiduciary duty.
2. If the abuse of power relates to illegality, whether under the *Corporations Act* or some other statute, this does not affect the grant of the company's power under s 124(1). Illegality however may still be relevant to contractual capacity under contract law, in the same manner as it would affect individuals.
3. If the abuse of power relates to an excess of authority, limits on an agent's authority do not affect outsiders as long as the person purporting to exercise the power is an officer, in which case the outsider can assume that the officer has customary or actual authority, and can assume that the officer has formal authority to execute documents.
4. If the outsider is not a bona fide purchaser for value without knowledge (i.e. actual knowledge) of the abuse of power, then the transaction is not void, but may be voidable at the company's option. The *Corporations Act* does not alter this general principle of equity.

78 [1991] 2 QdR 360, 371.

5. If the abuse of power relates to a fiduciary breach by directors, the extent of the threat depends to some extent on the scope of the statutory assumption as to proper performance of duties, discussed in chapter 6. Otherwise, a contract will be voidable unless the outsider is a purchaser for value without knowledge of the fiduciary breach. Knowledge is a critical concept here, as degrees of actual and constructive knowledge by the outsider may also trigger constructive trust liability.

More comprehensive guidelines to the conduct of transactions, taking into account the indoor management rule and all statutory reforms are offered in the concluding chapter, chapter 10. To conclude this chapter, several points are made:

1. The outsider needs to identify the corporate party, by sighting a certificate of registration. This confirms that the *Corporations Act* applies to the entity, and that it is actually registered. Pre-registration contracts are enforced under Part 2B.3.
2. If the company is regulated under the *Corporations Act*, there is also an issue in determining which version of the law applies. As outlined above, there have been three stages of statutory reform. The first of July 1998 is a critical date because that is when major change occurred. However, the substance of the change is not significant so as to affect these concluding remarks.
3. The outsider needs to know the number of and identity of current corporate officers.
4. The outsider does not need to sight current nor former constitution. If the outsider currently has those documents, it amounts to knowledge of the restrictions on powers, or object, if any. However, knowledge of the constitution is not enough to make any contract voidable.
5. The outsider may be inconvenienced if the company is involved in litigation over disputes with compliance with the constitution. Such disputes may affect the viability of the company and cause inconvenience to outsiders, but will not affect transactions. Whether such litigation occurs is beyond the control of an outsider.
6. Similarly, the outsider will be inconvenienced if the company is involved in disputes with the regulator for breaching its constitution, for example, a No Liability company may be required to change status for breaching its restriction to mining purposes, but will not affect transactions.

Chapter 6

The Statutory Assumptions: Section 129

The Content of the Assumptions

This chapter examines in detail the scope of the assumptions available to outsiders. The drafting of the current assumptions in s 129 reflects a new, more streamlined style compared to former s 164(3). Section 129(8) gives specific instructions as to their application: "the assumptions that may be made under this section apply for the purposes of this section." This statement of application has three effects:

1. Each of these assumptions is separate and discrete: *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*.[1] This means that just because an outsider cannot rely on a particular assumption, he or she is not prevented from relying on the other assumptions.
2. The assumptions apply only where the qualifying circumstances in s 128 have been met (discussed in chapter 5) and not for other purposes of the *Corporations Act*.
3. The outsider does not have to prove that they actually made the assumption to rely on it.

These are examined below.

First, as the Explanatory Memorandum states, the assumptions are intended to be cumulative.[2] This avoids the awkward drafting apparent from earlier iterations of the rule that required internal cross-referencing. A similar effect had been achieved under the previous assumptions, which had been held to be discrete assumptions, so that if access to one failed, then others were still available.[3] For example, in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*,[4] the outsider could not assume compliance with the constitution, as it had actual knowledge of non-compliance, but that did not prevent it from relying on the assumption as to due sealing.

However, the reverse is not the case, as Horrigan states, it is unlikely that outsiders may actually subsume the assumptions.[5] That is, if a specific assumption cannot be relied upon, then the outsider cannot fall back on the more general. For example, where a sealed document has not been attested by two officers as required by the sealing assumption, the general assumption as to compliance with the constitution will not save it.[6] Brennan J,

1 (1992) 10 ACLC 253.
2 Explanatory Memorandum, *Company Law Review Bill 1998*, [8.9].
3 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48, 58 (Kirby P).
4 (1992) 10 ACLC 253.
5 B Horrigan, 'Busting Guarantees!' [1998] 7 *National Law Review* [63].
6 *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1997) 15 ACLC 1,057 (Handley and Powell JJA, obiter). That case involved the same officer, Mr Edmonds, attesting the seal as director and secretary, although he did occupy both offices. Compare an earlier decision, not referred to, *Belven Enterprises Pty Ltd v Lydham Pty Ltd* (1996) 14 ACLC 1478, where Commissioner Wheeler QC held that the sealing assumption was not relevant, as the outsider had not invoked it. In this case, the purchaser under a contract had not actually seen the executed contract and its sealing, but rather was relying on the general assumption that the company it was dealing with had complied with its constitution.

in refusing special leave to appeal in *Bank of New Zealand v Fiberi Pty Ltd*,[7] said that the applicability of the first assumption to a dispute over the attestation of the seal is a doubtful proposition, having regard to the particular assumption as to sealing.

Second, the assumptions only apply to that section, meaning that they operate only as procedural assumptions. This confirms the procedural regularity purpose of the rule. As expressed by Mahoney JA in *Story v Advance Bank Australia Ltd*, the assumptions do not validate the transaction, but rather prevent the company from relying on the invalidity.[8] So, for the procedural assumptions to apply elsewhere, specific provision is made, for example, s 442F.[9] In addition, this means that the assumptions are only available to counter assertions against the company. In *Australian Capital Television Pty Ltd v Minister for Transport and Communications*,[10] it was held that the former s 164(1) allows the assumptions to be made only in relation to assertions by the company that they are not correct. Where an assertion of non-compliance with a company's constitution is made by a third party, the statutory provisions do not apply and the common law Rule in *Turquand's* case and its limitations will still be operative.

Third, it is not necessary for an outsider to actually make these assumptions in order to rely upon them. In *Lyford v Media Portfolio Ltd*,[11] a company argued that evidence showed that the making of the assumptions would have been contrary to the usual practice of the outsider in making loans, therefore the assumptions could not be made. Nicholson J dismissed this argument on the basis that the statutory rule prevents a company from asserting that any of the assumptions are incorrect. This is so, whether or not the assumptions were actually made by the outsider:

> "It is the assertion which brings into application the provisions and not proof that assumptions were in fact made." [12]

The new statutory version of the indoor management rule has been reworded and restructured, prompting a comparison between new ss 128–129 with the former sections. The previous six assumptions that the outsider was entitled to make are now restructured into seven in s 129,[13] with some modification consequent upon other *Company Law Review Act* 1998 innovations. The utility of each assumption is analysed below.

Compliance with the Constitution: s 129(1)

The terms of the assumption are that: "The company's constitution (if any) and the replaceable rules that apply to the company, have been complied with" (based on former s 164(3)(a)).

This assumption for corporate compliance in s 129(1) appears to mirror and so "codifies" the existing common law. In particular, the assumption is expressed as "compliance" with the constitution. "Compliance" connotes procedural matters only, and does not import any suggestion that the powers in the constitution have actually been exer-

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7 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 232, 236.
8 *Story v Advance Bank Australia Ltd* (1993) 11 ACLC 629, 640.
9 Section 442F provides that the assumptions are available where the administrator has control of the company.
10 (1989) 7 ACLC 525.
11 (1989) 7 ACLC 271.
12 (1989) 7 ACLC 271, 281.
13 See Appendix I where the provisions are set out in full.

cised. This assumption retains the common law distinction between procedural regularity and substantive exercise of powers. Accordingly, the principles discussed in chapter 3 from *Northside Developments Pty Ltd v Registrar-General* are still correct where it was asserted that potential authority cannot be treated as actual authority, merely because the company's constitution confers the power to grant authority.[14]

However, in another sense, it appears to have a wider operation because the Rule in *Turquand's* case was subject to the doctrine of constructive notice, which has now been abolished by s 130. Outsiders are no longer taken to be aware of provisions in the constitution. This enables outsiders to make the assumption that the company has complied with its constitution even though the constitution has not been complied with and this would have been apparent to the outsider had it been read. For example, if the constitution contains a restriction on the power of the board to borrow in excess of a certain sum, an outsider who is unaware of this provision is not taken to know of this restriction. In fact, the outsider can assume that the board has the power to borrow an amount greater than the specified amount.

This broader operation of the statutory assumption arising from the abolition of the doctrine of constructive notice has significant implications. It places an outsider who is unwilling to read the company's constitution in a stronger position than one who makes an effort to read the constitution. This may sometimes unfairly advantage an outsider who deliberately dons blinkers in circumstances where there are grounds for suspicion that an officer or agent of a company is acting in an unauthorised manner. This situation is addressed by the limitations to the assumptions contained in s 128(4).

The operation of this assumption depends upon the wording of the particular constitution involved. Further, the existence of the specific assumptions in the following subsections suggests a very limited role for this first assumption, but a case such as *Belven Enterprises Pty Ltd v Lydham Pty Ltd* [15] shows that it can provide a valuable fallback.

Officers Named on the Public Record: s 129(2)

The terms of the assumption are that: "Anyone who is named, from information provided by the company available from ASIC, as director or company secretary, has been duly appointed and has the authority to exercise the company's powers and perform the duties customarily performed by an officer of a similar company" (based on former s 164(3)(b)).

According to the Explanatory Memorandum to the 1984 amendments,[16] this overcomes the non-appointment or defective appointment of directors or officers. As demonstrated in chapter 4 above, there was conflicting authority at common law regarding the outcome of cases involving defective appointments and whether the rule applied. For example, the failure by the shareholders to properly exercise their power to appoint the directors in *Mahoney v East Holyford Mining Co*[17] was treated by the court as procedur-

14 (1990) 11 ACLC 611, 640 (Dawson J).
15 (1996) 14 ACLC 1478. Commissioner Wheeler QC held that the more specific sealing assumption was not relevant, as the outsider had not invoked it. In this case, the purchaser under a contract had not actually seen the executed contract and its sealing, but rather was relying on the first assumption that the company it was dealing with had complied with its constitution.
16 Explanatory Memorandum, *Companies and Securities (Miscellaneous Provisions) Bill 1983*, [204].
17 (1875) LR 7 HL 869.

al matters covered by the rule, whereas in other cases, such as *Rama Corporation Ltd v Proved Tin and General Investments Ltd*,[18] a failure to properly appoint a managing director was treated as a substantive matter of delegation that could not be assumed. Now, the circumstances of appointment are irrelevant provided the identity of the officer is revealed on the public record.

An early illustration of this assumption, relying on former s 164(3)(b), was *Re Madi Pty Ltd*.[19] A subsidiary company entered into a deed of guarantee in which it guaranteed repayment of loans made to its holding company. The company seal was affixed to the deed attested by a director and a person who signed as secretary. The company later claimed that it was not bound by the deed of guarantee because the person who signed as secretary had not been appointed despite having been named as one of two company secretaries at the relevant time. The company argued that it was not bound because the seal had not been affixed in accordance with its constitution. The Victorian Supreme Court held that the company was bound because the person had been named as secretary in the annual return lodged under the *Companies Code* equivalent of s 345. This amounted to a holding out by the company that the named person was its secretary and thereby authorised to affix the company's seal.

One of the flaws of the former provision was that it was more specific as to the source of ASIC information. Former s 164(3)(b) required the outsider to make the assumption based only on the information contained in the latest register of officers (former s 242) or annual return (former s 335).[20] Where there was inconsistency in the information available to the outsider, such as in *Dawson v Westpac Banking Corporation*,[21] the outsider ought to only rely on the prescribed sources.

ANZ Ltd v Australian Glass and Mirrors Pty Ltd[22] involved the issue of inaccurate public records. The bank was faced with conflicting information regarding the officers of the company. Kaye J confirmed that the bank, acting reasonably, is not required to make any additional searches of the public record. A company search by the bank's solicitors revealed the officers of the company to be a solicitor, Semmel, and his secretary Sullivan. In reality, the company was incorporated as a shelf company and sold to clients, Mr and Mrs Vasiljevic. Mr and Mrs Vasiljevic were already customers of the bank. When they purchased the company, they applied for loans in the company's name. Security documents were executed under seal and signed by Mr and Mrs Vasiljevic. The bank queried the information on the statutory registers. Under the statutory rule, the bank was entitled to treat Semmel and Sullivan as directors. Ultimately, the bank accepted the document signed by the Vasiljevics by relying on further information and representations.

18 [1952] 2 QB 147.
19 (1987) 5 ACLC 847.
20 P Lipton, *The Authority of Agents and Officers to Act for a Company: Legal Principles* (1996) 34, argued strongly in favour of expanding former s 164(3)(b).
21 (1989) 7 ACLC 1,175, 1179, at first instance, (Bryson J): "if there were anomalies or doubts created by documents which were not filed primarily for the purpose of notifying to the public the identities of office-holders, but referred to such matters incidentally, such as annual returns, the latter documents should not have been relied on". The case pre-dated s 68A. This issue was not raised on appeal.
22 (1991) 9 ACLC 702, 707.

National Australia Bank v Sparrow Green Pty Ltd[23] is a case that involves a reverse situation of conflicting information. The bank in that case checked the ASIC register and noted that the directors of the borrower company were Mr Green and Mr Sparrow. However, the bank accepted the documents signed under the seal of the company attested by Green only, as sole director. Sparrow's resignation did not actually occur until some six months after the transaction. However, the bank accepted the representations by Green and the company's accountant that Sparrow intended to resign; and did not follow up on its request to view documentary evidence of Sparrow's resignation at the time of the transaction. The Court held that the bank had actual knowledge that there were two directors of the company, therefore it could not assume (pursuant to s164 (3) (b)) due sealing by Green only.

The recent case of *Myers v Aquarell Pty Ltd*[24] is a good illustration of the paramouncy of the public record. In that case, the company's constitution required it to have two directors. The lender sought to rely on a document sealed by the company, attested by one director who signed as sole director. Regardless of the constitution, Gillard J held that where there was only one director on the public record, the company could legitimately operate as a sole director company. Unlike *Sparrow Green*, the lender had no actual knowledge of the company's constitution.

The expanded provision referring to information on the public record makes searching superficially easy for the outsider. It allows reliance to be placed on the electronic search obtained from the ASIC as to the identity of officers. It does not however resolve the problem of conflicting information. Loxton alerts to the risk of a transcription error by the ASIC and a consequent judicial holding that the officer is not properly appointed.[25] Where there may be a mistake in the public records, revealed for example if the outsider obtains or retrieves hard copies of the annual return or return of directors, the outsider has two choices:

1. rely on an expedient interpretation of s 129(2) that preserves the paramountcy of the public record to prevent the company from asserting the contrary; or
2. as in *ANZ v Glass & Mirrors* and *Sparrow Green*, request confirmatory information from the company to form the basis of a representation and apparent authority.

An interpretation of s 129(2) that preserves the efficacy of the ASIC records is of course the preferable one from the outsider's point of view.

By referring to customary powers and duties, s 129(2) enacts the common law rules of customary authority, set out in chapter 2.

The current s 129(2) is based on former s 164(3)(b), but is not identical. A change in wording is evident by the phrase "similar company" in s 129(2). Former s 164(3)(b) referred to the customary authority of an officer exercised by a "company carrying on a business of the kind carried on by the company". This change in wording highlights the second flaw in the drafting of former s 164(3)(b), as the phrase "company carrying on a business of the kind carried on by the company" unnecessarily limited the scope of the

23 (1999) 17 ACLC 1665.
24 [2000] VSC 429.
25 D Loxton, 'One Step Forward, One Step Back: The Effect of Corporate Law Reform on Procedures in Dealing with Companies Borrowing or Giving Guarantees' (1999) 10 *Journal of Banking and Finance Law & Practice* 24, 34.

customary authority of an officer. This change in wording in s 129(2) overcomes the narrower application that involved a consideration of the kind of business carried on by the company. (Curiously, this narrow application was not evident under the former s 164(3)(c) assumption.) It was unclear how the nature of the business carried on by a company affected the customary authority of the company's officers. Thus it was difficult to determine how customary authority under former 164(3)(c) differed, if at all, from that under former s 164(3)(b).

The kind of business carried on by a company may have been a reference to the size of the company and may have allowed for a distinction to be made between tightly-held, small proprietary companies effectively run by one director and listed public companies which usually have large boards which operate in a collegiate manner. The customary authority of a director of a small company may be regarded as broader than the customary authority of an individual director of a large public company.

According to our discussion in chapter 2, customary authority is defined according to a number of factors, including the size of the enterprise, the purpose of the company and why it was incorporated. Where a company has a limited purpose of merely holding a particular asset, the customary authority of a managing director may be considerably narrower than would be the case where the company is engaged in regular business. A consideration of the kind of business carried on by a company may also refer to the usual business activities of the company. If a managing director enters into a contract on behalf of the company that falls outside and is unrelated to the usual business activities of the company, then the assumption may not apply.[26]

As both former s 164(3)(b) and former s 164(3)(c) relied on the concept of customary authority, it is entirely unclear as to why only s 164(3)(b) contained the "business of the kind carried on by the company" phrase and whether it was intended to cause the second and third assumptions to have dissimilar operations. The Explanatory Memorandum to the *Company Law Review Act* 1998 states that the change to "similar company" is merely intended to be a plainer version of the former provision,[27] so the uncertainty remains in relation to any disputes occurring prior to the *Company Law Review Act* 1998.

Holding Out: s 129(3)

The terms of the assumption are that: "Anyone who is held out by the company as officer or agent, has been duly appointed and has the authority to exercise the company's powers and perform the duties customarily performed by an officer of a similar company" (based on former s 164(3)(c)).

Section 129(3) enacts the common law rule of apparent authority, which according to Diplock LJ in *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd*,[28] requires there to be:

- a representation made by a person with the actual authority of the company,
- that the agent has authority,

26 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law*, (10th ed, 2001) [13.390]. The authors refer to *ANZ Executors & Trustee Co Ltd v Qintex Aust Ltd* (1990) 8 ACLC 980. McPherson J said that "corporate property may be applied only for corporate purposes" (at 988).

27 Explanatory Memorandum, *Company Law Review Bill 1998*, [8.10].

28 [1964] 2 QB 480, 566.

- that the contractor has relied upon that representation, and
- that the company, pursuant to its constitution, was not deprived of the capacity to enter into that contract.

Outsiders, when dealing with an officer or agent of the company, are generally not aware of the extent of the actual authority of the agent. This is because actual authority stems from the principal-agent relationship and outsiders are rarely privy to this. It is much more common for the outsider to gain the impression that a particular person has authority to bind the company from the representations or conduct of the company itself or of persons acting as the company or on behalf of the company. Such representations or holding out create an agency relationship that binds the company by apparent authority.

This assumption comprises two main elements that must be established by the outsider:

1. a holding out or representation by the company that a person is an officer or agent; and

2. the particular power exercised by this person is within the scope of powers customarily exercised or performed by an officer or agent of the kind concerned.

What is a "holding out by the company"?

The indoor management rule cases have drawn a clear distinction between what amounts to a representation for the purposes of the assumption and what does not. For example, in *ANZ Ltd v Australian Glass and Mirrors Pty Ltd*,[29] the bank relied on a prescribed Form 61 (Particulars and Changes in Particulars of Directors)[30] produced by the Vasiljevics, to satisfy it that the Vasiljevics were in fact the appropriate officers of the company.[31] The Court held that the Form 61, together with other circumstances such as the Vasiljevics being existing customers of the bank, constituted a holding out by the company that Mr and Mrs Vasiljevic were officers of the company.

Outsiders relying on a representation that the authorised officers have attested the seal/signature have to prove that the maker of the representation had the actual authority to do so. The difficult cases involve the acquiescence type cases, such as *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd*[32] and *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*.[33] In the acquiescence type cases (discussed in chapter 2), the outsider typically deals with one officer of the corporate borrower/security provider, whom the outsider believes to have authority. The legitimacy of the outsider's impression depends upon the board's conduct or acquiescence in creating this impression. The outsider's unilateral, although expedient belief regarding the officer's authority is not enough. Reasonable explanations accepted at the time of the transaction mitigate search costs, but with hindsight become implausible. The results from the cases are mixed.

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29 (1991) 9 ACLC 702, 707.
30 The equivalent of current Form 304 Notification of change to officeholders, lodged pursuant to s 205B.
31 In fact, nearly 2 years elapsed until the Form 61 was lodged with the Corporate Affairs Commission.
32 [1964] 2 QB 480.
33 (1992) 10 ACLC 253.

A common thread in both *Brick & Pipe and Equiticorp Finance Ltd v Bank of New Zealand*[34] to the lenders' success in preventing a corporate borrower asserting lack of authority was the courts' willingness to hold that the dominant manager, acting with acquiescence of the board, had the actual authority to bind the company.[35] The courts have accepted that this conferral of authority may be informal and based on a course of dealings between the outsider and the lender.[36]

Other cases on the statutory rule show that that the outsider failed to prove that the officer they were dealing with had actual or apparent authority either through acquiescence, or by a representation emanating from the company. For example:

- In *Bank of New Zealand v Fiberi Pty Ltd*,[37] the bank portrayed Mr Doyle, the head of the Doyle group in that case as a "dominant" persona. Mr Doyle represented his son to be the secretary of Fiberi Pty Ltd for the purpose of attesting the seal on a third party mortgage. In fact his spouse, Ms Arnhold, was the secretary, and she had no knowledge of the representation or the transaction. The bank relied on the representation, but was subsequently unable to prove that Mr Doyle had the actual authority of Fiberi to make it. Allen J at first instance[38] distinguished *Brick & Pipe* on the basis that there was no knowledge or acquiescence by the board of Fiberi to Mr Doyle's activities.
- In *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*,[39] Michael and Lisa Kandy attested the seal of the company on a third party mortgage, whereas Lisa's parents, the Tafts, were the officers. The Tafts had no knowledge of the mortgage. Macquarie Bank, in dealing with the Kandys, relied on previous dealings with other companies in the Kandy group, the Kandy group solicitors, (who were not retained to act for Sixty-Fourth Throne) and had no direct contact with the Tafts. The bank, through its solicitors, obtained a company search showing that the Tafts were directors, but never pursued this information and did not check the sealed documents in relation to it.[40] Hedigan J at first instance, held that the case was similar to Fiberi, in that the only representations as to Michael Kandy's authority came from third parties who had no authority to make the representations on behalf of the company.[41]
- Nathan J in *Pyramid Building Society v Scorpion Hotels Pty Ltd*[42] found the facts of that case "dissimilar" to *Brick & Pipe*, as Mr Lewis, the dominant manager, had assumed authority but was not invested with it. Lewis had embarked on a course of conduct designed to exclude the other board members from the affairs of the company. He never presented himself in company with the other directors,

34 (1993) 11 ACLC 952.
35 See Table 5.2 in chapter 5 for a summary of the comparison of the relevant cases. For another example outside the banking/finance application, see *Greater Pacific Investments Pty Ltd v ANI Ltd* (1996) 39 NSWLR 143 which was also a successful case for an outsider where the court held that the dominant manager by acquiescence (Brian Yuill) had actual authority to bind the company.
36 *Bank of New Zealand v Fiberi Pty Ltd* (1992) 10 ACLC 1,557, 1,569 (Allen J).
37 (1994) 12 ACLC 48.
38 (1992) 10 ACLC 1, 557, 1,570–1,571. The argument was not pursued on appeal.
39 [1998] 3 VR 133.
40 [1998] 3 VR 133. This finding of fact about the search was outlined in Tadgell J's judgment on appeal at 148.
41 (1996) 14 ACLC 670, 674. The argument was not pursued on appeal.
42 (1996) 14 ACLC 679.

in the market place or anywhere else, as having dominion over them.[43] There was a subsidiary argument that the directors had authorised Lewis to negotiate bridging finance with another bank, so that that authority carried over to the current transaction. Nathan J rejected this "carry over" argument, and in any event, found that Lewis had exceeded his authority in that transaction.

- The facts of *National Australia Bank v Sparrow Green Pty Ltd*[44] provided the bank with some conflicting information that it chose to resolve by relying on the director who assumed control of the company. The bank knew that there was only one director, Green, who was managing and controlling the company, but the bank also knew from the company's constitution and from the ASIC search that the company was required to have a second director and that Sparrow occupied that position. The bank relied on assertions by both Green and the company's accountant that Sparrow was resigning, but the bank was not entitled to rely on that assertion for two reasons. First, Green was only a director, and did not have the actual authority to make a representation about another officer's capacity, nor was there any other evidence that anyone else had the company's actual authority to make the representation. Secondly, the bank knew that, in any event, the borrower company was required to have two directors and that there were two directors shown on the public record.

The lenders in these cases were primarily operating on their own mistaken belief and fooled by the dishonesty or delusions of the individuals purporting to exercise corporate power. The mistaken reliance on the dominant officer was fuelled, in cases such as *Fiberi* and *Scorpion*, by the lenders' failure to check from ASIC records the officers' identities. Even as in *Sparrow Green*, where the bank checked the ASIC registers, it was uncommercial to accept the risk that it could rely on a single director's representation that the public record was inaccurate. In practice, this confirms the desirability of securing a directors' resolution, which is not commercially unreasonable to ask for in all finance transactions.

The apparently contrary results in this series of cases exposes the statutory rule to criticism. It exposes an outsider to uncertainty where someone who an outsider reasonably believes has authority makes a representation but it turns out that the representation was not made by someone with actual authority "to manage the business of the company either generally or in respect of those matters to which the contract relates."[45] It is often almost impossible for an outsider to discover who has actual authority to make representations for the company.

An obvious measure to enhance the outsider's protection under s 129(3) is to extend the assumption to cases where a representation is made by someone with *actual or apparent* authority to manage the business of the company either generally or in respect of the particular contract concerned. This extension meets the original purpose of the statutory amendment, which was stated to "ensure that a person who deals in good faith with persons who can be reasonably supposed to have the authority of the company

43 (1996) 14 ACLC 679, 694.
44 (1999) 17 ACLC 1665.
45 *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 505–6 (Diplock LJ).

should be protected against later [claims] by the company that the person purporting to act for it lacked authority."[46]

Further, the model for s 129 is the *National Companies Bill* 1975 para 34(2)(c) and s 142(2) of the Ghana *Companies Code*.[47] These provisions extend to a person "represented by the company (acting through its members in general meeting, through its directors or through its principal executive officer) to be an officer or agent of the company." This explains more fully whose representations may be attributed to the company for the purpose of a "holding out by the company." It would appear to encompass a representation made by a de facto managing director.

An extension to s 129(3) must be balanced against the purpose of the rule in its entirety. That is, the rule is a procedural convenience. To allow outsiders to assume that an officer has authority to make representations plunges into a matter of substantive law. Regardless of the scope of the assumption, an outsider is still subject to the disentitling circumstances of the exceptions. To take any of the examples where the outsider lost the "holding out" assumption, would the outcome have been different under an extended assumption in s 129(3)?

For example, *Fiberi* was primarily decided on the disentitling circumstances. Accordingly, regardless of the scope of the s 129(3) assumption, the bank was not entitled to assume that the purported 'secretary' who signed the seal was an officer of the company, because they had knowledge that this was not accurate.

In *Scorpion* and *Sixty-Fourth Throne*, there was no representation by a director that another person had authority. These were both cases where purported officers made representations about there own authority, unsubstantiated by any conduct or acquiescence from the board.

In *Sparrow Green*, even had the bank been able to rely on the representations of one director, it had actual knowledge to the contrary. In relation to all of the recent cases examining s 129(3) then, an expanded assumption would not have altered the outcome. This may suggest that the balance between the assumption and the disentitling circumstances, as they currently stand, is about right.

Finally, the statutory rule is more readily available than common law apparent authority, in the sense that actual reliance is not necessary. In order for agency by apparent authority to arise at common law, it must be shown that the outsider was induced by the representation to enter into the contract and in fact relied upon it.[48]

It appears that the common law rules of agency as stated in the *Freeman and Lockyer* case may have been modified by the s 129(3) assumption. In *Lyford v Media Portfolio Ltd,*[49] it was held that an outsider need not have actually made the assumptions contained in former s 164(3) in order to rely upon them. A company is prevented under s 128(1) from asserting that the assumptions are incorrect. It is not relevant that the outsider actually made the assumptions, as "...the section talks only of assumptions which may be made and need not necessarily reflect the actual assumptions made by the parties seek-

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46 Explanatory Memorandum, *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983*, [188].

47 D Obadina, 'Irregular, Intra-vires Corporate Transactions and the Protection of Third Parties in the UK and the Commonwealth – The Case for Reform: Part 1' (1997) 18 *The Company Lawyer* 45, 51.

48 *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 505.

49 (1989) 7 ACLC 271.

ing to rely on s 68A [now s 129]."[50] This appears to dispense with the common law requirement that the outsider must rely on the representation in order to hold the company bound by the acts of an agent who was held out by the company to be an officer or agent.

An alternative interpretation that may impede the efficiency of the statutory rule is that while s 128(1) prevents an assertion that the s 129(3) assumption is incorrect, the assumption itself may not operate if a "holding out by the company" requires reliance by the outsider on the representation in accordance with the common law principles. There is no authority for this restrictive approach.

Customary authority of agents

The second element of s 129(3) is that the person who has been held out by the company to be an officer or agent has authority to exercise the powers and perform the duties customarily performed by an officer of a similar company. This aspect involves a consideration of the customary authority of a company's officers, which would appear to incorporate the general agency rules in their application to companies.

We generally discussed 'customary authority' in chapter 2, and summarised the points under the previous assumption in s 129(2) above. The assumptions in s 129(2) and (3) are similar because they both refer to duties "customarily performed by an officer of a similar company". Where the outsider deals with someone held out by the company to be its managing director, that person has wide customary authority that is only limited in cases of unusual transactions. These limits were considered under the common law principles.

Where the person with whom the outsider deals is an ordinary director, the outsider is at risk because the courts are reluctant to regard an ordinary director as having customary authority to bind the company, in the absence of further circumstances that would indicate otherwise. This application of agency law to companies is probably contrary to widespread commercial practice. It is generally the case that once an outsider establishes that the person with whom dealings are conducted has been appointed as a director, that person will usually be regarded as having authority to bind the company in a wide range of contracts. In the absence of suspicious circumstances, such a belief is consistent with the operation of the indoor management rule. If the director does not have the requisite authority to bind the company, this is a matter to do with the internal regulation of the company and the outsider has no realistic means available to check whether the company's constitution have been complied with or a delegation of authority has been properly made.

The strict application of agency principles in a company context is inappropriate because there is a different balance of interests. An officer of a company generally stands closer to the company than does an agent in relation to a principal. It is therefore more important to protect the interests of a principal in cases where an agent acts in an unauthorised manner. In the case of a company standing as a principal, the policy of the legislation is to hold the company liable for the acts of its officers. An outsider should not

50 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253, 265 where the Full Court of the Supreme Court of Victoria approved this statement of Ormiston J at first instance.

be deprived of the protective assumptions where the making of such assumptions is reasonable. The limitations contained in s 128(4) are intended to operate in cases where the outsider does not act in good faith.

Accordingly, the statutory rule still does not relieve the outsider of the obligation to verify both the identity and the position of the person with whom they are dealing. If they are dealing with only one representative of the company, in the absence of a written contract, the company may not be bound by the contract if the person is merely a single director with limited customary authority. If the outsider is relying on a written document that purports to have been executed by the company, then there are additional procedural assumptions available in ss 129(5) and (6).

Proper Performance of Duties: s 129(4)

The terms of the assumption are that: "A person may assume that the officers and agents of the company properly perform their duties to the company"(based on former s 164(3)(f)).

There has been minor change to this provision, as former s 164(4)(f) also applied to "employees" performing their duties. Whilst the significance of this alteration is discussed below, it relates to the overall controversy surrounding this assumption: whether s 129(4) extends the assumption to proper performance of directors' *fiduciary* duties to the company. Accordingly, there are three potential interpretations of this assumption:

1. that "duties" refers to administrative or statutory tasks undertaken by officers as assigned in the constitution or legislation;
2. that "duties" refers to substantive fiduciary duties and the duty of care; or
3. that "duties" connotes a combination of the above, which provides the assumption with its widest possible ambit.

Potential constructive trustee liability imposed on outsiders emerges as a substantial consequence of the interpretation of this assumption. The meaning of s 129(4), and its application in constructive trustee liability, is examined below.

Contemporaneous commentary, when the assumption was first introduced in 1983, is equivocal whether the assumption extended the Rule in *Turquand's* case. For example, Ford, Paterson, Ednie and Ryan, in their *Guide to the National Companies and Securities Scheme* merely comment that: "Section 68A (3) (a) and (f) [i.e. s 129 (1) and (4) currently] are legislative adopters of the rule [in *Turquand*]".[51] However, Professor Ford, in his own texts,[52] is more specific about former s 68A(3)(f), linking the assumption to situations where directors exercise their power for an improper purpose.

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51 H A J Ford et al, *Guide to the National Companies and Securities Scheme* (2nd ed, 1984).

52 Professor Ford's 1984 supplement to the third edition only indirectly equates the newly inserted proper performance of duties assumption to abuse of power: H A J Ford, *Supplement to the Third Edition of Principles of Company Law* (3rd ed, 1984) [525].
By the fifth edition, Professor Ford was more circumspect on the connection between the assumption and abuse of powers: "Whether a third person dealing with the company can be prejudiced if the company fails to affirm the transaction [in abuse of power], depends upon whether the third party can make the assumption … that the persons acting for the company are properly performing their duties to the company." H A J Ford, P*rinciples of Company Law* (5th ed, 1990) [88]. There are two levels of uncertainty in this statement and Professor Ford has not distinguished them: whether the ambit of the assumption precludes reliance for abuse of power, or whether the assumption covers abuse of power, but the third party's reliance depends on the statutory exceptions. The 1990 statement indicates less certainty than his views expressed at the time the reforms were introduced.

The meaning of "duties"

The Explanatory Memorandum,[53] in justifying this provision, stated: "This statutory presumption of regularity restates the common law rule (e.g. see *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112 at 142)."

In *Richard Brady Franks Ltd v Price*, Dixon J[54] referred to two rules relating to the exercise of corporate power in the case. The first rule was the common law principle of regularity (the indoor management rule), in the context where the validity of the contract was challenged due to the procedural defect in the directors' resolution authorising it. This case involved an issue of debentures to persons including directors of the company. The validity of the debentures was challenged on the grounds that the issue was not authorised by a quorum of directors who were entitled to vote. The holders of the debentures were protected from the assertion by the company that the persons purporting to act for it lacked authority.

However, the second rule of regularity was an analogous rule of regularity from agency law, applied to the company director context. Dixon J said:

> "Under the general law of agency it is a breach of duty for an agent to exercise his authority for the purpose of conferring a benefit upon himself or upon some other person to the detriment of his principal. But, at the same time, if his act is otherwise within the scope of his authority it binds the principal in favour of third parties who deal with him bona fide and without notice of his fraud (Hambro v Burnand (1904) 2 KB 10; Lloyds Bank v Chartered Bank of India, Australia and China (1929) 1 KB 40, 56 (Scrutton LJ). The rule, no doubt, is the same with respect to the acts of directors. It follows that a transaction carried out by directors for their own or some other persons' benefit and not to further any purpose of the company is voidable but not void."

In analysing the derivation of this assumption and the judgment of Dixon J, Carroll[55] concludes that former s 164(3)(f) means that the company's officers and agents may be assumed to have duly performed the tasks and duties assigned to them by the company under the constitution or by other means, that is, the first interpretation. O'Donovan also concludes, "there is no clear authority that a bank can rely upon [former] s 164(3)(f) to argue that it is entitled to assume that the directors have properly performed their fiduciary duties."[56] Horrigan[57] interprets the section as containing shades of grey: s 129(4) does not operate as a catch all provision, as the fiduciary duty to act in the interests of the company as a whole is a "broad concept embracing many discrete things". In 1998 he acknowledged that the interpretation of s 129(4) is still "undetermined" and "hotly contested".[58]

The conservative view of former s 164(3)(f) favoured a "tasks" interpretation, and there are several factors that support that narrow interpretation:

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53 Explanatory Memorandum, *Corporations Bill 1988*, [570].

54 (1937) 58 CLR 112, 142. The plaintiff was unable to discharge the burden of proof that the defendant directors acted in bad faith, so the transaction was not voidable.

55 R Carroll, 'Proper Performance of Duties by Company Officers: The Statutory Assumption in s 164(3)(f)' (1995) 69 *Australian Law Journal* 200.

56 J O'Donovan, 'Corporate Benefit in Relation to Guarantees and Third Party Mortgages' (1996) 24 *Australian Business Law Review* 126, 130.

57 B Horrigan, 'Third Party Securities – Theory, Law and Practice' in J Greig and B Horrigan (eds), *Enforcing Securities* (1994) 275–277.

58 B Horrigan, 'Busting Guarantees!' [1998] 7 *National Law Review* [20].

1. The indoor management rule is a common law rule of procedural regularity only. It would be an unintended consequence of the statutory enactment if it created a substantial new limb to the rule that effectively subsumes the whole area of fiduciary duties and equitable remedies.[59]
2. Based on the interpretation of the words used, the assumption refers to "performance" of duties. This term is more appropriately applied in a procedural context. Substantive fiduciary duties are not "performed".
3. Ipp J in *Vrisakis v ASC*[60] (in examining the statutory duty of diligence, which also refers to "performance of duties") referred to "duties" as meaning the tasks undertaken by directors and these may vary from one company to another. This is different from a duty that is owed to the company, which remains constant. Essentially, His Honour is distinguishing a matter of fact (what are the tasks assigned to that office?) from the matter of law (what are the obligations that attach to that office and the standards of conduct expected?). A rule of procedural regularity is confined to assuming matters of fact.

The advantage of the narrow "tasks" interpretation is that it refers both to matters set out in the constitution and to statutory obligations. As for the constitutional "tasks", this approach appears consistent with the other assumptions of the statutory rule, as it represents a part of the Rule in *Turquand's* case, enabling a presumption of regularity in the internal workings of the company. It appears to complement the first assumption that refers to compliance with the constitution and therefore applies to conferral of authority by the constitution. This interpretation at least enabled an outsider to seek the protection of the assumption in former s 164(3)(f) where the company's officers or agents act beyond authority conferred on them by the company and purport to affix the company seal.

In addition, the "tasks" interpretation covers matters of procedural regulation that apply independently of the constitution. The assumption is suggesting that the outsider does not have to read the constitution, nor the statute, to check for compliance. For an example under the current legislation, the replaceable rules confer upon directors the power to call a general meeting under ss 249C and 249CA. However, s 249D imposes on directors the duty (in the sense of task) of co-operating with a request from members to hold a general meeting. Even though it is not a matter under the constitution, the outsider can access s 129(4) to assume that the directors performed their duties when the general meeting was held.

To continue to impose this "tasks" definition on the current assumption in s 129(4) is at least of some utility to outsiders, although it confines the ambit of s 129(4) to that of an adjunct to the main *Turquand* rule in s 129(1).

Balancing the "tasks" view, however, we can construct an argument in favour of reading into s 129(4) the widest possible ambit, that is, that it includes both "tasks" and "duties", including general law duties of good faith and care. Since Carroll's article, there has been additional case law and commentary on former s 164(3)(f) and s 129(4). Further, the wording of the former provision, as analysed by Carroll is slightly different

59 L Law and J Pascoe, 'Financiers and Constructive Trusts: Protection Versus Liability' (2000) 11 *Australian Journal of Corporate Law* 219, 229.
60 (1993) 11 ACLC 763, 767.

to s 129(4). Former s 164(3)(f) also applied the assumption to “employees”. While employees may have tasks assigned to them as part of their “duties”, they do not owe fiduciary duties to the company in the same sense as officers to a company or agents to a principal. The deletion of “employees” from s 129(4) may be an argument in favour of reassessing its interpretation.

Since s 129(4) was passed, Loxton disagrees with the sustainability of Carroll’s view. Loxton states that excluding fiduciary duties “seems very difficult to accept… s 129(4) now makes it clear that a person may assume that the officers and agents of the company perform their duties, and that the ‘duties’ referred to … must include fiduciary duties.”[61] Whilst the proposition is sound, Loxton does not operationalise the reason for it.[62] Whincop devotes considerable argument favouring the widest possible interpretation of s 129(4), to enhance his general argument that the corporate law needs to be more responsive and less formalistic.[63]

Section 129(4) (and its predecessors) has not been successfully argued in any of the indoor management rule cases, although its significance has been noted by McPherson J in *ANZ Executors & Trustee Co Ltd v Qintex Australia Ltd*,[64] Brennan J in *Northside Developments Pty Ltd v Registrar-General*[65] and *Hansen J in Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*.[66]

The Explanatory Memorandum accompanying the *Company Law Review Act 1998* is silent on the existing or intended interpretation of s 129(4).

The factors that support the widest interpretation (i.e “tasks” + “duties”) are:

1. The wide view supports the general approach of maximising the ambit of statutory protection to outsiders.
2. As the statute codifies and clarifies the common law rule, the extension of the assumption to fiduciary duties fulfils the promise of “clarification”. Proper performance of fiduciary duties was not part of the original common law rule, but forms part of analogous doctrine from agency law. Agency law principles have been used in the other assumptions to extend the rule.
3. For what purpose does the outsider actually need to assume that the directors have complied with their substantive fiduciary duties? This would be a threshold assumption only, and still subject to the company’s other remedies. A breach of fiduciary duty enables the company to avoid the contract if the purchaser is not

61 D Loxton, ‘One Step Forward, One Step Back: The Effect of Corporate Law Reform on Procedures in Dealing with Companies Borrowing or Giving Guarantees’ (1999) 10 *Journal of Banking and Finance Law & Practice* 24, 29–30. See also M Sneddon, ‘Protection of Financiers From Ultra Vires and Related Defences’ (1992) 66 *Law Institute Journal* 70, 71; D Obadina, ‘Irregular, Intra Vires Corporate Transactions and the Protection of Third Parties in the UK and the Commonwealth: The Case for Reform’ (1997) 18 *Company Lawyer* 45, 51: “In spite of assertions to the contrary, it would also appear wide enough to protect the outsider where the functionary has breached fiduciary duties, or otherwise abused his (sic) powers.”

62 The surrounding argument is unconvincing given that first, the new section is almost identical to the former, so there is no comparative change in position, and second, there is no support for the assertion that the issue has been in any other way made clear.

63 M Whincop, ‘Nexuses of Contracts, the Authority of Corporate Agents and Doctrinal Indeterminacy: From Formalism To Law and Economics’ (1997) 20 *University of New South Wales Law Journal* 274, 301–302.

64 [1991] 2 Qd R 360, 374.

65 (1991) 11 ACLC 611, 635, Brennan J wished to reserve his opinion on the effect on the creditor’s enforcement where a guarantee, though due execution may be assumed, is taken with notice that it is in breach of directors’ fiduciary duty.

66 [1998] 3 VR 16, 124.

taking as bona fide purchaser for value without notice. There is support for the view that the voidability of contracts is not affected by the statutory enactment of the indoor management rule.[67] Additionally, the outsider may incur personal liability if they participate in the breach of duty. The principles that give rise to participatory liability are discussed next, and are not merely subsumed by the indoor management rule. Additionally, the rule applies subject to actual and constructive knowledge (i.e "suspicion") exceptions in s 128(4).

The reference to "duties" in s 129(4) also probably includes the full range of statutory duties under ss 180–184 and Chapter 2E, the general law fiduciary duties and, in an insolvency context, the duties to creditors. The duty of directors to consider the interests of creditors (as a whole, not individually) has been developed considerably within the ambit of the fiduciary duties.[68] At the same time, the statutory duty to prevent insolvent trading has been expanded.[69] Further recent developments have also resulted in a wider duty to exercise care, diligence and skill.[70]

Accordingly, the real issue of substance for the outsider should not be the scope of the assumption itself, but the ambit of the disentitling circumstances. The widest interpretation is therefore the more logical view.

An application of the assumption of "proper performance of duties": participatory liability

The significance of the ambit of this assumption to outsiders lies in the protection, if any, conferred by the *Corporations Act* where the issue of the outsider's participatory liability is involved.[71] Whether directors, in entering into a transaction, have breached their duty, is fundamentally an internal matter. The equitable principles of constructive trusts are relevant to consider in this context because in certain cases they allow a company to recover property from a third party or prevent the third party from enforcing rights under a contract. This may enable a company to obtain a remedy despite the operation of the statutory assumptions that protect the outsider.

There are three potential effects on the outsider where directors act in breach of their duties:

1. A transaction entered into in breach of fiduciary duty may be voidable at the company's option, depending upon whether the party to the contract acted in good faith without knowledge of the fiduciary breach.[72]

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67 R Carroll, 'Duly Sealed Documents and Knowledge of Directors' Breach of Fiduciary Duty' (1993) 23 *Western Australian Law Review* 173, 180; *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253, 264; *Northside Developments Pty Ltd v Registrar-General* (1991) 11 ACLC 611, 635, Brennan J wished to reserve his opinion on the effect on the creditor's enforcement where a guarantee, though due execution may be assumed, is taken with notice that it is in breach of directors' fiduciary duty.

68 See *Walker v Wimborne* (1976) 137 CLR 1; *Ring v Sutton* (1979) 5 ACLR 546; *Nicholson v Permakraft (NZ) Ltd* [1985] NZLR 172; *Kinsela v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722; *Grove v Flavel* (1986) 4 ACLC 654; *McNamara v Flavel* (1988) 6 ACLC 802; *Jeffree v NCSC* (1989) 7 CLC 556, *Spies v The Queen* (2000) 18 ACLC 727.

69 Section 588G *Corporations Act*. This is a redrafted version of its predecessor s 592.

70 *Daniels v Anderson* (1995) 13 ACLC 614; *Hilton International Ltd v Hilton* (1988) 4 NZLC 96–265; See further S Sievers, 'Farewell to the Sleeping Director – The Modern Judicial and Legislative Approach to Directors' Duties of Care, Skill and Diligence – Further Developments' (1993) 21 *Australian Business Law Review* 111; S Sievers, 'Directors' Duty of Care: What is the New Standard' (1997) 15 *Company and Securities Law Journal* 392; J Bird, 'The Duty of Care and the CLERP Reforms' (1999) 17 *Company and Securities Law Journal* 141.

71 This issue has been raised in Law and Pascoe, supra n 59.

72 *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, 142 (Dixon J); *Reid Murray Holdings Ltd v David Murray Holdings Pty Ltd* (1972) 5 SASR 386.

2. Whilst the contract may remain enforceable, the outsider may become indirectly affected, or at least inconvenienced, by internal disputes. (For example, shareholder action for oppression remedy or winding up, or where the company sues its directors for damages or account of profits for breaches of directors' duties.)
3. The outsider may be involved in the breach of duty to the extent that they incur personal liability as constructive trustee, so that the outsider takes the property or funds the subject of the transaction as trustee for the original beneficiaries of the duty.

Under this assumption, it remains for us to examine the threat to the outsider of constructive trustee liability. The *Corporations Act* does not directly prevent the imposition of a constructive trust on the outsider. There are provisions in the *Corporations Act* that alter or modify the common law in regulating the conduct of directors. It is often provided that such legislation is to be read as being in addition to other provisions of the *Corporations Act* or any other rule of common law or equity. Compliance with the legislation is not taken to relieve directors of their statutory or fiduciary duties.[73] In the statutory indoor management rule, there is no such statement. However, it would be preferable to give full effect to the enforcement of the duties of directors and other officers and expressly make the s 129(4) assumption subject to common law and equitable principles.

The rules of constructive trusts show how equitable principles dealing with the duties of directors may affect the relationship of an outsider with the company and its directors. These rules probably overlap with and are in addition to the statutory indoor management rule and affect the balance of policy considerations referred to above in *Northside Developments Pty Ltd v Registrar-General*.[74]

For example, in both *Northside* and *Bank of New Zealand v Fiberi Pty Ltd*,[75] a director affixed the company seal in an unauthorised manner for the purpose of mortgaging the sole major asset of the company in order to secure loans that were for the benefit of the director and of no benefit to the company. This probably constituted a breach of fiduciary duty by the director even though the courts did not refer to their fiduciary duties or to the equitable remedies that may be sought to enable the company to set aside a contract with an outsider.

The principles relevant for when an outsider is liable as a constructive trustee and liable to pay compensation for loss arising from a breach of duty, evolved from the case of *Barnes v Addy*.[76] This case laid down two principles in order for a stranger to be liable as a constructive trustee. Either the trust property must be received with the requisite degree of knowledge of the breaches of duty by the directors; or there must also have been participation in the breaches or the taking of an advantage for the stranger's own benefit with the requisite knowledge.

This raises the question of what constitutes "knowledge" on the part of the third party. In *Baden Delvaux and Lecuit v Societe Generale*,[77] (discussed in chapter 4) Peter

73 For example, s 179 expressly recognises that other duties under legislation and other laws (including the general law) are imposed on directors in addition to the statutory directors' duties imposed under Part 2D.1. See for other examples: s 230 in relation to financial benefits to related parties (Chapter 2E) and s 260E in relation to the authorisation of financial assistance (Part 2J.4).

74 (1991) 8 ACLC 611. See Chapter 3.

75 (1993) 11 ACLC 952.

76 (1874) 9 Ch App 244.

77 [1983] BCLC 325.

Gibson J classified knowledge into five categories:

(i) Actual knowledge

This is knowledge that a person actually knows in a conscious and subjective sense. In some cases it may include knowledge which a person does not admit to but from the evidence a court may conclude that the person must have known for example, that the directors of a company breached their duties.[78]

(ii) Wilful blindness

Where a person "wilfully shuts his or her eyes", it may be inferred that the person possessed actual knowledge.[79]

(iii) Wilful or reckless failure to make inquiry

This type of actual knowledge is similar to and overlaps with wilful blindness. For example in *Agip (Africa) Ltd v Jackson*[80] certain parties were held to have known or wilfully abstained from making inquiries so as to avoid discovering that their clients were laundering money. They were held to be constructive trustees because they were treated as having sufficient knowledge that there had been an exercise of power for an improper purpose.

(iv) Failure to make inference from knowledge of circumstances

This is where a person knows certain relevant facts but fails to appreciate their factual or legal significance in circumstances where an honest and reasonable person would make such an inference.[81] Actual knowledge may be inferred where there is ignorance of the law or "moral obtuseness".[82]

(v) Knowledge which ought to have put a person on inquiry

Where a person is put on inquiry and fails to make inquiries, the person is taken to have constructive knowledge of information that person would have known had reasonable inquiry been made. This differs from the other aspects of knowledge because it arises from the fact that proper inquiries were not made.

These categories of knowledge are relevant in determining whether a third party has knowingly assisted a trustee in committing a breach of trust. Where this has occurred, the third party may be liable to pay compensation or be required to restore the property and is unable to claim that he or she is a purchaser for value without notice.[83] The principles of constructive trusts are also applicable to breaches of duty by directors involving transactions where company property is transferred to an outsider. This enables a company to attack the validity of a transaction under equitable principles. There is considerable overlap between the types of knowledge that may result in an outsider becoming a constructive trustee and the knowledge or suspicion required as the exceptions to the rule (see s 128(4) discussed in chapter 8).

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78 *Agip (Africa) Ltd v Jackson* [1991] Ch 547; *Rolled Steel Ltd v British Steel Corp* [1986] 1 Ch 246; *International Sales & Agencies Ltd v Marcus* [1982] 3 All ER 551.

79 *English and Scottish Mercantile Investment Co v Brunton* [1892] 2 QB 700.

80 [1992] 4 All ER 385.

81 See for example *Belmont Finance Corp v Williams Furniture Ltd* (No 2) [1980] 1 All ER 393; *Ninety Five Pty Ltd v Banque Nationale de Paris* [1988] WAR 132.

82 *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373.

83 For further discussion of these principles see C Harpum, 'The Stranger as Constructive Trustee' (1986) 102 *Law Quarterly Review* 114 and 267; J D Heydon, 'Recent Developments in Constructive Trusts' (1977) 51 *Australian Law Journal* 635; R P Austin, 'Constructive Trusts' in P Finn (ed) *Essays in Equity* (1985) and Carroll (1993), supra n 67.

These five categories of knowledge ought to be considered as a scale of "impropriety", with category (i), actual knowledge, being the most subjective, up to category (v) that approaches an objective standard similar to negligence. In *Royal Brunei Airlines Sdn Bhd v Tan*[84] the Privy Council held that the Baden five-point knowledge scale is relevant in cases of knowing receipt.

The application of the knowledge scale has recently been examined by several Australian commentators,[85] as well as extensively addressed by Hansen J in *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*[86] and Kirby P in *Equiticorp Finance Ltd v Bank of New Zealand*.[87] In particular, Lodge discusses in detail the application of *Baden* in other cases, including Australian, English and New Zealand authorities. Her analysis of *Barnes v Addy* concludes that the classification of knowledge ought not to be considered as a rigid scale, but as overlapping categories. This analysis however does not conclude on the vexed issue of the application of category (v), "knowledge of circumstances which would have put an honest and reasonable person on inquiry". Category (v) knowledge is most controversial, because it imports an objective standard similar to negligence, which has a profound effect on liability. If category (v) is sufficient, then it places an active duty on outsiders to enquire into the possibility of the directors' fiduciary breach when the company enters into a transaction. This approaches the undesirable effect of inadvertent liability. Scaling back from category (v) approaches more a standard of intention, which appeals more to the purpose of constructive trustee liability.

Not all of the Australian cases on recipient liability directly address the *Baden* scale, but it is used as a reference point in discussing the main Australian cases, below:

- *Ninety Five Pty Ltd v Banque Nationale de Paris*[88]
- *Equiticorp Finance Ltd v Bank of New Zealand*[89]
- *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*[90]
- *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*.[91]

These cases contribute to the question of knowledge and as they are not included in Lodge's analysis, they are examined in detail below.

1. Ninety Five Pty Ltd v Banque Nationale de Paris

The decision in *Ninety Five Pty Ltd v Banque Nationale de Paris* is one of the first cases in Australia to impose recipient liability following the High Court decision on participatory liability in *Consul Development*. It is a more unusual case than the other three listed above, because the bank was a true "stranger" to the transaction, in the sense that there was no direct contractual relationship between the bank and the plaintiff company.

84 [1995] 2 AC 378.
85 Including; P Finn, 'The Liability of Third Parties for Knowing Receipt or Knowing Assistance' in D Waters (ed), *Equity Fiduciaries and Trusts*, (1993) 200; S Barkehall Thomas, 'Knowing Receipt: Options and Issues for the High Court', in *Perspectives on Banking Finance and Credit Law*, ed W Weerasooria (1999); Also M Bryan, 'Cleaning Up After Breaches of Fiduciary Duty – the Liability of Banks and Other Financial Institutions as Constructive Trustees' (1995) 7 *Bond Law Review* 67; J Pascoe, 'Equitable Remedies in Cases of Misapplied Company Funds: Recent Developments' (1996) 14 *Company and Securities Law Journal* 393; and M Lodge, 'Barnes v Addy: The Requirements of Knowledge' (1995) 23 *Australian Business Law Review* 25.
86 [1998] 3 VR 16.
87 (1993) 11 ACLC 952.
88 [1988] WAR 132.
89 (1993) 11 ACLC 952.
90 [1998] 3 VR 133.
91 [1998] 3 VR 16.

In that case, the bank lent money to another company, Bicton Investments Pty Ltd, for the purpose of acquiring the issued share capital in the plaintiff company. Prior to the acquisition, the plaintiff company was part of the Metro group. It was the practice in the group for subsidiaries to deposit surplus funds with the holding company, at a commercial interest rate. Accordingly, on settlement of the share transaction, the plaintiff company received a cheque drawn from the bank on Bicton's account for $3 million. In addition, the plaintiff company received cheques for $1.3 million, from its former holding company, to discharge the debt owed by the former holding company. However, the proceeds from the discharged debt were immediately on lent to the purchaser Bicton, so that on settlement, the cheques for $1.3 million were endorsed by the plaintiff company to Bicton. The bank's officer at settlement took the endorsed cheques for $1.3 million and deposited them to Bicton's account. There was no dispute that the effect of the transactions effected at settlement amounted to a breach of fiduciary duty by the plaintiff company's directors, specifically because they granted financial assistance for the purchase of the plaintiff company's shares in breach of the *Companies Act* 1961 (WA) (Now see Part 2J.3 *Corporations Act*).

The dispute related to the bank's role as participating in the breach of duty. In an uncontroversial decision, Smith J held that because the bank had actual knowledge of the breach of duty, it was liable under both limbs of *Barnes v Addy* as constructive trustee.[92]

Insofar as recipient liability is concerned, the judgment of Smith J makes several exploratory points:

- Smith J confirmed that breach of fiduciary duty is the same as breach of trust for *Barnes v Addy* liability.[93]
- Smith J defined "constructive knowledge" in terms of "constructive notice" as "where the recipient does not know but ought to know",[94] but His Honour did not refer this back to the *Baden* scale. By referring to constructive "notice" His Honour is satisfied that recipient liability will arise on category (v), as he endorsed other authority that referred to the expectation that the recipient act as a reasonable person and demand inquiry.[95]

In the final result, Smith J did not need to conclusively decide or apply this definition of constructive notice, as His Honour decided that the bank had actual knowledge that it received the plaintiff company's settlement funds in breach of the company's directors' fiduciary duty, and was liable as constructive trustee to account to the plaintiff for the funds received.

2. Equiticorp Finance Ltd v BNZ

The facts of Equiticorp Finance represent the main scenario engaging this part of this chapter: the danger that outsiders may experience dealing with companies where breach of the directors' fiduciary duties are alleged.[96] However, the case is more of academic interest than practical importance, as only Kirby P in dissent imposed recipient liability

92 [1988] WAR 132, 178.

93 [1988] WAR 132, 173.

94 [1988] WAR 132, 174.

95 [1988] WAR 132, 175, citing R Austin, 'Constructive Trusts' in P Finn (ed) *Essays in Equity* (1985) 226 and the New South Wales Court of Appeal decision in *United States Surgical Corporation v Hospital Products International Pty Ltd* [1983] NSWLR 157, 285.

96 The description of the case is based on Law and Pascoe, supra n 59, 236–237.

as constructive trustee on BNZ. The case was discussed briefly in chapter 2 on aspects of the officers' authority to enter into the external contract, whilst here it is discussed in more detail examining the effect on the outsider of the officers' breach of duty.

BNZ was the principal banker to the Equiticorp Group of companies. The Equiticorp Group was structured with two separate arms: the industrial group and the finance group, both encompassed under the holding company, Equiticorp Holding Ltd. Allan Hawkins was chairman of the Group and a director of some of its 140 companies. It appears that of the companies directly involved in the case, there were common directors. In June 1987, a loan facility of $200 million was made available by BNZ to one of the wholly owned subsidiaries, Uruz. Uruz acted as the conduit through which the money flowed to fund the activities of the industrial group. By January 1988, BNZ was concerned as to its exposure, and the facility was reduced to $65 million. By April 1988 it was apparent that the financial position of the industrial group was tenuous. To try to protect the financial group, two of the finance group companies, Equiticorp Finance Ltd and Equiticorp Financial Services Ltd, created liquidity reserve accounts with BNZ into which approximately $50 million was deposited in June 1988. In July 1988, Allan Hawkins made the decision, uncontested by other directors, to apply the liquidity reserves in repayment of the Uruz debt. (The two companies were "compensated" for the loss of funds via the transfer to them of certain receivables owned by other companies in the industrial group.) The reason for the decision was to maintain the support of BNZ, which was described as "imperative for the survival of the Group".

In the subsequent liquidation of the finance group companies, Equiticorp Finance Ltd and Equiticorp Financial Services Ltd, the liquidators sued BNZ to recover the liquidity reserves.

On the face of it, the liquidators had a very strong claim. In summary, their argument was that the directors of the finance companies owed fiduciary duties of loyalty and good faith to the shareholders and creditors of those companies. Using the companies' funds to repay the debts of another company is a breach of that fiduciary duty, applying *Walker v Wimborne*.[97] BNZ was involved to the extent that it knew of the breaches of duty, obliging it to account to the companies for the sums received. Kirby P was prepared to uphold the liquidators' claim against BNZ, and in particular, to impose constructive trust liability on BNZ over the funds that it received, knowing they were tainted by the directors' breach of fiduciary duties.

However, Kirby P was the dissenting judge in this case. The majority, Clarke and Cripps JJA held that there had been no breach of fiduciary duties by the directors of Equiticorp Finance Ltd and Equiticorp Financial Services Ltd:

> "Mr Hawkins considered, with some justification, that the welfare of the group was intimately tied up with the welfare of the individual companies. … In a climate of substantial liquidity problems and having regard to the holding company's guarantee of the Uruz debt, we would conclude ... that those responsible for managing the two companies thought that the steps taken to protect the group as a whole, and in particular the holding company, coupled with the compensation scheme, were of definite benefit to the companies. The alternative was possible disaster for the whole group including the two companies."[98]

97 (1976) 137 CLR 1.
98 (1993) 11 ACLC 952, 1,019.

Therefore, the result was that the directors did not breach their duties and BNZ was not liable as constructive trustee for the funds. However, this is merely a result confined to its facts: the judgment of Kirby P contains a cautionary tale for the outsider. Kirby P held that a bank was a constructive trustee in circumstances where it was aware of breaches of fiduciary duties by the directors and participated in them by taking advantage of the breaches for its own benefit. He said that while a bank does not "have the responsibility of gratuitously supervising or checking the managerial activities of its customers, it is not relieved of obligations arising from the particular circumstances of its relationship with a particular customer.[99]

3. Sixty-Fourth Throne Ltd v Macquarie Bank Ltd

The case was previously discussed under the assumption of apparent authority, s 129(3). It is now discussed briefly in respect of potential equitable liability on the outsider for the officers' breach of duty.[100] The Macquarie Bank had advanced funds to Michael Kandy on the security, inter alia, of a guarantee and registered mortgage over the respondent company's property. The financing transaction was risky, with no evident benefit to the company. The mortgage had been executed by the fraud of Kandy, the son-in-law of the company's two directors, Dr and Mrs Taft. A claim of participatory liability against the Macquarie Bank was unsuccessful because the majority held that the principles of constructive trusteeship, based either on recipient or accessory liability, could not be imposed to undermine the doctrine of indefeasibility of interests established by the Torrens system. The High Court refused an application for special leave to appeal.[101] However, it is worth noting the strong dissenting judgment of Ashley AJA. His Honour emphasised the need for the law to give adequate protection to trust property and the interests of innocent beneficiaries, and was prepared to fix the bank with recipient liability. His judgment strongly endorsed the view that the concept of constructive knowledge should be given a broad application. He held that knowledge in the fourth *Baden* category would clearly suffice for recipient liability and that the Macquarie Bank "at the least [ought to] have been put on enquiry."

4. Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd

The *Koorootang* case provides an example of a situation where the constructive trust was imposed on an external party contracting with a corporate security provider.[102] The ANZ bank had dealt with Mr Jock Jeffries and the Jeffries Group of companies for twenty years. Jock Jeffries was also a director of Koorootang, a company that was not related nor connected to the Jeffries Group. Koorootang was formed to act as trustee in administering the estates of the Ramsay family, (Mrs Jeffries' family). Koorootang had two other directors, but they and the rest of the family, left Jock Jeffries to run the company. Unknown to the Ramsay family, the Jeffries Group was in financial difficulty. Jock Jeffries offered, and ANZ accepted, security for the Jeffries Group loans over Koorootang's property, comprising shares and real property. The negotiations with ANZ and the execution of the security documents took almost a year, between December 1992, and November 1993. In executing the security documents (scrip lien, real property mort-

99 (1993) 11 ACLC 952, 986.
100 The description of the case is based on Law and Pascoe, supra n 59, 237.
101 High Court Transcript, 9 October 1998.
102 The description of the case is based on Law and Pascoe, supra n 59, 223–224.

gage and associated requisitions) in Koorootang's name, Jock Jeffries forged the signature of one of the other directors. None of the other members of the Ramsay family were aware that the transactions had occurred, nor did ANZ directly consult with any other family members over the transactions. The real property mortgage was registered.

The shares, which were the subject of the scrip lien, were sold on 8 September 1993. The fraud was uncovered in late 1994. Koorootang's solicitors wrote to ANZ disputing the validity of the transaction, and ANZ took steps to exercise its power of sale. Koorootang commenced proceedings against ANZ, claiming, inter alia:

- a declaration that the scrip lien and mortgage were void and unenforceable,
- alternatively, a declaration that ANZ's interest in the scrip lien and mortgage was held on constructive trust for Koorootang,
- an injunction restraining ANZ from enforcing the mortgage,
- recovery of the proceeds of the sale of shares, based on conversion, moneys had and received, and breach of duty of care.

In finding for the plaintiff, Hansen J held that ANZ was a constructive trustee for Koorootang of the real property the subject of the security transaction.[103] ANZ was the recipient of trust property, knowing that it was tainted by the breach of trust. As to the requisite degree of knowledge, Hansen J held that ANZ had:

- actual knowledge that the mortgaged property was trust property; and
- constructive knowledge that the trust property was misapplied by Koorootang as trustee and by Jock Jeffries, in breach of his fiduciary duty to Koorootang.

Hansen J found the bank had constructive knowledge of Jock Jeffries' breach of fiduciary duty and breach of trust, and expressed it in terms of the bank's wilful and reckless failure to make inquiries about the matter that an honest and reasonable banker would have made in the circumstances. Reference to "wilful" and "reckless" is analogous to category (iii) (a type of actual knowledge, but Hansen called it constructive), and Hansen J expressed disapproval at ANZ's conduct, holding that the bank's conduct fell short of that expected of a reasonably prudent bank.[104] Although the facts were complex, the main aspects leading to Hansen J's assessment of the bank's conduct included:

- it was a third party security;
- the mortgage was for a large amount ($7 million);
- failure by the bank's officers to follow procedure and obtain legal advice as to the use of the trust's assets to secure Jeffries' Group indebtedness;
- failure by the bank's officers to clarify inconsistent information on their file (for example, the bank obtained a letter from Jock Jeffries confirming that the security was not trust assets, but that this was clearly inconsistent with earlier detailed information that the bank had about the financial affairs of the trust);
- failure by the bank to contact any other directors of Koorootang;
- evidence of concern within the bank as to Jock Jeffries' potential conflict of interest.

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103 Hansen J declined to determine whether constructive trusteeship applied to ANZ's interest under the scrip lien. Instead, Hansen J resolved the problem according to the rules of priority of competing equitable claims. Koorootang's claim was successful, based on the priority accorded to the first in time created.

104 [1998] 3 VR 16, 122, 123.

Hansen J therefore did not need to express a concluded view on whether any category of constructive knowledge ((iv) or (v)) would apply, although he explicitly stated a preference for at least category (iv) knowledge. He stated that category (v) is not sufficient, as cases in that category are characterised as ones where the outsider is merely careless.

The *Koorootang* case examined the scenario where the outsider knew about the breach of trust. The *Koorootang* case considered, but did not resolve, the relevance of the indoor management rule assumptions to constructive trustee liability. As Hansen J noted,[105] in any case in which a fraud is carried out by an officer or agent of a corporation, former s 164 (now s 129) will have an important, perhaps conclusive, role to play. The scope of the assumptions were not considered, because Hansen J decided that the exceptions precluded ANZ from accessing any assumption, but Hansen J left open the likelihood of the assumptions proving conclusive in a case where the *Barnes v Addy* claim had only been based upon Jock Jeffries' fiduciary duties as a director.

5. The Australian cases: support for constructive knowledge

To assess the state of recipient liability in Australia, the cases show that the prevailing criterion is that the outsider must have constructive knowledge of category (iv): knowledge of circumstances that would have indicated the facts to an honest and reasonable person. Whether this would extend to being more objective (i.e. category (v)) was floated by Kirby P but has not been adopted. As there is no direct application where the outsider to the contract with a company has incurred personal liability due to breach of the fiduciary duty owed to the company by its officers, the risk is therefore hypothetical rather than actual.

The only residual point of uncertainty is even if the scope of the assumption allows fiduciary duty compliance, it still depends on the scope of the rule's exceptions in s 128(4). It is unlikely that the exceptions to the rule, based on knowledge, would not overlap with participatory liability.[106] Both demand high standards of prudence, conduct and integrity in commercial dealings, standards emphasised by the High Court in *Northside* and referred to in chapter 3.

The overlap between corporate law principles and wider equitable principles has now been made. The significance of this is that if circumstances arise pursuant to s 128(4) that will preclude an outsider from relying on the procedural assumptions,[107] the corporate borrower may go further and seek equitable relief for breach by its directors of their fiduciary duty.

Documents Executed Without Common Seal: s 129(5)

The terms of the assumption are that: "A person may assume that a document has been duly executed by the company if the document appears to have been signed in accordance with subsection 127(1). For the purposes of making the assumption, a person may also assume that anyone who signs the document and states next to their signature that

105 [1998] 3 VR 16, 116.

106 Law and Pascoe, supra n 59.

107 There is now sufficient authority in Australia that defines what those circumstances are, from *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611and subsequent cases mentioned in Table 5.2 in chapter 5.

they are the sole director and sole company secretary of the company occupies both offices" (no former equivalent).

A company may enter into contracts directly,[108] but the company's assent to be bound must be in the proper form.[109] "Proper form" is specified in the *Corporations Act* however other statutes may specify procedural requirements. For example, *Jovista Pty Ltd v Pegasus Gold Australia Pty Ltd* [110] concerned the execution by a company of a statutory lien registered pursuant to the *Workman's Liens Act* 1893 (NT). Section 10(3) required the notice to be "signed … and attested". It was argued that by sealing the documents, the company had "signed" but not "attested". Bailey J held:

> "the signatures of Jovista's director and secretary have the effect of authenticating the company's signature by attesting that the company's seal was affixed in accordance with its Articles … the four applications were 'signed and attested' in accordance with s 10(3) of the Act."

There arises, as a separate issue to the officers' authority to exercise corporate power, the issue of the officers' authority to provide the company's assent in the proper form. As two separate issues, there is a distinction between "substantive authority" and "formal authority",[111] where:

1. "substantive authority" is the existence and scope of the officers' authority to enter into the contract; and
2. "formal authority" is the officers' authority to signify, in the proper form, the company's assent.

The assumption in s 129(5) is new, since 1 July 1998, and is a necessary consequence now that the common seal is optional under s 123. Even if a company has a common seal, the effect of s 127(1) is to make it optional whether the company uses it. For execution without the seal, s 127(1) provides that a company may execute a document without the seal if it is signed by:

(a) 2 directors; or
(b) a director and a secretary; or
(c) the sole director of a single director proprietary company.

Recent companies legislation has never prescribed the situations in which contracts and transactions with outsiders are to be under seal.[112] This has been left to commercial practice, and therefore the outsider essentially dictates the procedure by which the company's assent to be bound is evidenced.

Section 127 (particularly subsection (1)) has no direct former equivalent section, and the Explanatory Memorandum only makes brief reference to the section facilitating the execution of documents without a seal.[113] As s 127 is new, does it change the law, in terms whereby it either:

1. confirms the existing distinction between substantive authority and formal authority; or

108 *Richardson v Landecker* (1950) 50 SR (NSW) 250.

109 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (10th ed, 2001) [14.010].

110 (1999) 17 ACLC 524, 528 (Bailey J).

111 I Ramsay, G Stapledon and K Fong, 'Affixing of the Company Seal and the Effect of the Statutory Assumption in the Corporations Law' (1999) 10 *Journal of Banking and Finance Law and Practice* 38, 39.

112 The seal was only required on share certificates: s 1087 prior to 1 July 1998.

113 Explanatory Memorandum, *Company Law Review Act* 1998, [8.6].

2. merges, or otherwise renders indistinct, the difference between substantive and formal authority?

The section refers to its effect by the note: "If a company executes a document in this way, people will be able to rely on the assumptions in subsection 129(5) for dealings in relation to the company."[114] Section 129(5) allows the assumption that a document is "duly executed" if it complies with s 127(1).

The cross-reference between s 127(1) and s 129(5) is a useful drafting device but must be read as merely confirming that the officers of the company have formal authority to sign.[115] To look at the issue of execution another way, is it possible that there may still be disputes regarding authentication is the proper from, where substantive authority is not contested? The facts of *Tilley v Egan*[116] provide an example, suggesting that there is no merger of formal authority and substantive authority. *Tilley* involved a priority dispute between two charges. The chargor company was a sole director proprietary company. There was no substantial challenge to the officer's authority to grant the charge. The dispute related to whether the officer had actually signed at all, there being contested evidence whether his signature was intended to authenticate the document as the company's.

To outsiders, the role of s 127 is to:

- confirm formal, implied authority on officers to execute company documents; and
- define "proper form" of authentication, to assist the operation of the procedural assumptions that may be made under s 129.

Accordingly, the assumption confirms that the company can enter into contracts directly,[117] but it does not resolve the question as to authority, unless the signatories may also be assumed to be a director or secretary. This is discussed under s 129 (6) below.

Documents Executed With Common Seal: s 129(6)

The terms of the assumption are that: "A person may assume that a document has been duly executed by the company if:

(a) the company's common seal appears to have been fixed to the document in accordance with subsection 127(2); and

(b) the fixing of the common seal appears to have been witnessed in accordance with that subsection.

For the purposes of making the assumption, a person may also assume that anyone who witnesses the fixing of the common seal and states next to their signature that they are the sole director and sole company secretary of the company occupies both offices" (similar to former s 164(3)(e)).

The major drafting difference between the former provision and the current provision is the cross-referencing. In order for the former s 164(3)(e) to operate, the outsider was also required to access either the assumption as to customary authority of officers or

114 This is the note to s 127(1). The note to s 127(2) is identical, except it refers to the assumptions in s 129(6).

115 Ramsay, Stapledon and Fong, supra n 111, 52.

116 [2000] QCA 356. The case was an appeal against summary judgment. The Court of Appeal decided that the case should go to trial.

117 *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112.

ostensible authority of officers attesting the seal.[118] Internal cross-referencing in this form is not required, as the assumptions operate cumulatively: s 129(8). Instead, the cross-reference is to s 127(2) (execution of company documents under seal). The significance of this change was recently examined,[119] to determine whether this change in drafting has rendered a substantive change in the ambit of the rule. There is a distinction made between substantive authority to bind the company and formal authority to affix the seal. Cases on the former s 164(3)(e) limit the assumption to formal authority, that is, the assumption relates only to procedural regularity in ensuring that the company's assent is in the proper form. Substantive authority relates to the authority of the officers to exercise corporate power to enter into the transaction. The former provision did not cure defects in authority,[120] nor was the common law indoor management rule intended to create authority where there was none.[121]

Accordingly, there are two possible views of the redrafted s 129(6):

1. the "narrow" view, under which s129(6) is intended to remain as a rule of procedural regularity.
2. The "wide" view that s 129(6), via s 127(2), is designed to overcome lack of authority.

The wide view is not sustainable, as it is not consistent with previous Australian authority, nor has the legislature unequivocally signalled an intention to depart from that previous law.[122] Such an interpretation of s 129(6) does not accord with the indoor management rule's role as a rule of procedural regularity, and one that operates as an adjunct to the principles of agency but not in derogation of them.

The company's signature, whether represented by a seal or not, can only be physically inscribed via the actions of its officers or agents. The indoor management rule was designed to cure most defects relating to formal authority to execute. A series of examples of authentication problems are discussed below. These examples prove the comprehensive ambit of the rule's application. Set out below are the types of sealing disputes that have arisen in litigation, and the extent to which the statutory assumptions resolve them.

The collapse of s 129(6) into s 129(1)

The assumption as to sealing, and the more general first assumption as to compliance with the constitution, are generally treated as separate. This usually operates in favour of the outsider, so that their disentitlement to the first assumption does not disentitle them to the more specific assumption.[123] However, the outsider does not usually get the benefit of the reverse, that is, the assumption as to compliance with the constitution generally does not operate in lieu of s 129(6) in a sealing dispute.[124] *Belven*[125] provides an inter-

118 Section 164(3)(e) permitted the assumption of due sealing when three conditions were met:
1. the document had an impression of the seal;
2. it was attested by two persons (subject to single director proprietary companies);
3. those two persons were assumed to be a director and either director or secretary pursuant to s 164(3)(b) (statutory register of offices) or s 164(3)(c) (holding out by the company as to authority).

119 Ramsay, Stapledon and Fong, supra n 111.

120 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1991) 9 ACLC 324, 343 (Ormiston J).

121 *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 641 (Dawson J).

122 Ramsay, Stapledon and Fong, supra n 111, 49–50.

123 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1991) 9 ACLC 324.

124 *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1997) 15 ACLC 1,057 (NSW Court of Appeal); *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 232, 236 (Brennan J).

125 *Belven Enterprises Pty Ltd v Lydham Pty Ltd* (1996) 14 ACLC 1478.

esting corollary. Commissioner Wheeler QC held that former s 164(3)(a) could apply where the outsider had not actually seen the document that they were seeking to enforce.

The *Belven* argument still applies to the current provision, which requires the common seal to "appear" to have been fixed to the document.

"Appears" to be sealed

Where a company has a seal, s 123 requires the seal to state the full name and ACN of the company (similar to former s 219). This is significant because the assumption as to due sealing in s129(6) requires the document to appear to have been sealed. If the seal was defective through non-compliance with s 123 and as it is a matter capable of detection by mere casual physical examination, then arguably the outsider is precluded from the assumption because they have actual knowledge of the defect or at least a "suspicion" (s 128 (4)).

A situation arose in *Westpac Banking Corporation v Dawson*[126] where the borrower company used the seal for its proposed new name some four months prior to the name change taking effect with the issue of a new certificate of registration. The New South Wales Court of Appeal held the intention of the parties to enter into that transaction with the borrower identified by its proposed new name and evidence that the appropriate internal procedures had been complied with were sufficient to cure the defect. The circumstances arose prior to the statutory enactment of the rule. The case adds only indirect support that such a defect could not be cured by the assumption in s 129(6) alone.

Where there is a non-complying seal, it may be that a court will disregard the seal and s 127(2), and allow the outsider to assume that the document has been executed in accordance with s 127(1). For the assumption to apply under s 129(5), the outsider would only need to rely that officers signed the document. Whilst there is no direct authority, this is similar to the approach of the High Court in *MYT Engineering Pty Ltd v Mulcon Pty Ltd*.[127] The majority of the High Court held that as the document in question did not need to be sealed, then authentication of the company's consent was sufficiently evidenced by the signature of its directors.

Forged seal

Contrast the above situation with a forged seal. Provided it is genuine on the face of it, then the assumptions as to sealing in s 129(6) and absence of fraud and forgery in s 128(3) protect the outsider. After reviewing the relation between the former provisions (s 164(3)(e) and s 166) Justice Handley[128] concluded that:

> "if the person dealing with the company is entitled to make the assumptions in [s164(3)(e)] that person is also protected against the risk that a counterfeit seal has been used or that one or more of the attesting signatures have been forged unless that person has actual knowledge of such forgery".

The main concern for outsiders since the *Company Law Review Act 1998* is whether the current provision relating to forgery in s 128(3) is excluded beyond actual knowl-

126 (1990) 8 ACLC 681; affirmed on appeal by the High Court in *Dawson v Westpac Banking Corporation* (1991) 66 ALJR 94.

127 (1999) 17 ACLC 861, 864.

128 'When are Outsiders on Notice that Corporate Agents Lack Authority?' Paper presented at QLS *Securities Intensive VII Seminar*, Coolum, October 1993, 20, 32.

edge. Former s 166 only excluded actual knowledge. This issue is pursued in chapter 7, where we argue that under the statutory rule, the outsider cannot make the assumption if they knew or suspected that the seal/signature was a forgery.

Forged signatures

As referred to by Justice Handley above, it is unlikely that a forged signature on the company seal or signature affects the validity of execution from the outsider's point of view. *Story v Advance Bank Australia Ltd*[129] is a case precisely on point. Mr Story (a director and secretary of Fleetwood Star Pty Ltd) forged his wife's signature (as the other director) on a third party mortgage to secure his loans. The signatures appeared consistent with the public information on the company and it was held that the bank had no actual knowledge and no duty to make inquiry from the circumstances, as to whether Mrs Story's signature was genuine. The bank was able to rely on former s 164(3)(e).

Incorrect designation of officers as signatories

An outsider can still rely on the execution of a contract, even if the officers sign in another designation. A person who may be assumed to be a director can sign as "secretary" as long as the other requirements of fixing the seal are satisfied such as the other signatory can be assumed to be a director, the document will be assumed to have been duly sealed.[130]

Two different signatories attest the seal

The wording of former s 164(3)(e) required, as one of the elements to make the assumption as to due sealing, that the sealing of the document must "appear" to be attested by two persons. Further, former s 240(7) specifically provided that a requirement that an act is to be performed by a director and a secretary is not satisfied by its being done by the same person acting as both director and secretary. This provision has not survived the *Corporate Law Economic Reform Program Act* 1999[131] and suggests that this issue is open for reassessment. Despite the absence of s 240(7), the issue may depend upon judicial attitudes expressed in past cases to affixing the corporate seal. The problem of the single signatory actually gives rise to two separate scenarios:

1. where one signature appears, intended to witness the seal in different capacities,[132] and
2. where two signatures appear to witness the seal, but they are in fact the signature of the same officer.

In the first situation, whether the sealing clause requires two different signatures, the Court in *re Efron's Tie & Knitting Mills Pty Ltd*[133] held the same director could not sign the seal in their capacity as director and again as attorney for another director, regardless of the terms of the power of attorney. Such execution did not comply with a sealing clause in the constitution that required the signature of two officers. By extrapolation,

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129 (1993) 11 ACLC 629.

130 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253, 265–266; *Story v Advance Bank Australia Ltd* (1993) 11 ACLC 629, 637.

131 Operational 13 March, 2000.

132 Windeyer J in *Equity Nominees Ltd v Tucker* (1967) 116 CLR 518, 525 declined to accept the proposition that a single signature of an officer operated both as a signing by that officer and a signing by the officer as nominee for another officer.

133 [1932] VLR 8, 23 (Cussen ACJ); applied in *Mancini v Mancini* (1999) 17 ACLC 1570 (Bryson J).

this may not affect compliance with s 127(2), as the provision does not require "two signatures" but merely that the seal is "witnessed by" two directors. For the *Efron* view to prevail, s 127(2) would require an interpretation that the seal is to be *physically* witnessed by "two *different* directors."[134]

In the second situation, the High Court in *MYT Engineering Pty Ltd v Mulcon Pty Ltd*[135] held that the former s 164(3)(e) assumption was not available where the same officer signed in both capacities as director and secretary. In that case, Mr Edmonds held the positions of director and secretary of MYT. The other director, Mr Pullen, was unavailable to affix the company seal on a deed of arrangement. Edmonds, with Pullen's informed consent, affixed and attested the seal. However, Gleeson CJ, Gaudron, Gummow and Hayne JJ referred to the changes in the law due to the *Company Law Review Act* 1998, indirectly alluding to a change in effect.[136] The assumption requires the seal to be witnessed by two directors or by a director and a company secretary (s 127 (2)). It no longer explicitly refers to the witnesses being two separate people. This simplification in the wording of the sealing of a document may have the substantial effect of altering a case such as *MYT Engineering*. Since July 1998, if the same officer signs as both director and secretary, as Edmonds did, the outsider is in a stronger position to argue compliance with s 127(2) and access the sealing assumption in s 129(6).

In *MYT Engineering*, the document itself was held valid under former s 182(7), that enabled a company to authenticate a document or proceeding by the signature of an officer in lieu of the common seal. The ultimate result was that the signature of the officer authenticated the deed of company arrangement on behalf of the company.[137]

There is no current equivalent to s 182(7), which suggests either oversight, or that s 127 renders such a provision redundant. As former s 182 is replaced by a combination of ss 123, 126 and 127, the better view is the redundancy one. The *Corporations Act*, when referring to company contracts, no longer distinguishes between "execute" and "authenticate", as it did in former s 182. The majority judgment of the High Court in *MYT Engineering*,[138] and the judgment of Asprey JA in 195 *Crown Street Pty Ltd v Hoare*[139] indicate that it is unnecessary to distinguish between a company signing a document, executing a document or authenticating a document, as they all mean the same thing: the manifestation of the company's assent. If *MYT Engineering* were to arise after the *Company Law Review Act* 1998 changes and in the absence of the express "authentication" provision in s 182(7), the majority's view still stands. Accepting that the deed did not need to be sealed,[140] a single director's signature, affixed to the seal in two capacities, with the consent of the other director, still authenticates the company's assent. Arguably,

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134 Unlikely, since *Myers v Aquarell Pty Ltd* [2000] VSC 429.

135 (1999) 17 ACLC 861, 864 (Gleeson CJ, Gaudron, Gummow and Hayne JJ) and 875, (Kirby J).

136 Their Honours said, in footnote 4 to their judgment: "The provisions of the Law governing assumptions that may be made by persons dealing with companies have since been amended by the *Company Law Review Act* 1998 (Cth) as applied by the *Corporations (New South Wales) Act 1990* (NSW) s 7. Among other things, changes have been made to reflect the possibility that a company may have only one officer. See ss 128, 129 of the Law. These changes do not affect the present matter."

137 *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1999) 17 ACLC 861, 870. Kirby J dissented on this point.

138 *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1999) 17 ACLC 861, 870.

139 [1969] 1 NSWR 193, 202 (Asprey J): The company's "signature can be affixed by that [natural] person in a variety of ways so long as what is done by him is performed with the intention of authenticating the document so as to be binding on the company under whose authority he is executing the document."

140 This was a point upon which Kirby J dissented.

now given that s 127(4) provides that s 127 "does not limit the ways in which a company may execute a document", it would apply to the same effect. As to whether outsiders are affected by this form of authentication is a question left open by the majority in *MYT Engineering* and depends upon the scope of s 129.

Certainly, in *Myers v Aquarell Pty Ltd*, decided after 1 July 1998, where the company had appointed a sole director (despite the constitution requiring a minimum of two directors), Gillard J held that that person signing in their capacity as both director and secretary complied with the constitution.[141]

Note that this does not apply to a case where a director incorrectly describes himself/herself as a "sole director", where the ASIC records indicate that there are two directors. This type of error is resolved under the next heading.

Curing contested authority

If the company has a constitution comprising articles of association (ss 135 and 1415), then its articles will invariably provide that the seal must be affixed by authority of the board of directors (e.g. former Table A article 84). In most situations, s 129(1) allows the outsider to assume that the meeting was held. But even where reliance on s 129(1) may be precluded, as in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*,[142] this does not affect the availability of the more specific assumptions in s 129(5) and (6). In *Brick & Pipe*, the lender had read the company's constitution and so had actual knowledge of it. It also had actual knowledge that the transaction had been entered into in breach of the constitution.[143] However, actual knowledge of non-compliance with the constitution was held not to affect the lender's capacity to rely on the assumption as to the sealing as they are discrete assumptions.[144]

Similarly, a director acting outside the scope of the company's interests affects their authority to bind the company.[145] However, the company is bound unless the outsider had notice of the fiduciary breach. The assumptions as to due execution do not allow the outsider to escape the effects of voidable contracts, where they have notice of the breach. We discussed voidable contracts under the assumption as to proper performance of duties, s 129(4).

The rule does not allow the assumption that an officer has the actual authority of the company to enter into the transaction. The outsider still needs to know with whom they are dealing, and, in a formal sense, their connection with the company. At best, the rule allows the outsider to assume either customary authority (s 129(2)), or apparent authority (s 129(3)). If the outsider cannot rely on s 129(2), it has the more difficult evidentiary hurdle of proving "apparent" authority. As discussed in chapter 2, this requires a representation from a person who has the actual authority to make it.

A director cannot bind the company,[146] but the managing director might, subject to the wide conferral of actual authority. The appointment of a person to the post of managing

141 [2000] VSC 429, [71].
142 (1992) 10 ACLC 253.
143 Specifically, the financier actually knew that one of the directors, Goldberg, breached article 89, precluding "interested directors" from voting on a resolution, and article 107, as to use of the seal.
144 (1992) 10 ACLC 253, 264–265.
145 See *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1986] 1 Ch 246; *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360 .
146 *Re Haycraft Gold Reduction and Mining Co* [1900] 2 Ch 230, Dawson J in *Northside*.

director is not necessarily available from the public record. In two of the major cases, *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*[147] and *Equiticorp Finance Ltd v Bank of New Zealand*,[148] the court assisted the lenders' bid to enforce a transaction by holding that a person who appeared to be in a position of dominance and control, with the support and acquiescence of the board, had the actual authority to bind the company. As discussed in chapter 2, subsequent cases emphasise that "acquiescence" means that the board knew of the usurper's role, so that lenders in later cases were unsuccessful in proving actual authority.

The *Brick & Pipe* case was the breakthrough success for lenders. The company was part of the "Goldberg Group" of companies, all of which were managed under the close control of Mr Goldberg. He was on public record as being director of the company along with Mrs Goldberg, Mr Furst and several "independent" directors, yet in reality he took effective control. The third party security documents had to be signed under seal and attested to by a director and the secretary only.[149] Goldberg signed as director. Furst signed as secretary, when he did not hold this position. The lender queried Furst's capacity to sign as secretary. Goldberg assured the lender that the appropriate parties had attested the seal.[150] The company later disputed the validity of the execution. The lender relied on Goldberg's statement, treating it as a representation from the company that Furst was secretary.

By virtue of the board acquiescing to his control, it may be argued, as in *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd*,[151] that Goldberg had apparent authority to bind the company. But an agent with merely apparent authority cannot make a representation binding the company as to another person's authority.[152]

Goldberg was considered by all, outsiders and insiders, to be the alter ego of each of the companies in the group. In the affairs of Brick and Pipe, Goldberg acted without first seeking board approval. The board routinely authorised transactions already completed and did not interfere. Due the extent of his control Goldberg was clothed with the actual authority of the company. For the lender, this finding completed the links in the chain: Goldberg had actual authority to hold out Furst as secretary, thus s 164(3)(c) operated so that Furst could be assumed to be secretary, triggering the assumption of due execution.

Brick & Pipe is a good illustration of how the principles of authority work together with the indoor management rule to overcome disputes as to authority. The effect of the decision is not to confer authority on Furst where none existed, but to use the principles of agency and substantive authority to link into the rule's assumption as to formal authority to execute documents.

Warrant Documents Genuine: s 129(7)

The terms of the assumption are that: "A person may assume that an officer or agent of the company who has the authority to issue a document or a certified copy of a document

147 (1992) 10 ACLC 253.
148 (1993) 11 ACLC 952.
149 An unusual requirement of the company's constitution.
150 The facts were a bit more convoluted: the statement was made by the Group's financial controller, in the presence of Goldberg to which Goldberg did not object. The Court therefore treated it as Goldberg's statement.
151 [1964] 2 QB 480.
152 *Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising and Addressing Co Pty Ltd* (1975) 133 CLR 72.

on its behalf also has authority to warrant that the document is genuine or is a true copy" (based on former s 164(3)(d)).

Consistent with the execution assumptions, this paragraph extends to formal authority only so is limited to its procedural effects.

The Scope of the Statutory Rule

The indoor management rule is a rule of procedural convenience only, and it primarily protects outsiders from effects of non-compliance with the constitution, defects in formal authority to authenticate documents and possibly, from improper performance of fiduciary duties by officers.

The rule's genesis has been traced back to cases over one hundred years ago, notably *Royal British Bank v Turquand*,[153] *Ernest v Nicholls*[154] and *Mahoney v East Holyford Mining Co*.[155] Developments in the rule through the twentieth century have been noted, to demonstrate the complications and inconsistencies in the rule's evolution. The rule's operation was affected by three other common law doctrines, classic ultra vires, the effect of forgery and the doctrine of constructive notice of public documents. Some of the inconsistencies identified relate to factors such as:

- whether the cases have adopted a clear or blurred distinction between procedural or substantive limitations that the outsider is seeking to assume;
- the role of the public documents and whether the outsider actually relied on their contents;
- the extent to which delegation and agent's authority is a matter that may be assumed from the company's constitution.

Case law developed exceptions to the rule, based on actual knowledge and due inquiry. This culminated with the High Court's decision in *Northside Developments Pty Ltd v Registrar-General*.[156] This case held that the due inquiry exception required balancing between business convenience and preventing fraud on the company. The judgments also indicate the combination of circumstances that put the outsider on inquiry, such as: the powers of the company (if relevant); the nature of the company's business; a reasonable apprehension that the transaction is entered into for purposes unrelated to the company's business. These factors were discussed in chapter 4 and collated in Table 5.2 in chapter 5.

All four common law doctrines (i.e. the indoor management rule, classic ultra vires, forgery and constructive notice) were modified by statute in 1983. So far as the rule was affected, Parliament's intention was to clarify and codify the existing common law. The introduction of the first statutory version was followed by a decade of uncertainty regarding two main aspects of the rule. The first uncertainty related to the preconditions for relying on the rule, in particular whether the outsider had "dealings" in "proceedings" with the company. The second uncertainty was the scope of the exceptions. Chapter 7 examines the remnants of the forgery rule, and chapter 8 considers the scope of the statutory rule's exceptions.

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153 (1856) 6 E&B 327; 119 ER 886.
154 (1857) 6 HL Cas 401.
155 (1875) LR 7 HL 869.
156 (1990) 8 ACLC 611.

Chapter 7

The Indoor Management Rule and Forgeries

The Common Law

Chapter 3 examined the scope of the common law indoor management rule and its exceptions. A significant limitation on the operation of the rule was where the company alleged forgery in the execution of its contracts. It is unlikely that the scope of the common law indoor management rule was designed to cure forgeries. In the separate judgments of the High Court in *Northside Developments Pty Ltd v Registrar-General*,[1] Mason CJ, Brennan J, Dawson J and Toohey J all discussed in some detail the alleged "forgery" exception to the Rule in *Turquand's* case. Overall, the members of the Court treated forgery as a separate doctrine, not essentially part of the rule itself.

According to the various judgments of the High Court in the *Northside* case, forgery in a limited sense operated to defeat the Rule in *Turquand's* case. Brennan J thought that it did not matter whether a false seal or signatures were used or the seal and signatures were genuine but affixed or signed without authority. In both types of cases, a company will be bound only if it is estopped from denying that the seal or signatures were false or put on the document without authority. Therefore Brennan J did not regard forgery as a separate issue but part of the general principles of estoppel.[2]

Dawson J adopted a similar approach but noted that in the case of a false seal or signatures, the company will usually not have represented that the forger had authority to act. Thus a forgery will usually be a nullity under ordinary agency principles. Where the seal and signatures are genuine, the question arises whether the seal and signatures were affixed by persons held out by the company to have authority to do so. In such a case, the Rule in *Turquand's* case applied. Correspondingly, s 129(1) and (6) would now govern this situation in much the same way because the agency rules of apparent authority have been incorporated into the assumption of valid sealing.

Mason CJ expressed doubt that forgery was a true exception to the rule but thought that in any case it had a limited operation.[3]

Brennan J[4] noted that confusion arises due to the two senses in which "forgery" is used: in the strict sense of a false signature or seal, or in a wider sense, where the seal or signatures are genuine, but where there is no authority to execute.

The common law dilemma demonstrated by the so-called forgery exception is illustrated by cases such as *Ruben v Great Fingall Consolidated*,[5] *South London Greyhound Racecourses Limited v Wake*[6] and *Kreditbank Cassel (GmbH) v Schenkers Ltd*.[7] *Ruben*

1 (1990) 8 ACLC 611.
2 (1990) 8 ACLC 611, 633.
3 (1990) 8 ACLC 611, 617.
4 (1990) 8 ACLC 611, 633.
5 [1906] AC 439.
6 [1931] 1 Ch 496.
7 [1927] 1 KB 826.

involved the fraudulent sealing of a share certificate. The certificate was attested by the secretary. The company was not bound by the document and the secretary had no authority to warrant that the share certificate was genuine. The secretary did not have actual authority, nor had been held out as having authority. It was held that the indoor management rule did not apply to transactions that were not genuine. The forged signature rendered this document "not genuine".

Kreditbank and *Wake*, however, involved genuine signatures that were held to be forgeries insofar as they purported to bind the company. *Kreditbank* involved bills of exchange signed on the company's behalf, as drawer, by a branch manager. The branch manager had no authority to sign. It was held an outsider could not assume that the usual authority of a branch manager in the company's business was to draw bills. The case could have been disposed of on the basis of lack of authority. However, the Court went on to hold that the rule did not apply because the bills were forgeries.

In *South London Greyhound Racecourses Limited v Wake*[8], the seal of the company was affixed by the managing director and secretary with their genuine signatures, but without the authority the board. The document was held to be a forgery.

The inconsistency of the latter type of case with the genuine forgery cases has been criticised elsewhere.[9] The common law effect of forgery, at least in the strict sense, has now been abrogated by s 128(3).

However, the outsider is still at risk from the common law position, that for forgery in the strict sense, the company is not bound, as its consent is a nullity.[10] For forgery in the wider sense, it is not really a matter addressed solely by the indoor management rule: the resolution rests ultimately on agency principles and the extent of the actual or apparent authority of the agent to execute.

The principles relating to the effect of fraud now depend upon whether the *Corporations Act* applies to the transaction. For events occurring before 1 January 1984, the applicable law is the common law; for events occurring on or after 1 January 1984, former *Companies Codes* s 68D applies;[11] after 1 January 1991, s 166 *Corporations Law* applies; and after 1 July 1998, s 128(3) *Corporations Act* applies.

Statutory Intervention

Former s 166

With the statutory reform in 1984 came modification to the common law rule on forgeries. Extending the protection conferred to outsiders, former s 166 provided that the outsider in the case of fraud or forgery could still make the statutory assumptions. Former s 166 provided that the assumptions may be made in relation to dealings with a compa-

8 [1931] 1 Ch 496.

9 I Campbell, 'Contracts with Companies' (1960) 76 *Law Quarterly Review* 115, 130–36; H A J Ford, *Principles of Company Law*, (2nd ed, 1978) 124. At first instance, Young J in *Northside Developments Pty Ltd v Registrar-General* (1987) 5 ACLC, 642, 651 attempted to reconcile them; an explanation of the *Ruben* and *Kreditbank* cases may well be that in those cases the forged instrument was not warranted as genuine by someone with actual authority.

10 According to Brennan J in *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 633, it is difficult to envisage a case where the company has represented that it would be bound by a forgery.

11 It was held that s 68D does not have any retrospective effect (i.e. before 1 January 1984): *Barclays Finance Holdings Ltd v Sturgess* (1985) 3 ACLC 662.

ny even if an officer, agent or employee referred to in the specific assumption acted fraudulently in relation to the dealings or forged a document that appeared to have been sealed on behalf of the company. The outsider lost this entitlement to make the assumptions where that person had actual knowledge that the officer, agent or employee of the company or the person held out as such acted fraudulently or forged a document.

The purpose of s 166 was stated in the Explanatory Memorandum[12] as being to restate the common law rule that a company will not escape liability for the acts of its officers, agents or employees merely because they have acted fraudulently, if the company would otherwise have been made liable by the fraudulent act. It also over-rules the interpretation placed on *Ruben v Great Fingall Consolidated*[13] that a forgery is a nullity and therefore comprises an exception to the Rule in *Turquand's* case. This interpretation of *Ruben's* case was rejected by the High Court in *Northside Developments Pty Ltd v Registrar-General*.[14]

However, there were two points of uncertainty regarding the interpretation and application of former s 166:

- does the fraud or forgery used in the section refer to either or both the strict sense and the wide sense as discussed in Northside?
- Is actual knowledge the only disentitling circumstance to relying on former s 166, or does the second statutory exception apply as well?

Forgery in the strict sense only

Former s 166 does not explain whether a fraudulent act or a forged document includes an unauthorised affixing of the company seal or whether it is restricted to the affixing of a seal or signatures that are not genuine. It probably refers only to a fake seal or signatures because unauthorised affixation of a genuine seal would be covered by the other assumptions as to execution in former s 164(3)(a) and (e) in any case. Kirby P in *Bank of New Zealand v Fiberi Pty Ltd*[15] concluded that there was an overlap between former s 164(3)(a) and (e) and that paragraph (a) could be applicable to cases involving the use of the company seal. His Honour suggested that paragraph (a) did not operate where "the sealing" was carried out with a fake seal. This restriction on the operation of s 164(3)(a) was evident because any reference to "the seal" in a company's articles implicitly referred to a genuine seal.[16] Where a seal that was not genuine was used, the outsider was still protected by former s 164(3)(e). This is made clear by virtue of former s 166.

Comments by Kirby P in *Fiberi* sustain the argument that former s 166 is confined to forgery in the strict sense. His Honour stated, "it would not be surprising that the legislature should make a distinction between the use of a genuine seal [the wide forgery] and of a forged seal [the strict forgery]."[17] If this is the correct interpretation, then s 166 represented a change in the common law by providing more protection to the outsider.

As forgery in the wider sense involves issues of officers' authority, this is still a matter to be left to the general rules of agency, combined with the specific statutory assump-

12 Explanatory Memorandum, *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983*, [216].
13 [1906] AC 439.
14 (1990) 8 ACLC 611, 617 (Mason CJ).
15 (1994) 12 ACLC 48.
16 (1994) 12 ACLC 48, 58.
17 (1994) 12 ACLC 48, 58.

tions, to resolve. This represents a sensible interpretation of the various statutory enactments dealing with the indoor management rule and is consistent with the case law that has substantially been about forgery in the wider sense.

There are two major cases dealing with former s 166 and forgery in the strict sense: *Story v Advance Bank Australia Ltd*[18] and *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*.[19] In *Koorootang*, the bank did not rely on s 166. In *Story*, one director forged the signature of the other director when affixing the company's seal to a mortgage. The New South Wales Court of Appeal confirmed that in this situation, s 166 protected the bank, unless it had actual knowledge of the forgery. However, this only sustained the bank insofar as the forgery in the strict sense was concerned and Gleeson CJ dealt with the second uncertainty with s 166: the relevance of constructive knowledge.

Actual knowledge and ought to know apply to s 166

Gleeson CJ in *Story* made the pertinent point that invariably, the question as to forgery in the wider sense, the lack of authority on the part of the forger, also arises. That is, the second follows the first: if there is a forged signature on the seal, then there will be an absence of authority from the company to enter into the transaction. Despite the wording of s 166 confining the exception to actual knowledge, there is a symbiotic relation between s 166 and the indoor management rule that requires investigation of what the outsider ought to have known as well. This latter issue is dealt with under the principles of agency together with the indoor management rule.

In *Story*, Gleeson CJ did not regard the bank's absence of actual knowledge of the forgery as conclusive of the dispute. The bank also had to rely on the assumption as to due execution (former s 164(3)(e)) to enforce the mortgage. As there were no circumstances requiring inquiry by the bank, then the indoor management rule applied. Significantly, when assessing what the bank ought to have known, Gleeson CJ alluded to the company's apparent interest and benefit in the loan transaction.[20]

In *Koorootang*, Hansen J articulated the "difficult question of construction concerning the relationship between s 166 and s 164 [the indoor management rule assumptions and exceptions].[21] His Honour agreed with Gleeson CJ in *Story* and concluded that actual knowledge is not the only fact that disentitles an outsider to access the indoor management rule assumptions when forgery is involved.

Debate as to the second uncertainty carries over into the reworded statutory protection.

Section 128(3): effect of fraud by officer or agent

Pursuant to the *Company Law Review Act* 1998, the statutory rule as to forgeries has been physically shifted from a separate section following the indoor management rule, to being fully integrated with the provisions that establish the scope of the rule. This observation may be important as it reflects on possible interpretations of the redrafted rule on forgery. The simplified provision now states: "The assumptions may be made even if an officer or agent of the company acts fraudulently, or forges a document, in connection with the dealings."

18 (1993) 11 ACLC 629.
19 [1998] 3 VR 16.
20 (1993) 11 ACLC 626, 639.
21 [1998] 3 VR 16, 124–125.

A major point of distinction with former s 166 was that s 166 included a specific proviso that actual knowledge by the person of the fraud or forgery precluded reliance on the assumptions.

Subsection 128(3) now does not explicitly refer to actual knowledge, but resolves the ambiguity regarding the relation between the forgery assumption, the other statutory assumptions and exceptions.

There are at least two arguments that follow:

1. As there are no specific exclusions mentioned in the section, there is not intended to be any proviso precluding an outsider making the assumptions in the case of forgery or fraud. That is, the outsider may make the assumptions even where they have actual knowledge of the fraud or forgery.[22] This argument represents a significant departure (reversal) from both the former s 166 and the preceding common law principles relating to the effect of fraud and forgery on transactions.
2. This provision is subject to the general exceptions in s 128(4).
   Subsection 128(3) provides that fraud may be disregarded by the outsider in making the assumptions, whereas s 128(4) specifies the circumstances where the assumptions cannot be made, based on whether the outsider knew or suspected the matter to be incorrect. Therefore, the general rule in s 128(3) is subject to the exceptions in s 128(4). Whilst the effect of the exceptions is discussed in chapter 8, the immediate consequence of the restructured provisions is that the rule for fraud is explicitly subject to two exceptions. In *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*,[23] Hansen J stated that the new drafting "makes it abundantly clear" that, even in the case of fraud or forgery, a person dealing with a company is not entitled to make any relevant assumption" when the person knew or suspected that the assumption was incorrect.[24]

Conclusion: Fraud and the Exceptions to the Statutory Rule

There are two comments that we contribute as to the operation of s 128(3). First, the section will only operate in the case of forgery in the strict sense, that is, where a signature or seal is not genuine. Secondly, although chapter 8 examines the precise scope of the s 128(4) exceptions, the assumption as to fraud and the enumerated assumptions in s 129 are closer in alignment as both are subject to the same disentitling circumstances.

22 Although the structure of the reform has changed since the *Second Corporate Law Simplification Bill* 1995, there was early commentary on whether the revised fraud section was subject to any proviso. See P Ryan, 'Impact of the Second Corporate Law Simplification Bill on Financiers' Dealings with Companies' (1997) 13 *Australian Banking Law Bulletin* 19 who opined that "A financier will be entitled to rely on the statutory assumptions even where they had actual knowledge that an officer or agent of a company acted fraudulently or forged a document..."

23 [1998] 3 VR 16.

24 [1998] 3 VR 16, 165. Also in agreement with this view: H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Company Law* (10th ed, 2001) [14.110] thought that the reformed fraud provision will operate differently from former s 166 in that it will be subject to both of the statutory provisos. This was also the view expressed in P Lipton, *The Authority of Agents and Officers to Act for a Company: Legal Principles* (1996) 57.

Chapter 8

The Limitations to the Statutory Assumptions

The History of the Exceptions

Chapter 3 examined the ambit of the common law rule, and chapter 4 identified and discussed in detail the provisos and exceptions that were developed that affected the operation of the common law rule. Those chapters noted that the rule's operation was affected by two sets of principles:

1. Direct exceptions to the rule, so that the assumptions of procedural regularity did not operate where the outsider had knowledge that the assumption was incorrect. Knowledge incorporates a spectrum from actual knowledge to due inquiry. "Actual knowledge" includes subjective knowledge, wilful or reckless blindness,[1] or knowledge that insiders ought to know.[2] "Due inquiry" incorporates the notion of outsiders reasonably acting on existing information.[3]
2. Indirect fetters to the rule, such as the doctrine of constructive notice (its abolition discussed in chapter 5) and the rule against forgeries (discussed in chapter 7).

Similarly, the efficacy of the statutory rule must ultimately be judged according to the exceptions. The statutory exceptions are loosely based on the common law. The operation of the statutory limitations to some extent serves the same purposes as the common law exceptions to the Rule in *Turquand's* case because they prevent a person dealing with a company from assuming that the indoor management of a company is always regular. They play a crucial role in determining the balance of interests between commercial convenience on the one hand and discouraging fraud and unauthorised acts by officers and agents on the other. Of particular importance here is the extent to which the statutory limitations differ from the common law exception to the Rule in *Turquand's* case where the outsider is put upon inquiry.

In relation to this knowledge exception, the legislative formulations, both in 1984 when the first round of statutory reform commenced[4] and more recently in the *Company Law Review Act 1998*, depart from the common law rule of "due inquiry". The main uncertainty is to assess the degree of correlation between the common law notion of due inquiry and the current statutory exception. This part of the chapter argues that whilst the statutory test appears different, it substantially relies on similar factors that gave rise to the due inquiry exception.

Table 8.1 below sets out the two separate stages of statutory reform to the limitations. Accordingly, this chapter adopts a chronological approach to developments.

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1 *Howard v Patent Ivory Manufacturing Co* (1888) 38 Ch D 156.
2 *Morris v Kanssen* [1946] AC 459, 475 (Lord Simmonds).
3 *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611.
4 *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983*, commenced on 1 January 1984. The legislative background was described in chapter 5, see particularly Table 5.3.

Table 8.1 The legislative history of the exceptions to the rule

The exception	**Companies Code 1984**	**Corporations Law 1991**	**Company Law Review Act 1998**	**Comment on CLRA**
"actual knowledge"	S68A(4)(a) S68A(5)(a)	S164(4)(a) S164(5)(a)	S128(4)	Assumption not available if the person "knew" it was incorrect
Other knowledge	S68A(4)(b) S68A(5)(b) "connection or relationship with the company is such that he ought to know that the matter... is not correct"	S164(4)(b) S164(5)(b) "connection or relationship with the company is such that he ought to know that the matter ...is not correct"	S128(4) "knew or suspected that the assumption was incorrect"	The wording of the exception has now changed, and requires discussion whether this changes the previous law.

The boundaries of the exceptions identify the point where protection for the outsider is lost. The immediate differences with the common law are in relation to the second limb of the exception, as it is expressed in different terms than the common law "due inquiry" principle. This leads to broader questions of policy to examine areas of overlap between the common law and statute.

The 1984 Legislation

Significance of the statutory formulation of the knowledge exceptions

As outlined in Table 8.1 above, the first statutory codification of the indoor management rule occurred in 1984, with the insertion of s 68A in the *Companies Codes*. With the commencement of the *Corporations Law* in 1991, s 68A was renumbered s 164. Accordingly, the wording of former s 68A is identical to the wording of former s 164. The latter provision is reproduced in Appendix I.

The assumptions in former ss 68A(3) and 164(3) were not available under ss 68A(4) and 164(4) where either:

1. the outsider had actual knowledge that the matters were incorrect; or
2. the outsider had a connection or relationship with the company, which is, such that the outsider ought to know that the assumption was incorrect.

The Explanatory Memorandum, in introducing s 68A(4), the predecessor of s 164(4), stated that the purpose of these limitations was "to make it clear that the protection afforded by the 'indoor management rule' is only available to 'innocent' parties".[5]

The two limitations contained in former s 164(4) differentiated between situations where the person dealing with the company had no "connection or relationship" with the company and where there was such a connection or relationship. In the latter case, the protective assumptions were lost where the person dealing with the company ought to

5 Explanatory Memorandum, *Companies and Securities Legislation (Miscellaneous Amendments) Act 1983*, [207].

have known of circumstances that would indicate that the assumptions were incorrect.

It is interesting that in the 1998 round of reforms, the legislature abandoned the "connection or relationship" distinction, in favour of a more simply stated "actually knew or suspected" exception (see s 128(4)). Before we can comment on the current provisions, it is worth noting that the interpretation of the former provision in s 164(4) was far from settled.[6]

Commentary on the former provisions is divided as to whether the different wording effected any substantial change from the common law. The commentary presented three views:

1. The "substantial change" view, that the statutory formulation was intended to mean something different from the common law exceptions.[7]
2. The "amalgamated view", that due inquiry as articulated in *Northside Developments Pty Ltd v Registrar-General*[8] applied to former s 164(4)(b).[9] Kirby P in *Bank of New Zealand v Fiberi Pty Ltd*[10] contributed to the "amalgamated" view, that is, that no substantial change had been effected.
3. A "hybrid view", expressed in Lipton,[11] that the second exception as to "connection or relationship" is substantially changed, but that the notion of due inquiry forms part of the first exception in s 164(4)(a).

There is a significant distinction between the first and either the second or third view, as it affects the degree of protection afforded to outsiders. Specifically, the first view reduces the burden of inquiry on outsiders, as it is the "connection or relationship" that triggers inquiry, not the circumstances of the transaction.[12]

The arguments for each of the views are presented below. The essential question, for each view, is to determine the extent to which the statutory provisions mirrored the common law approach to actual knowledge and due inquiry.

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6 See more comprehensively: C Hammond, 'Section 164(4)(b) of the Corporations Law: 'To be Put Upon Inquiry or Not to be Put Upon Inquiry: Is that the Question?' A Problem of Statutory Interpretation' (1998) 16 *Company and Securities Law Journal* 93.

7 P Lipton, 'The Inquiry Exception to the Rule in Turquand's Case: Past or Present?' (1991) 9 *Company and Securities Law Journal* 37, 44, but moderated this view with a different interpretation of the first exception. This view was indirectly supported by those authors who speculated that had *Northside Developments Pty Ltd v Registrar-General* been decided on the statutory provisions, the result may have been different.
See T Cain, 'The Rule in Royal British Bank v Turquand in 1990' (1990) 2 *Bond Law Review* 152 and L Law and D Morrison, (1993) 'Company Law: Recent Developments in the Indoor Management Rule' paper presented at the *Accounting Association of Australia and New Zealand Conference*, Darwin, 1993.
See also R Grantham, 'Contracts with Companies: Rule of Law or Business Rules' (1996) 17 *New Zealand Universities Law Review* 39, for commentary on similar New Zealand provisions.

8 (1990) 8 ACLC 611.

9 M Mourell, 'Northside' (1991) 19 *Australian Business Law Review* 36; B Horrigan, 'Third Party Securities – Theory, Law and Practice' in J Greig and B Horrigan (eds) *Enforcing Securities* (1994) 262 preferred the view that the comments of Mason CJ and Brennan J in *Northside* "would have some ongoing relevance."

10 (1994) 12 ACLC 48.

11 P Lipton, *The Authority of Agents and Officers to Act for a Company: Legal Principles* (1996) 61–62. See also J Stumbles, 'Corporate Benefit and the Guarantee' in G Burton (ed) *Directions in Finance Law* (1989) 204, 216.

12 The Hon Justice Paul de Jersey, 'A Question of Notice' paper presented at QLS *Securities Intensive V Seminar*, Gold Coast, 1991.

13 See the factors set in chapter 4 under 'The Knowledge Exceptions', for example a third party security that appeared to be unrelated to the purposes of the company's business and from which it derived no benefit: *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 622 (Mason CJ); 631 (Brennan J).

The 'substantial change' view of the statutory knowledge exceptions

The common law exception examines the circumstances that put the outsider on inquiry.[13] The former statutory rule required a connection or relationship such that the outsider ought to know that the assumption is incorrect.[14] When the statutory rule was introduced, it provoked debate whether the "connection or relationship" parameter limited the common law exception.

The Explanatory Memorandum[15] did not explain this difference in formulation between the common law and the statute, other than to note:

> "...A person dealing with a company, or with a person who has acquired, or purports to have acquired, title to property from a company, will not be entitled to make assumptions under Bill sub-cl. 164(3) where the person knows or ought to know that the assumption is incorrect."

There were several cases on the statutory provisions that referred to the apparent difference between the common law and statute's second exception, but not conclusively. In *Lyford v Media Portfolio Ltd*,[16] one of the first cases to consider s 164(4)(b), Nicholson J stated that the common law "due inquiry" rule and the statutory "connection or relationship" rule were substantially different.[17] His Honour agreed with Professor Ford[18] who suggested that s 164(4)(b) applied only to a director, secretary, shareholder or employee of the company who is having dealings with the company.

This view was endorsed in the subsequent case of *Bell Resources Holdings Pty Ltd v Commissioner for ACT Revenue Collections*.[19] Although the application of s 164(4)(b) was not an issue requiring determination in that case, Jenkinson J pointed out that the facts of the case illustrated the type of situation to which the "connection or relationship" rule would apply. That case involved a share transfer executed under the respective common seals of the vendor and purchaser companies. Both companies had common officers and the same two people affixed the respective seals at the same time. Jenkinson J held that the "connection or relationship" of each of the two officers and the purchaser with the vendor was such that they ought to have known of the irregular sealing.[20]

In *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*,[21] the Court acknowledged that s 164(4) "does not incorporate the concept of being 'put upon inquiry' and we are obliged to have regard to the assumptions, as defined by the section, which the respondents [the lender] were entitled to make subject to the exceptions in sub-s. 4."

Studdert J (at first instance) in *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* agreed with the comment in *Brick & Pipe* and held that: "the codified rule does not attract consideration of those matters which prior to the codification might have been considered to have put a person dealing with the company upon inquiry."[22]

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14 Section 164 (4)(b).
15 Explanatory Memorandum, *Corporations Bill* 1988, [567].
16 (1989) 7 ACLC 271.
17 (1989) 7 ACLC 271, 281.
18 H A J Ford, *Principles of Company Law* (4th ed, 1986) 102.
19 (1990) 8 ACLC 533.
20 (1990) 8 ACLC 533, 543.
21 (1992) 10 ACLC 253, 262.
22 (1992) 10 ACLC 703, 712. However, this view did not survive the appeal in *Story v Advance Bank Australia Ltd* (1993) 11 ACLC 629, discussed below.

However, the substantial change view does not hold up to subsequent authority. This is explained in the next section.

The amalgamated view of the statutory knowledge exceptions

The comments from *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*[23] supporting the view that the statutory exceptions substantially alter the common law ought not to be taken as highly influential,[24] for two reasons:

1. The Court avoided the application of the second exception by taking a generous approach to the threshold issues of the officers' authority to transact. The case involved contested authority of the officers to affix the seal to a guarantee. By making the robust finding that the director, Goldberg, had the actual authority of managing director, then the other signatory could be assumed under the holding out assumption to be entitled to sign. The Court concentrated on the relation between the sealing assumption and the actual knowledge exception.
2. The second exception was not substantially argued, nor did the Court specifically indicate how the result might have been different under the common law rule, other than to speculate that it may well be that the Rule in *Turquand's* case may not have assisted the lender. Although the Court acknowledged that the facts and circumstances of *Northside* were "markedly analogous" to those here,[25] this comment is too superficial. There are also some marked differences between the facts of *Northside* and *Brick & Pipe* that rule out the due inquiry exception in the latter. In *Brick & Pipe*, the Court correctly asserted the similarities involving a third party security for which there was no corporate benefit. But these two factors, according to Mason CJ in *Northside*, are not the only features of the transaction to alert inquiry. If the effect of *Northside* were this strict, then virtually any third party security would be unenforceable unless the lender made inquiry. The differences in this case, such as the agency principles curing the alleged defect in authority via the acquiescence of the board, provide a stronger case for the lender.

The year 1993 marked a turning point in judicial thinking as the first instance decisions filtered through to appeal courts. *Gleeson CJ in Story v Advance Bank Australia Ltd*[26] commented that, with respect to former s 164(4)(b), "it is unlikely that Parliament intended a radical narrowing of the qualification to the common law rule."[27]

In 1994, the Court of Appeal of New South Wales handed down its decision in *Bank of New Zealand v Fiberi Pty Ltd*.[28] There were two judgments in the case: Kirby P and Priestley JA (with whom Clarke JA agreed).

In the judgment of Kirby P, the language of s 164(4)(b) required clearer wording to oust the common law notion of "due inquiry". By way of justification, His Honour endorsed the policy view of Mason CJ in *Northside* that the indoor management rule rep-

23 (1992) 10 ACLC 253, 262.
24 See also the similar view based on the absence of reasonable explanation by the Court for the inapplicability of the second exception: Hammond (1998), supra n 6, 97.
25 (1992) 10 ACLC 253, 262.
26 (1993) 11 ACLC 629.
27 (1993) 11 ACLC 629, 639.
28 (1994) 12 ACLC 48.

resented a balancing of competing choices as to where the loss for fraud (in the wider sense) should rest. In his opinion, the phrase "connection or relationship" still admitted the common law alternatives of either:

- a person who had a particular relationship with the company and was in a position to know about the company's internal management; or
- the "connection" arising due to the nature of the transaction itself.

Given the features of the transaction entered into between the bank and Fiberi Pty Ltd, and the similarity to *Northside*, the trial judge, Allen J, held that the bank was put on inquiry.[29] Kirby P affirmed this conclusion.

The same outcome was achieved by the decision of Priestley JA, however, his judgment represents a more subtle approach to the amalgamated view. His Honour distinguished at least three possible meanings of the words "ought to know" following the connection or relationship phrase in former s 164(4)(b). A person "ought to know" the assumption was incorrect either:

1. because of facts actually in the person's possession should cause them to realise the true position; or
2. because the person is under some kind of obligation to inform themselves (the nature of the duty was not specified); or
3. because the person is reasonably expected to know the true position of the matter assumed. The test for this reasonable expectation was referred to in terms of the knowledge a reasonably competent and prudent banker in the "factual matrix" presented by this case, would be expected to know, regarding the identity of the officers and agents of the corporate borrower, especially as this information is not difficult to procure. If there is difficulty in obtaining this information from the borrower, then the need for it becomes more obvious.[30]

The third approach was favoured, but from where did Priestley JA derive the duty of the outsider to act reasonably in making the assumptions? No external authority was provided for this point: rather, it arose from the interpretation of the preceding phrase: "connection or relationship". The qualifying effect of those words requires the court to consider the full factual circumstances of the outsider's connection or relationship with the company with regard to the particular matter or transaction.

Significantly, unlike Kirby P, Priestley JA did not claim to be influenced by the existing common law doctrine articulated in *Northside*. His Honour's comments however are consistent with common law doctrine, to the extent that the common law requirement of "good faith" subsumes elements of reasonable conduct (see chapter 4 where we discussed this element of good faith).

The differences between the judgments are that Priestley JA did not completely endorse Kirby P's vision of the amalgamated view. In what has been described as a "slight variation"[31] to "somewhat different,"[32] Priestley JA's comments are more consistent with an approach that interprets the statute with reference to, but not identical with, the common law "due inquiry":

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29 *Bank of New Zealand v Fiberi Pty Ltd* (1992) 10 ACLC 1557, 1571.
30 (1994) 12 ACLC 48, 59.
31 Hammond (1998), supra n 6, 100.
32 *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* [1998] 3 VR 16, 120.

> "The concept introduced by s 68A(4)(b) seems to…be slightly different, although undoubtedly there is some overlapping between the contents of the two concepts."[33]

Priestley JA's view is a more conservative one, and more logically consistent with the wording of the statute. The statute specifically limited due inquiry by interposing the phrase, "connection or relationship", but respects the view in the Explanatory Memorandum that the statutory provisions ensure that only innocent parties may take advantage of the rule. In refusing special leave to appeal to the High Court, Brennan J confirmed Priestley JA's view that a reasonable bank in the position of BNZ would have seen to it as a matter of routine that information confirming the identity of the company's secretary was in the bank's possession.[34] There was no specific discussion of the different interpretations of the statute by Kirby P and Priestley JA.

Kirby P's view of the complete transposition between the common law and statutory law holds attraction as providing certainty: the meaning of due inquiry was fully explored by the High Court in *Northside*. To determine the significance of the difference between the two positions, two questions are relevant:

1. How has the distinction between the two *Fiberi* judgments been applied in subsequent cases? In both *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*[35] and *Pyramid Building Society v Scorpion Hotels Pty Ltd*,[36] the trial judges indicate that the difference between "put on inquiry" and "ought to know" is more apparent than real, suggesting that on the type of cases confronted, there would be no difference in result. In both cases, the court referred to and agreed with both Fiberi judgments, but their application was more aligned with Priestley JA's "reasonable and prudent banker" test, than in applying the various factors from *Northside*. As Table 5.2 in chapter 5 shows, both cases were very similar to *Fiberi*, as all three involved third party securities where corporate benefit was in doubt, but significantly, the lenders did not ascertain from reliable sources the identity of the signatories to the corporate seal. The results of these three cases are sustainable on agency grounds, as the lenders dealt with purported officers who were not appointed and had no authority to bind the company.

   In *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*, Hansen J specifically preferred Priestley JA's interpretation, as it gave higher regard to the wording of the section.[37] This case involved a different factual matrix, in that the bank did a company search, but it made no difference[38] and the bank knew that the assets the subject of the third party securities were trust assets. His Honour held that it was this information, that the bank knew, that lead to the requirement that a reasonable and prudent banker would make further inquiries of the trustee's powers.

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33 (1994) 12 ACLC 48, 60.
34 (1994) 12 ACLC 232, 236.
35 (1996) 14 ACLC 670, 671 (Hedigan J).
36 (1996) 14 ACLC 679, 697 (Nathan J).
37 [1998] 3 VR 16, 121.
38 It made no difference because one of the transactions involved a scrip lien, evidenced by the deposit of share certificates. The bank dealt with Jock Jeffries, who was a director of the company. In the second transaction, the mortgage, the signature of the other person, whom the bank knew to be a director, had been forged.

In *National Australia Bank v Sparrow Green Pty Ltd*, Debelle J (at first instance) held that even if the bank did not have actual knowledge that Green lacked authority to make representations, the bank's connection or relationship with the company was such that it ought to have known.[39] His Honour specifically cited Priestley JA in *Fiberi*, but did not elaborate upon the factual matrix in this case that gave rise to the need to inquire.

2. Does it make any practical difference, from the outsider's point of view, whether the common law is reflected by, or merely interpretative of, s 164(4)(b)? Priestley JA presents us with a lesser degree of due inquiry, so are there circumstances involving a corporate borrower where Priestley JA's view would provide a greater protection threshold than would be the case under due inquiry? The subsequent cases do not provide any examples. In each case, the courts applied Priestley JA's test to find that the lenders had not acted as reasonable and prudent bankers. The difference is that the statute assesses what the particular person acting reasonably would have known (the meaning of s 164(4)(b)); whereas the common law involves the court in asking whether there were features of the particular situation that required further inquiries.[40] In the applications so far, there is no practical difference in approach.

Finally, the overlap between common law and statute in relation to the first limb "actual knowledge" is a matter that is not substantially argued in the amalgamated approach. Debelle J at first instance in *Sparrow Green* said that "The common law rule as to actual knowledge is now to be found in s164(4)…".[41] The significance of the former s 164(4)(a) actual knowledge is more important in the arguments relating to the hybrid view, outlined below.

The hybrid view of the statutory knowledge exceptions

The "hybrid view" of the knowledge exceptions hypothesises that due inquiry is still relevant, but as part of the concept of actual knowledge.

A strict reading of former s 164(4)(a) would indicate that this limitation is significantly narrower than the common law exception that puts outsiders on inquiry. The Full Court of the Supreme Court of Victoria alluded to this interpretation in the *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* case by stating:

> "The expression 'actual knowledge' means, we think what it says. It does not lend itself to definition or elaboration."[42]

However the Court implicitly recognised that such a strict interpretation may afford protection to an outsider in circumstances where this would be inappropriate.

Such circumstances may arise in the fact situation that occurred in the *Northside* case. In applying the common law rules, all members of the High Court held that in the circumstances, the lending bank was put on inquiry and therefore could not rely on the

39 *Perkins v National Australia Bank* (1999) 30 ACSR 256, 264, citing Priestley J in *Fiberi*. The appeal court in *Sparrow Green* did not comment on the effect of former s 164(4)(b).
40 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48, 60 (Priestley JA).
41 *Perkins v National Australia Bank* (1999) 30 ACSR 256, 264. It is assumed His Honour is referring to s 164(4)(a) only by this comment, as he later discusses "connection or relationship" in s 164(4)(b).
42 (1992) 10 ACLC 253, 264.

protection of the Rule in *Turquand's* case because it had not made further inquiry when its suspicions of irregularity should have been aroused. Under the statutory provisions, a strict interpretation of "actual knowledge" in s 164(4)(a) would have resulted in the bank being able to assert the protective assumptions in s 164(3). This is because despite the existence of suspicious circumstances, the bank did not actually know that the company seal had been affixed by persons unauthorised to do so.

To give protection to an outsider in these circumstances may encourage the outsider to refrain from making reasonable inquiries in the fear that such inquiries may lead to the acquisition of knowledge that would result in the loss of the protective assumptions. This would encourage outsiders such as lenders to don blinkers and perhaps unwittingly assist company officers to breach their duties or act without authority to the detriment of the company and its innocent shareholders or creditors. Mason CJ in the *Northside* case commented that to put a lender on inquiry in the circumstances of the case was to strike a fair balance between promoting business convenience and discouraging fraud and dishonesty. It would compel lending institutions to act prudently and thereby enhance the integrity of commercial transactions and morality.[43]

Perhaps in recognition of these policy considerations, the Full Court of the Supreme Court of Victoria in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*[44] retracted from a strict interpretation of "actual knowledge" when it added: "What amounts to 'actual knowledge' is largely dependent on the facts and circumstances in a particular case and the inference they allow".[45]

The court was prepared to impute to the lender the actual knowledge of its solicitor. It was not necessary to establish the actual knowledge of the lender itself. This means that the knowledge of an agent may be imputed as "actual knowledge" of a principal.[46]

This hybrid view derives from an interpretation of former s 164(4)(b) "connection or relationship" that confines it to a species of actual knowledge, that is, knowledge that insiders ought to know. That section provided that the assumptions were not available where the person's connection or relationship with the company is such that the person ought to know that the assumption is not correct.

This limitation appears to adopt something similar to the common law inquiry exception to the Rule in *Turquand's* case in situations where the person dealing with the company has a "connection or relationship" with the company. This limb of former s 164(4) may strengthen the argument that the first limb should be given a narrow reading in the interpretation of "actual knowledge". The doubt raised by the wording of former s 164(4)(b) was that if Parliament intended the inquiry exception to apply generally, it would not have restricted the section to situations where the person dealing with the company had a connection or relationship with it.

The purpose behind the second limb of former s 164(4) appears to be the adoption of the common law principle that directors and other "insiders" of a company generally cannot gain the protection of the Rule in *Turquand's* case.[47] This exception was restricted so

43 (1990) 8 ACLC 611, 622.
44 (1992) 10 ACLC 253.
45 (1992) 10 ACLC 253, 264.
46 (1992) 10 ACLC 253, 264, 264–5.
47 *Morris v Kanssen* [1946] AC 549.

as not to operate against a director who did not act as such in the particular transaction.[48] Section 164(4)(b) does not refer to this distinction. Its terms are satisfied if there is a connection or relationship with the company, irrespective of whether the person acted for the company in the particular transaction.

On this interpretation it would appear that former s 164(4)(b) had a narrow application so that it only applied to a non-arm's length connection or relationship where the person dealing with the company was an "insider". The Explanatory Memorandum to the 1983 amendments stated the purpose of the provisions as being to protect persons who are "innocent" and act in good faith. The existence of a connection or relationship which resulted in a non-arm's length dealing would strike at the innocence and good faith of the person dealing with the company.

As mentioned under the substantial change view, this narrow interpretation of "connection or relationship" has authority, notably in *Lyford v Media Portfolio Ltd*.[49] Media borrowed money from Broadlands and secured the loan by conferring a charge that was executed under the common seal of Media. The common seal was affixed and signed by a director who acted without authority. The articles of Media provided that the common seal could only be affixed with the authority of a resolution of the board. Such a resolution was not passed. Broadlands sought to enforce the charge and relied on the assumption of due sealing under former s 164(3)(e). Media argued that Broadlands was prevented from relying on this assumption because Broadlands and one of its directors had a relationship with the director of Media such that Broadlands ought to have known that the director of Media was acting without authority. This argument asserted that former s 164(4)(b) prevented Broadlands from making the assumption. Nicholson J rejected this argument and gave former s 164(4)(b) a narrow operation. He held that it referred to knowledge that a person ought to have by reason of a connection or relationship with the company and not to knowledge that the person ought to have because of the circumstances of the transaction itself.

Obviously, a person who is a director or secretary would have a connection or relationship with the company such that the person would be deemed to have knowledge of irregularities in the company's internal affairs. To allow an officer of the company the protection of the statutory indoor management rule would be "to encourage ignorance and condone dereliction of duty."[50] Such encouragement may arise where a director gained protection so as to enforce a transaction that was not beneficial to the company and also where directors are unaware of the articles of their company and whether the internal proceedings are properly carried out.

A non-arm's length relationship may also occur where the person dealing with the company is an employee or solicitor of the company or perhaps a major shareholder. A person may also be regarded as having a connection or relationship with a company for the purposes of the narrow view of s 164(4)(b) where that person is involved in the operation of a group of companies of which the company with which he or she is dealing is a member.[51]

48 *Hely-Hutchinson v Brayhead Ltd* [1968] 1 QB 549.
49 (1989) 7 ACLC 271.
50 *Morris v Kanssen* [1946] AC 459, 476.
51 *Bell Resources Holdings Pty Ltd v Commissioner for ACT Revenue Collections* (1990) 8 ACLC 533, 543 (Jenkinson J).

According to *Lyford v Media Portfolio Ltd*, in order for the limitation contained in s 164(4)(b) to apply, it is necessary to refer to all the circumstances which show the nature of the connection or relationship. It may then be assessed whether that connection or relationship was such that the person ought to have known that the assumption was incorrect. Nicholson J did not extend "connection or relationship" to include an arm's length business relationship with past dealings. On the contrary, he considered that the past dealings indicated that the director of the chargor had the authority of the company to affix the common seal. This was because the lender knew the director was in day-to-day control of the management and finances of the company, the company's office was the director's office and earlier borrowings in the name of the company had been concluded by the director.[52]

The narrow interpretation outlined above has the effect of giving an outsider greater scope under the statutory rules to enforce a contract despite refusing to make inquiries about an apparent irregularity, than was the position previously at common law. This is because the inquiry exception as applied in the *Northside* case only operates where the person dealing with the company has a legal or non-arm's length connection or relationship with company.

Resolution of the former provisions

As a result of the decision in *Bank of New Zealand v Fiberi Pty Ltd*,[53] the amalgamated view was the preferred interpretation of former s 164(4) at the time the *Company Law Review Act 1998* was passed. However, this view was not entirely consistent with the wording of the legislation. Although the approaches of both Priestley JA and Kirby P in *Fiberi* caused a sensible result in accordance with the purpose of the legislation, this required a departure from a plain reading of the legislation. In particular, they did not address the ambit of former s 164(4)(a). The outsider was expressly required to make inquiry only where a connection or relationship with the company existed. According to the reasoning of the court in the *Fiberi* case, a connection or relationship would generally arise where the circumstances of a transaction ought to lead to inquiries. In a circular way, this then triggered the "ought to know" exception in former s 164(4)(b).

For this reason, we have continued to canvass the hybrid view, as a possible reconciliation of former s 164(4)(a) and (b), as this exercise continues to make a contribution.

It remains relevant to note this deficiency in the drafting of former s 164(4)(a). The Explanatory Memorandum to the 1983 amendments indicated that the predecessor of s 164 was aimed at protecting outsiders who acted "in good faith" or were "innocent". In this regard the statutory provisions were intended to adopt the policy behind the common law Rule in *Turquand's* case and its exceptions. Gummow J in *Australian Capital Television Pty Ltd v Minister for Transport and Communications*[54] thought that the predecessor of s 164 was not so much a "comprehensive code" as a provision designed to repair the failings of the common law. It is difficult to argue that the inquiry exception to

52 Recall that the view of Nicholson J that the statutory provisions did not include the common law inquiry exception was supported by Studdert J in *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* (1992) 10 ACLC 703 and the Full Court of the Supreme Court of Victoria in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992) 10 ACLC 253, 262.

53 (1994) 12 ACLC 48.

54 (1989) 7 ACLC 525, 535.

the Rule in *Turquand's* case is such a failure. The High Court in the *Northside* case strongly indicated that the common law inquiry exception was crucial in achieving the purposes of the rule.

Kirby P in *Bank of New Zealand v Fiberi Pty Ltd*[55] saw the interaction of the common law and statutory rules in these terms.

> "While effect should certainly be given to [former s 164] according to its terms, those terms do not appear in a legal, social and economic vacuum...[former s 164] is not to be seen as a provision which overrides well established principles and policies of the common law (as recently expressed in Northside) unless that result is made plain by the language of the section."

The strict wording of former s 164(4)(a), which revolves around the term "actual knowledge", did not adequately incorporate the policy behind the common law principles and as stated in the Explanatory Memorandum. This resulted in the courts showing some willingness to adopt a liberal interpretation of this term in order to arrive at a result which accords with the common law. It was through this route that we retain the inquiry exception to the Rule in *Turquand's* case or something similar to it, despite its apparent removal from former s 164(4).

This interpretation is to be preferred because the policy considerations referred to in the *Northside* case and the Explanatory Memorandum are largely concerned with the probity of the person dealing with the company. In effecting a balance of interests between a company and the outsider it is surely relevant to consider the "good faith" or "innocence" of the outsider. This matter is not directly referred to by the former provision, which only speaks of the state of actual knowledge possessed by the outsider. This state of actual knowledge on the strict, literal view is not affected by considerations such as whether the outsider has wilfully donned blinkers, has recklessly failed to make inquiries when the circumstances strongly point to the need to make them, whether an honest and reasonable person would have had actual knowledge of the facts given the surrounding circumstances and whether a reasonable and honest person would have been put on inquiry as a result of knowledge of the circumstances.

In considering whether an outsider should have the protection contained in the former s 164(3) assumptions, the good faith and probity of the outsider must be relevant so as to allow a consideration of these factors. This could have been achieved in the former provisions extending the operation of s 164(4)(a) to include a situation where the outsider ought to know that a protective assumption is not correct. The limitation would then be attracted where the outsider is put on inquiry but fails to do so in circumstances such as arose in the *Northside* case.

The implementation of this proposal also clarifies the operation of the former s 164(4)(a) limitation in accordance with the policy of the section and obviate the need for judicial ingenuity by giving a strained interpretation to the words "actual knowledge". Otherwise, it remains uncertain as to when inferences arise which would enable a court to deem an outsider as possessing actual knowledge when this cannot be strictly shown.

This extension of the limitation in former s 164(4)(a) to incorporate the inquiry exception would be consistent with equitable principles in relation to constructive trusts. A company may recover compensation from a third party who has assisted the compa-

55 (1994) 12 ACLC 48, 51.

ny's officers in a dishonest transaction with knowledge of their breach of duty.[56] The meaning of "knowledge" in these constructive trust cases has been broadly interpreted so as to include knowledge that would have been gained by a reasonable person put on inquiry due to the circumstances (discussed in chapter 4). The law of constructive trusts applies to directors who act in breach of duty as well as trustees. Therefore under equitable principles, a company may seek a remedy for the recovery of property from a third party who made a "calculated abstention from inquiry."[57]

If the equitable rules give a company greater scope to bring an action against an outsider to seek remedies to avoid the contract or recover property, a plaintiff company would be well-advised to rely, if possible, on the equitable rules which give a broad meaning to "knowledge". However this would require the company to firstly establish a breach of fiduciary duty by an officer. Former s 164 does not require this.

The extent to which "actual knowledge" may be inferred also causes significant uncertainty. For example it is difficult to determine whether actual knowledge exists in circumstances where the outsider is aware of various facts but may not have understood that these have a combined significance which if understood would have resulted in the acquisition of further actual knowledge. The circumstances where knowledge will be deemed under equitable principles of constructive trusts are quite clearly defined. These principles have evolved over a long period and it is difficult to determine the extent to which they may be incorporated into former s 164(4)(a).

The *Company Law Review Act 1998* redrafted the provisions, so it is necessary to examine whether the new version of the rule overcomes these difficulties.

Recent Legislation: s 128(4)

This brief review of the statutory history of the indoor management rule is relevant as similar questions arise since the introduction of the *Company Law Review Act 1998*. That Act purports to contribute legislative change, prompting the question whether substantive change has been effected in the scope of the second exception. This is examined under the next heading.

The Explanatory Memorandum to the *Company Law Review Act 1998* states that:

> "A person will not be entitled to make an assumption if they knew or suspected that the assumption was incorrect (Bill s 128(4)). This objective test is stricter than the [former] law and makes it clear that the common law 'put on inquiry test' has no application to the statutory provisions: see Bank of New Zealand v Fiberi Pty Ltd (1994) 12 ACLC 48, 14 ACSR 736."[58]

These assertions warrant analysis. There are two apparent differences between the wording of former s 164(4) and (5) and s 128(4):

1. there is a specific temporal connection introduced by the phrase "at the time of"; and

56 *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373; *Baden Devaux and Lecuit v Societe Generale* [1983] BCLC 325; *Ninety Five Pty Ltd v Banque National de Paris* [1988] WAR 132.

57 *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 408 (Stephen J).

58 Explanatory Memorandum, *Company Law Review Bill* 1998, [8.7].

2. The formulation of the knowledge required to preclude reliance has been changed from "a *connection or relationship* with the company that is such that the outsider ought to know that the assumption was incorrect" to "knew or suspected".

Significance of "at the time of ..."

The insertion of the phrase "at the time of" adds no particular significance to the previous section. In *National Australia Bank v Sparrow Green Pty Ltd*, Debelle J (at first instance) confirmed that under former s 164, the relevant time to determine the outsider's knowledge is at the time when it entered into the transaction.[59]

Significance of "knew or suspected ..."

It is challenging to find a suitable interpretation of either "knew" (i.e. actual knowledge) or "suspicion" that renders either exception an objective test as asserted in the Explanatory Memorandum.[60]

Whilst attempting to avoid constructing an overly pedantic analysis of the meaning of s 128(4), the Explanatory Memorandum gives rise to three points of uncertainty:

1. Elsewhere in the *Corporations Act* where the test "to suspect" appears, it is also accompanied by the express qualification of reasonableness (discussed below). It is the use of "suspect" and "reasonable" together that renders the suspicion an objective test. Section 128(4) does not expressly use the word "reasonable". It is difficult to sustain the assertion in the Explanatory Memorandum that the test for the exception is objective, unless the courts imply into s 128(4) the requirement of "reasonableness".

   Alternatively, Ford, Austin and Ramsay[61] argue that the test of suspicion is itself subjective, but as the proof of the suspicion must be by inference, "consideration of the behaviour of a hypothetical reasonable person can be part of the process of proof." It is in this sense that the test is objective. If the legislative intention effectively was to make the test objective, they argue that the wording "ought to know" should have been retained.
2. To express the legislative intention in terms of the new law being "more strict" than the former law is ambiguous: from which party's perspective does the "strictness" operate? Is it "stricter" on the circumstances precluding reliance so the exceptions are less frequent, or is it "stricter" on the outsider? The provision is an exception that denies to the outsider the benefit of a particular protection. The language of the Explanatory Memorandum approaches the expression in a double negative. However, "on balance, it seems that the Parliamentary intention

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59 *Perkins v NAB* (1999) 30 ACSR 256, 264.

60 Existing commentary is divided. For example, D Loxton, 'One Step Forward, One Step Back: The Effect of Corporate Law Reform on Procedures in Dealing with Companies Borrowing or Giving Guarantees' (1999) 10 *Journal of Banking and Finance Law and Practice* 24, 32, states that it is clear that suspicion means "actual suspicion", not constructive knowledge, although in practice there would be some latitude for the courts to draw inferences from a "deliberate shutting of eyes" to the obvious. B Horrigan, 'Busting Guarantees!' [1998] 7 *National Law Review* [53], is more flexible in his view of the change: "Taking a wider view, it is likely that the jurisprudence on the old common law 'put on inquiry' exception and the old statutory exceptions is likely to inform the new jurisprudence on new section 128(4), at least to some degree."

61 H A J Ford, R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (2001, 10th ed) [13.300].

was to create a provision which is more favourable to third parties than that which existed previously."[62]

3. The debate as to the ambit of former s 164(4)(b) was not concluded, so an intention to depart from the previous law is ambiguous. As discussed above, the meaning of s 164(4)(b) equivocates between either of the two views expressed in *Fiberi*: Kirby P's, that it equates with the common law "put on inquiry" and Priestley JA's that "ought to know" means an examination of the conduct of a reasonable and prudent outsider faced with the particular factual matrix. As the Explanatory Memorandum excludes "put on inquiry" *and* refers to *Fiberi*, but not to any specific judgment or passage, this could be interpreted as implicit support for the view of Priestley JA over Kirby P's "put on inquiry". This interpretation is supported by the fact that the Priestley JA view was concurred with by Clark JA.

Examining the wording of the provision, a new element is potentially introduced by using the word "suspect". The test "to suspect" is used elsewhere in the *Corporations Act* (e.g. s 588G), and in other areas of law (e.g. bankruptcy), and has existing principle upon which to base its application.

The classic definition of "suspect" as applied in Australia appears in the judgment of Kitto J in *Queensland Bacon Pty Ltd v Rees*:[63]

> "A suspicion that something exists is more than mere idle wondering whether it exists or not; it is a feeling of actual apprehension or mistrust ... Consequently, a reason to suspect that a fact exists is more than a reason to consider or look into the possibility of its existence."

As a definition of the degree of awareness that does not amount to "suspicion", Kitto J's test has proved useful in corporate law applications. Degrees of awareness that have been distinguished from suspicion are:

- more than a mere idle wondering;[64]
- association of action with risk;[65]
- mere passing suspicion;[66]
- compelling inference;[67]
- awareness of a reasonable and prudent person in the position of the outsider;[68]
- expectation or prediction;[69]

62 C Hammond, 'Put Upon Inquiry Has Been Put to Rest Under Section 128(4) of the Corporations Law, But Have Third Parties Dealing With Companies Been Placed in a Stronger Position? – A Question of Statutory Interpretation' (1998) 16 *Company and Securities Law Journal* 562, 563.

63 (1966) 115 CLR 266, 303.

64 *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266.

65 *Spedley Securities Ltd v Southern Sea Farms Ltd* (1991) 9 ACLC 1367. Young J held that even where a person makes a decision, aware that it is associated with risk, this is not a sufficient connection with the concept of suspicion.

66 H A J Ford (1986, 4th ed), supra n 18, 101 distinguished a "mere passing suspicion" from the basis for compelling inference, formed for example when the outsider has knowledge of some facts from which a reasonable person could infer that the assumption was incorrect.

67 Ibid.

68 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48, 59 (Priestley JA). There is negligible difference between this formulation and the one above.

69 To "suspect" as opposed to "expect" has been acknowledged in the insolvent trading cases to incorporate different degrees of awareness: *3M Australia Pty Ltd v Kemish* (1986) 4 ACLC 185, 192 (Foster J). See also *Metropolitan Fire Systems Pty Ltd v Miller* (1997) 23 ACSR 699, 711 (Einfeld J): "From the cases in which the meaning of these words has been considered, it would appear that to 'suspect' something requires a lower threshold of knowledge or awareness than to 'expect' it: see a discussion on 'to suspect' by Kitto J in *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266, at 303; and *3M Australia* at 192."

- "put on inquiry",[70] in the context as described in *Northside* and Kirby P in *Fiberi*;
- actual knowledge.

Suggested meanings for "suspicion" include:

- "a positive feeling of apprehension or mistrust, amounting to a slight opinion but without sufficient evidence";[71]
- "a degree of satisfaction, not necessarily amounting to belief, but at least extending beyond speculation as to whether an event has occurred or not";[72]
- "not necessarily a belief that something is occurring, but something more than merely considering the possibility, that is, a positive feeling that it may be occurring."[73]

These descriptions of awareness are presented as a continuum in Figure 8.2, with the levels of awareness flagged, to indicate, in the middle range, the boundaries where "suspicion" is triggered. This is not intended as an exercise in precision but to create a context for "suspicion" to operate.

The participatory liability cases discussed in chapter 6 provide another source of definition of degrees of knowledge. In the *Baden* case,[74] Peter Gibson J defined knowledge according to a five-point scale, from subjective (actual) to constructive. These categories of knowledge are illustrated in Figure 8.1, then merged into Figure 8.2.

70 Ford Austin and Ramsay, supra n 61, (10th ed, 2001) [13.300]: "While every case of suspicion in the *Queensland Bacon* sense would be a case of being put on enquiry, not every case of being put on enquiry amounts to a suspicion."

71 *Queensland Bacon Pty Ltd v Rees* (1966) 115 CLR 266, 303.

72 *CAC v Guardian Investments Pty Ltd* [1984] VR 1019, 1025 (Ormiston J).

73 Loxton, supra n 60, 31. This definition was formulated by amalgamating the case law and dictionary definitions of "suspect".

74 *Baden, Delvaux and Lecuit v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA* [1983] BCLC 325.

Figure 8.1 Degrees of knowledge: Baden

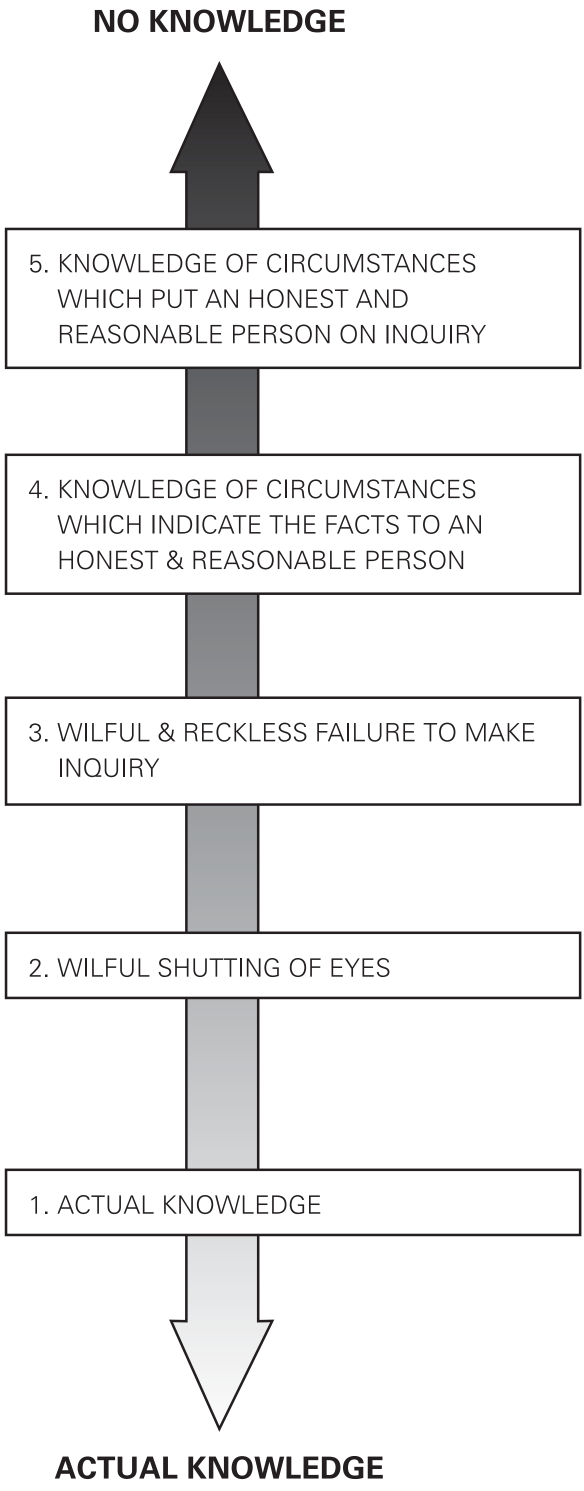
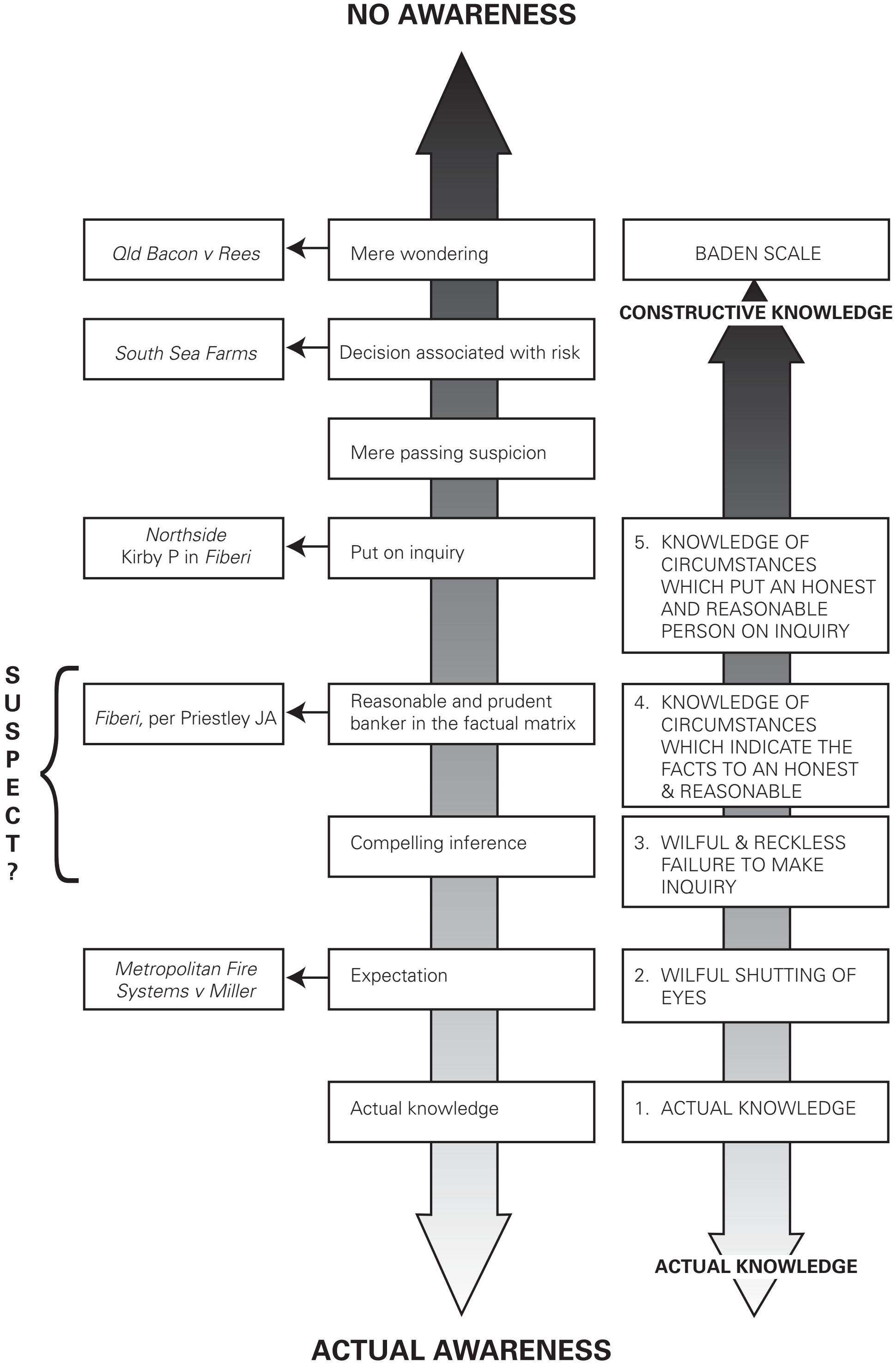


Figure 8.2 Degrees of awareness to pinpoint "suspicion"



Dismissing due inquiry or subjective suspicion

To suspect, in its subjective sense, lies in the middle of the continuum represented in Figure 8.2. Mere suspicion is not enough, but the next three levels down from mere suspicion represent the point where more objective considerations, other than the outsider's beliefs, are triggered. Taking into account the wording of the Explanatory Memorandum, with its reference to objectivity, strictness, *Fiberi* and its express denial of due inquiry, it would be legitimate for Australian courts to interpret "suspicion" in the range from "reasonable and prudent" outsider to "compelling inference" as indicated in Figure 8.2. In reaching this conclusion, the prior work of Bland is acknowledged, who has argued compellingly that the *Baden* scale should be reordered.[75] The fourth category of knowledge more logically belongs second on the scale after actual knowledge.

One extreme of this range confirms that suspicion is wholly subjective, albeit dependent upon reasonable inference of the outsider's state of mind.[76] Such an interpretation of "suspect" may accord with the judicial definitions outlined earlier, but it does not suit the context in which it is used. An overly subjective interpretation of s 128(4) would mean that the provision:

> "effectively reduces a person's incentive to make inquiries when dealing with a company as their inquiry may lead to the person forming a 'suspicion' that a fact which they would otherwise be able to rely on by virtue of the statutory assumption may not be correct."[77]

The statutory rule would not be intended to reward lazy or wilfully bind outsiders. This is consistent with the content of the more specific assumptions in s 129. For example, s 129(2) allows the outsider to assume that a person named in public documents as officer has been properly appointed. Whilst the outsider does not have to prove actual reliance on the public record, failure to search has, in past decisions, lead to an unacceptable risk of being unable to rely on the assumption. Whilst the assumption provides incentive to search the public record, the exception cannot effectively cancel out that incentive.

At the other extreme, s 128(4) could just mean the same as Priestley JA's interpretation of former s 164(4)(b). The latter argument has more theoretical appeal in the sense that it is consistent with the derivation and development of the rule, (i.e. that it is available to "innocent" outsiders). This is consistent with the Explanatory Memorandum and also consistent with the wider commercial themes discussed in chapter 3, in emphasising the role of the outsider's conduct in the transaction and Mason CJ's[78] notion of balancing commercial convenience with morality.

The new provision has stimulated debate about whether any real change will be reflected in judicial attitudes to the indoor management rule. The available commentary on the new provision is similarly confident that the provision is flexible enough to admit the existing jurisprudence.[79] Accordingly, the existing case law such as the due inquiry

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75 M Bland, *Knowledge, Constructive Notice and Unconscionable Conduct* LLM thesis presented to Queensland University of Technology Faculty of Law, 1995.

76 Supported by Loxton, supra n 60, 32.

77 I Ramsay, *The New Corporations Law* (1998) 35.

78 As expressed in *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 621–622.

79 Hammond (1998), supra n 62, 564: "it is not inconceivable that a court, when faced with a transaction lacking corporate benefit, could find that a reasonable person in the position of the lender would have a real apprehension of fear that the assumption ... was not correct." See also Horrigan (1998), supra n 60, 17: "this term is sufficiently open-ended to allow judges some flexibility to disentitle financiers and other outsiders dealing with companies from relying upon the assumptions in the right matrix of circumstances." Contrast, Loxton, supra n 60, 32.

exception is likely to remain relevant to s 128(4). The significance of earlier cases is discussed below.

The likelihood of the reasonable and prudent banker test

Although the scope of the second limb of the exception, "to suspect" in s 128(4) is not precise, a starting point is to examine a common scenario. It has been argued above that to suspect is not the same as the common law "put on inquiry", nor, at the other extreme, is it the same as a wholly subjective belief. The more compelling view is that Priestley JA's test – the suspicion that a reasonable and prudent banker, placed in the factual matrix of the case, would need to find out more – satisfies the competing interests of outsiders in enforcing the transaction and protecting stakeholders from abuse of power.

Both in the common law and statutory cases to date, the courts demand some level of accountability in transactions. Using the theme "commercial morality" discussed in chapter 3, the case law imposes on outsiders certain obligations to act in a manner that is not completely oblivious to the issues that dealing with corporate borrowers/mortgagors create. It is not enough just to bring the transaction under the umbrella of s 129 assumptions. The outsider must also conduct the transaction in a manner that does not trigger the exceptions. The emphasis here is on the positive obligation to monitor conduct; access to s 129 cannot be regarded as an automatic right.

The remaining questions are:

- What is the "factual matrix" that triggers Priestley JA's test and how is Priestley JA's test different to the common law "put on inquiry" formulation?
- Consequently, what errors are indicated from past cases that may help formulate guidelines for conduct under the current provisions?

1. The factual matrix

Taken directly from Mason CJ's judgment in *Northside*, the first four factors below are enough to trigger "due inquiry":

1. the existence of a third party security;
2. no indication that the loan transaction is related to the company's business;
3. no indication that the company derives any benefit from the loan transaction (described by Mason CJ as "decisive"); and
4. the outsider makes no searches or enquiries about the company.

Additional matters, to satisfy Priestley JA's factual matrix triggering the reasonable and prudent banker test, are evident from the cases such as *Fiberi*, *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*,[80] *Pyramid Building Society v Scorpion Hotels Pty Ltd*[81] and *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*.[82] The features comprising this factual matrix have been compiled relying on the matters discussed in Table 5.1 in chapter 5.

5. The company is not a trading entity, but merely owns assets. This was apparent from *Fiberi*, as well as *Northside*.
6. The outsider has had no previous dealings or relations with the company. It is not enough that the lender has had previous dealings with the individuals who

80 [1998] 3 VR 133.
81 (1996) 14 ACLC 679.
82 [1998] 3 VR 16.

purport to act for the company, as those previous dealings with the individuals do not create enough of a connection, or representation of a connection, with the company.

7. The general circumstances giving rise to the requirement of the financing transaction, such as the desperation of the borrower, the urgency with which the transaction is conducted, or the quantum of the loan.
8. The person deriving the benefit from the transaction is the director proffering the company's assets as security for loans for the director's personal or external interests. This is the next step in awareness for the lender taking out a third party security. Due to past dealings with the director in other capacities, the lender has actual knowledge that the common director is the link between the borrower and the security provider. This actual knowledge was emphasised in *Koorootang*.
9. The assets secured are trust assets.
10. The assets secured are of a non-commercial nature such as a family home not normally associated with corporate security transactions.
11. The outsider believes they are dealing with a corporate group, but does not independently confirm the relationship between the entities.
12. The outsider believes they are dealing with a "managing director", but does not independently confirm their authority. Similarly, the outsider may deal with several officers, mistakenly believing it is dealing with the board, but never authenticates that belief. In *Sixty-Fourth Throne*, the bank dealt with both Mr and Mrs Kandy, who were directors of other companies in past dealings, but did not authenticate their authority to deal for the corporate security provider.
13. The outsider has sought further information, but relied on a non-authoritative source for confirmation. For example, in *Sparrow Green*, the company's accountant contributed to the bank's belief that the second director had resigned. In *Sixty-Fourth Throne*, the bank relied on assertions from a solicitor, but it was the borrower's solicitor, not the company's solicitor.
14. The outsider chooses to disregard the public record. In *Sparrow Green*, the bank chose to believe the assertions of one director that the other director had resigned, even though the public record did not show that resignation. In *Sixty-Fourth Throne*, the bank's solicitors obtained a company search that accurately reflected the appointment of officers, but did not correlate that information with the sealed document.
15. The outsider has requested further information, but then does not insist on following through. This can be specific, such as in *Sparrow Green*, where the bank required a copy of the director's resignation, but settled the transaction without it; or it can relate to evidence of departure from the bank's usual practice. In *Koorootang*, the bank settled the transaction despite its officers not complying with the bank's usual procedure requiring legal confirmation that the trust's assets could be provided as enforceable security for the borrower.

16. The ease with which the outsider can access information about the corporate security provider. This factor highlights the difficult line-drawing exercise for the outsider. Priestley JA in *Fiberi* held that for the bank to obtain information verifying Doyle's assertions as to the identity of Fiberi's officers should have been a matter of no difficulty, and if it was, then the need for obtaining the information becomes more obvious.[83]
17. The existence of an independent duty between outsider and borrower creates an insider relationship and may preclude the indoor management rule. Although the circumstances in which it may arise in the case of a lender and corporate borrower may be unusual, Rolfe J in *Beach Petroleum*[84] held that a person dealing with a company is not entitled to rely on the assumptions if they have an independent duty to the company, for example, a fiduciary relationship. The rule cannot allow the person dealing with the company to avoid this duty.

This list is not exhaustive. For example, although Table 5.2 in chapter 5 mentions the role of shareholder ratification, it was not directly relevant in any of the cases, but is still relevant to the overall question of outsider protection. Nor does this list suggest that all factors need to be part of the outsider's awareness in every case. There is a point of accumulation. The courts that mention the "factual matrix" are not specific as to its global content or the point of accumulation. The extent to which the factual matrix can generate guidelines for outsider's conduct is discussed in the recommendations in Chapter 10.

Given this matrix, *Northside*, a case on due inquiry, shares similar features to *Fiberi*, *Sixty-Fourth Throne*, and *Scorpion*, prompting comparison with the common law due inquiry test and Priestley JA's interpretation of "ought to know". The two tests are different, although Hansen J in *Koorootang* acknowledged that: "It is difficult to imagine, but there may be, cases in which the difference between these two views could be decisive...".[85] If the latter is still relevant to s 128(4), then the Explanatory Memorandum requires a distinction. Several points are relevant to the distinction:

1. *Northside* was based on the Rule in *Turquand's* case, which is not specific as to the types of assumptions that may be made. The application of the exceptions to the case was a substantive pre-condition to the issue whether the rule applied and whether it was a procedural matter that Barclays was seeking to assume.
2. Under the statutory cases, the outsider first has to satisfy the court that the assumption applies before the company has argued the exceptions. In four of the five "ought to know" cases involving the corporate seal (*Fiberi*, *Sixty-Fourth Throne*, *Scorpion*, *Sparrow Green*), the lender could not access the assumption as to due sealing, but the courts still considered how the exception would have defeated the lenders in any event. *Koorootang* was decided the other way around, that is, instead of nominating the assumption that the bank was entitled to rely on, Hansen J dismissed the issue by deciding that the exception applied in any event.

83 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48, 59.
84 *Beach Petroleum NL v Abbott Tout Russell Kennedy* (1999) 33 ACSR 1. This case involved the availability of the statutory assumptions to the company's solicitor and is not directly on point in discussing a lender's duties.
85 [1998] 3 VR 16, 119.

3. The courts in the statutory cases have provided more detail to justify the factors that resolved the "ought to know" issue than is evident from *Northside*. Although the cases have been declared as similar, the later cases emphasise factors other than the "third party security without corporate benefit" factor. *Northside* suggests that "due inquiry" is triggered by the first four elements in the matrix, listed above. To the extent that Table 5.2 represents that other features were relevant in that case, these other features were not all emphasised in the case.
4. The indoor management rule cases involving a disputed sealing, whether based on "due inquiry" or "ought to know", would still be decided the same under the 1998 version of the rule. All cases involved issues of agents' and officers' authority, the defects in which are not cured by the indoor management rule. *Koorootang* is an exception to the extent that it involved two different transactions: a scrip lien and a subsequent mortgage. The scrip lien was just an issue of agency, as the bank accepted the deposit of share certificates in Koorootang's name under cover of a letter signed by one director, Jock Jeffries, without any corroboration that he had the authority of the company to enter into the transaction. The mortgage was sealed with the forged signature of the other director, so the case would turn on whether the bank actually knew or suspected the forgery. Given the added factual complication that the bank had actual knowledge that the assets charged under the third party security were trust assets, the issue is whether the trust asset point is a strong enough point of distinction with *Story* to trigger the suspicion. The indoor management rule does not allow the bank to assume that a corporate trustee has complied with its trust deed in granting the security, so dealing with a trust provided the bank with additional responsibilities of inquiry.
5. The distinction between categories of knowledge is still relevant under trust law, particularly the circumstances of the lender's knowledge that may lead to constructive trust liability. The rule does not preclude the imposition of the constructive trust remedy. This was discussed in chapter 5. A constructive trust was argued successfully in *Koorootang* and unsuccessfully in *Equiticorp* and the *Sixty-Fourth Throne* appeal.

The statutory "ought to know" exception was successfully avoided in *Brick & Pipe* and *Story*, which at first glance are also similar. Closer inspection reveals that they do not fit the matrix. In *Brick & Pipe*,[86] the lender made searches and inquiries as to the appropriate officers of the company but relied on a representation from the company to resolve inconsistencies. Brick and Pipe itself was also a trading company. In *Story*, Gleeson CJ commented that the case was different from *Northside* in that the company received some benefit from the loan transaction due to the intermingling of the financial affairs of Mr Story's external interests and the company.[87] *Equiticorp* does not fit the matrix because firstly the majority of the New South Wales Court of Appeal accepted that group welfare equated to corporate purpose. Secondly the majority accepted that the bank was dealing with a managing director who had the actual authority of the companies to enter into the transaction.

86 Although the Court did remark on how "analogous" the facts were to *Northside*.
87 (1993) 11 ACLC 629, 638.

The next chapter contains particular guidelines recommended to assist outsiders' to obtain maximum benefit from the statutory rule, particularly in avoiding the factual matrix of suspicion. The factors of comparison in Table 5.2 from chapter 5 are used as a basis for the recommendations.

Chapter 9

Implications for Lenders

The Factual Matrix That May Preclude Reliance on the Statutory Indoor Management Rule

Chapter 8 analysed the limitations to the statutory assumptions. We concluded that the factors of "due inquiry" that were highlighted by the High Court in *Northside Developments Pty Ltd v Registrar-General*[1] according to the common law are likely to continue to be relevant to the statutory formulation of "knew or suspected" in s 128(4).

The factors of due inquiry or "suspicion" were identified according to the collective description of the "factual matrix". This adopts the approach of Priestley JA in *Bank of New Zealand v Fiberi Pty Ltd*.[2] If the circumstances of the borrowing transaction fit the "factual matrix", the "worst case" for the outsider is that the new statutory rule still imposes the same obligations of inquiry as formulated by Priestley JA in *Fiberi*, that is, the standard of a reasonable and prudent banker. That standard at least comprises three main elements:

1. identifying the parties involved in the transaction, the nature of their involvement (e.g borrower, security provider, guarantor) and their relationship with each other;
2. identifying the officers of the corporate parties; and
3. relying on information on the public record to confirm identification.

Formulating recommendations to fit all transactions is imprecise due to the number of factors in the matrix. Other commentators have prefaced their practical suggestions with different concerns or priorities, for example:

- the new provisions should give rise to an expectation that the incentive to inquire is reduced.[3]
- There is a circular argument that could develop regarding the practical steps that a lender takes. If the lender adopts a particular practice as a safeguard, does that then become an inquiry that a reasonable and prudent banker would take, prompted by suspicion?[4]
- Under the former provisions, Horrigan described the line-drawing exercise between wilful blindness and making routine enquiries that initiate other queries.[5] That comment still applies, as there is little support for a view that "to suspect" something completely neutralises wilful blindness.

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1 (1990) 11 ACLC 611.
2 (1994) 12 ACLC 48.
3 I Ramsay, *The New Corporations Law* CCH (1998) 35.
4 B Horrigan, 'Busting Guarantees!' (1998) 7 *National Law Review* [78]: "might the presence of such a provision prompt an activist judge to conclude that putting it into the documentation must be an indication that the financier in these circumstances 'suspected' something was amiss?"
5 B Horrigan, 'Third Party Securities – Theory, Law and Practice' in J Greig and B Horrigan (eds) *Enforcing Securities* (1994) 244–245. Also see D Loxton, 'One Step Forward, One Step Back: The Effect of Corporate Law Reform on Procedures in Dealing with Companies Borrowing or Giving Guarantees' (1999) 10 *Journal of Banking and Finance Law and Practice* 24, 33: "when designing standard procedures, the level of risk of a transaction being set aside if you did not get further information needs to be balanced against getting it wrong, or being placed on notice of further defects."

The factors in the matrix are cumulative. As most of the litigation has concerned transactions with lenders, we formulate guidelines to maximise the lenders' reliance on the statutory rule. First, we indicate the general types of situations that may trigger the exceptions to the rule. Second, we recommend positive steps that lenders may take to maximise their position. Third, we examine in detail some particular scenarios, recurring in past litigation and illustrate how our recommended procedures may be applied or varied, as the particular factual matrix may require.

Situations that Risk Triggering the Exceptions

The courts have shown an increasing willingness to prevent lenders enforcing security rights in circumstances where the lender has failed to follow up information that ought to provide grounds for suspicion that an officer is acting without authority. In this respect, lenders appear to be treated more strictly than other outsiders such as trade creditors because they are in a stronger position to insist upon detailed scrutiny. The nature of financial transactions is such that it is appropriate to engage in thorough checking that the circumstances are regular.

The existence of the following circumstances should set off alarm bells for a prudent lender and lead to the making of further inquiries:

1. An officer who affixed the company seal is not named as an officer in the public documents lodged with ASIC. Company searches and further inquiries if unexpected information arises are crucial.
2. An ordinary director or secretary has more limited customary authority than does a managing director. However, even in the case of a managing director, implied actual or apparent authority may not extend to unusual transactions outside the ordinary activities of the company, contracts which are contrary to the best interests of the company or which secure assets of other companies in the group which carry on different activities.
3. The absence of consent or acquiescence of directors other than the ones with whom the lender deals, especially where those with whom the lender deals are the only ones to benefit from the transaction.
4. A mortgage secures the major asset of the company and there is no benefit to the company. This is particularly the case where the asset is of a non-commercial nature such as a residence.
5. The directors appear to be acting in their own self-interest or to the detriment of the company. The rules of constructive trusts probably operate in addition to the statutory provisions and may be more effective from the company's point of view to enable it to retain or recover its assets against a lender.

General Guidelines For Lenders

The following steps are proffered as general guidelines for lenders dealing with corporate borrowers:

1. Get to know the borrower at first hand. A lender should establish a relationship and make such inquiries as will enable the lender to understand the relationship

between the directors and shareholders of the borrower, its purposes and business activities, the reasons behind the proposed borrowings and the nature of the secured assets.

2. Carry out an ASIC search to ascertain the identity of the officers of the corporate borrower/third party security provider. This information is currently available in secondary form (printout ASCOT search) from the ASIC's transcription from primary documents. Discount any risk that the information is inaccurate.[6]

   For purposes other than reliance on the rule, the lender also needs to know the existence and terms of prior registered charges, as the doctrine of constructive notice still applies to charges: s 130(2).
3. Where the company search reveals the names of directors or significant shareholders with whom the lender has had no contact, inquiries should be made as to whether they consent or are opposed to the borrower entering into the proposed transaction.
4. Once the lender has carried out the search, its accuracy must be relied on to the exclusion of all other inconsistent assertions. If the information revealed by a company search is out of date or a search does not reveal required information because the borrower has been newly registered or a change of officers has occurred, it is best to wait until the appropriate returns are duly lodged. Where there is a sense of urgency that the transaction proceed quickly, the lender should obtain a certificate signed by a person who has actual authority of the company (the board, a managing director or the company's solicitor), stating that the relevant officers of the borrower have been duly appointed, are authorised to enter into the transaction and relevant returns have been lodged or will be lodged as soon as practicable

   In *National Australia Bank v Sparrow Green Pty Ltd*[7] and *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*,[8] the lender was persuaded to rely on information contrary to the public record. In the latter, the lender was successful through the circuitous route of proving that the source of the alternate information was a person with the actual authority of the company to make assertions regarding the authority of other officers. This type of representation was unsuccessful in *Bank of New Zealand v Fiberi Pty Ltd*,[9] *Pyramid Building Society v Scorpion Hotels Pty Ltd*,[10] *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*[11] and *Sparrow Green*, as the parties who made the representations regarding the officers did not have the actual authority to do so. The facts and outcomes of these cases were discussed in detail in chapters 2 and 5.

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6 Loxton, ibid, 34 discusses the scenario of an error in the initial search that renders it an abundance of caution to obtain document images of the returns. The possibility that an ASIC error will adversely affect the outsider's reliance on the rule was discounted in the discussion on s 129(2) in chapter 6.

7 (1999) 17 ACLC 1665.

8 (1992) 10 ACLC 253.

9 (1994) 12 ACLC 48.

10 (1996) 14 ACLC 679.

11 [1998] 3 VR 133.

In *Sparrow Green*, Debelle J (at first instance) noted that the lender called for a copy of the form recording the director's resignation.[12] Even this strategy is unreliable to counter the information on the public record, as there is no evidence that it has been lodged with ASIC. The pressure may be on the lender to accept such evidence if the transaction timetable is tight. To accept a copy of a form to be lodged would also require the lender to demand some evidence that it had been lodged (such as an ASIC receipt) prior to the transaction being executed.

In *Sixty-Fourth Throne*, the Court indirectly suggested it was a case of wilful blindness for the lender to obtain a search of the corporate security provider but then not cross-reference this information when presented with the signed mortgage.[13]

5. Do not obtain a copy of the company's constitution, as the information within is not required for any of the specific assumptions in s 129(1)–(7). *Myers v Aquarell Pty Ltd*[14] demonstrates that knowledge of the constitution was irrelevant for the outsider to access the assumption that the single director had validly affixed the seal to the mortgage.
6. If the lender already has a copy of the constitution (for example, from past dealings), then this will constitute actual knowledge of its contents. However, as *Brick & Pipe* and *Sparrow Green* show, this precludes reliance on the assumption in s 129(1), but it does not preclude reliance on other assumptions as to execution. In *Sparrow Green*, the bank's actual knowledge that the constitution required two directors, combined with its failure to rely on the public information as to officers, meant that the assumption as to proper execution was not available. This contrasts with the effect of *Myers*, as even if the lender had knowledge of the constitution, the sealing clause would be satisfied where there was only one director on the public record and that director affixed the seal as director and secretary.
7. Generally audit the other information that the lender routinely collects with a view to critically assessing the merit of that information. The facts from complex cases such as *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd* [15] indicate that the bank had accumulated a variety of information over the years that had become distributed amongst different files, which overall would have given it a high degree of insight into the activities of the borrower and the third party company.
8. Ascertain, in general terms, the purpose of the loan. This is information that banks routinely collect and is a particularly difficult factor to dismiss. On the one hand, the assertions by the borrower at the time of the loan application may be useful in demonstrating corporate purpose, either of the company itself, or for the third party security provider. (The third party situation is discussed under the particular factual matrices below). On the other hand, it may render

12 *Perkins v National Australia Bank* (1999) 30 ACSR 256.
13 [1998] 3 VR 133.
14 [2000] VSC 429.
15 [1998] 3 VR 16.

an otherwise routine transaction difficult for the lender, if the disclosure hints at anything involving non-corporate purpose. Non-corporate purpose encompasses the exercise of corporate power for illegal purposes (e.g. financing self dealings[16]) or improper purpose (e.g. directors breaching duties to the company, such as using funds for personal projects or simply some other potential for conflict) or just generally, lack of corporate benefit (e.g. loan being used to fund loans to or activities of other entities). An adverse disclosure of the purpose of the loan affects the lender because it relates to one of the factors in the matrix, lack of corporate benefit. As discussed below under the particular factual matrices, the effect of lack of corporate benefit as the sole factor is uncertain, as it is only one of the factors in the matrix for the reasonable and prudent banker test that triggers suspicion. To the extent that the disclosure hints at other matters such as illegality or fiduciary breach, the lender may also be vulnerable in equity, either because they will not be a bona fide purchaser for value without notice or they may become subject to participatory liability (discussed in chapter 6).

9. Do not accept a document signed either under seal, or on behalf of the company, without cross referencing the signatories to the ASIC search information. Also, do not accept a seal unless it accurately consists of the company's full name, the expression "Australian Company Number" and that number: s 123.
10. Avoid the situation arising where the company's officers execute documents on the lender's premises or otherwise in the vicinity of the lender's officers, as this may arouse actual knowledge. In the common law case of *Efron's Tie*,[17] it was held that executing documents in the bank's premises meant that it had actual knowledge of a breach of the constitution. Actual knowledge of a breach of the constitution does not directly affect proper execution, but actual knowledge of some adverse factors adds to the factual matrix and the climate of suspicion.
11. Do not rely on any assertions from any individuals purporting to represent the company until it is confirmed first, that they are officers from the public record, and secondly, that they have the actual authority to bind the company. This latter point is a barrier for reliance by an outsider. Only the managing director, the board as a whole and the shareholders in general meeting (subject to some limits) have the authority of the company. To rely on any of these sources for actual authority requires further inquiries: the existence of actual authority is not a matter that can be assumed. Here, the best evidence is a board resolution approving the transaction and the officers' authority to execute specific contracts. The situations where actual authority was found "with hindsight" by the courts, notably *Brick & Pipe* and *Equiticorp Finance Ltd v Bank of New Zealand*,[18] represent risky strategies for universal application. The lender cannot rely on any judicial disposition to treat high profile and self-appointed individuals as managing directors without some independent corroboration.

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16 "Illegal" in the sense that s 260D imposes civil penalty orders on those persons involved in the company's contravention of s 260A.
17 *Re Efron's Tie & Knitting Mills Pty Ltd* [1932] VLR 8. Discussed in chapter 4.
18 (1993) 11 ACLC 952.

12. Corporate benefit is not a major concern unless the transaction involves a third party security (see the specific scenarios below); or in some other way the lender has actual knowledge of its absence, such as discussed in point 8 above.
13. Check any relevant trust deed if the borrower or security provider is a trustee.
14. If doubts remain, the lender can incorporate draft minutes of proceedings of the board with the offer to finance.
    These minutes should record:
    - that named persons executing the required documentation are authorised to do so,
    - that the company seal is affixed by persons with authority and in compliance with the constitution,
    - the directors who were present.

Particular Factual Matrices

Particular recommendations are offered below, designed for typical factual matrices. The factual matrices, distinguished numerically, have been developed from the types of indoor management rule disputes already litigated.

Type 1: the third party security

A third party security has featured in all of the cases discussing the rule's exceptions (except *National Australia Bank v Sparrow Green Pty Ltd*[19]). It is a pervasive factor in lenders' enforcement failures. A conservative strategy to adopt is that the absence of obvious corporate benefit to the third party security provider means that there is none. However, the significance of absence of corporate benefit is unclear. None of the s 129 assumptions directly relate to assuming that the transaction has some corporate benefit. Absence of corporate benefit is one factor in the matrix (although "decisive" under the common law "due inquiry" test). It has been argued above that the new s 128(4) at least signals some change in direction to favour outsiders and that a third party security, by itself, should not be considered a suspicious transaction. In past disputes, however, sufficient other elements from the matrix have been present, to combine with the third party security and absence of corporate benefit factor, to trigger the exception. If third party security exists in isolation from other elements in the factual matrix, as for example in *Story v Advance Bank Australia Ltd*,[20] then further inquiry about the transaction is not warranted. Effectively, to totally isolate the third party security transaction from the matrix requires proactive strategies on the part of the lenders:

1. Enquire of the borrower the identity of the corporate third party security provider and its connection with the borrower. (Common examples include group relationships, see type 2 scenario below; trading relationships, evidence of which may indicate mutual corporate purpose; or personal relationships, that raise dubious corporate benefit connections).
2. Corroborate the connection from the third party company, or a source other than the borrower (if the borrower alleges a group situation, see type 2 below). In

19 (1999) 17 ACLC 1665.
20 (1993) 11 ACLC 629.

contacting the third party company direct, the lender creates evidence of corporate benefit. Hansen J in *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*[21] was critical of the bank's failure to contact other officers of the trustee company, or even the beneficiaries of the trust. External sources that have not been accepted by the courts include solicitors acting for the borrower with no evidence that they were retained by the security provider (*Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd*[22]) and, although not a case on third party securities, the company's accountant (*National Australia Bank v Sparrow Green Pty Ltd*[23]).

3. As in the general guidelines, ascertain the identity of the officers of the third party company from ASIC and rely only on that information.

Failure to take these proactive steps in a third party security situation does not automatically trigger the exception to render the rule unavailable. The risk of the failure is that, with hindsight, an aggrieved corporate third party could accumulate enough of the factors to argue the existence of a factual matrix that indicates a reasonable and prudent banker would have made inquiries.

Type 2: the "group" transaction

A particular subset of the third party scenario is the intra-group transaction, where it may be that the lender has more latitude in assuming corporate benefit than in the case of a less obvious connection between the borrower and the third party company. *Equiticorp Finance Ltd v Bank of New Zealand*[24] illustrates that lending transactions involving corporate groups often have sufficient corporate benefit to take them out of the factual matrix. However, there have been doubts expressed about a subsidiary's guarantees of holding company debts.[25] Further, the High Court in *Walker v Wimborne*[26] recognised a potential flowdown corporate benefit where company A, the holding company, makes a loan to a subsidiary to allow it to continue to trade. The transaction may be judged, from the standpoint of company A, to be in its interests. There was no discussion of correlative "upflow" benefits. Since *ANZ Executors & Trustee Company Ltd v Qintex Australia Ltd*, there have been developments legitimising the upflow benefits. For example, s 187 now provides that directors of a wholly owned subsidiary may act in the interests of the holding company. The Companies and Securities Advisory Committee has released its report suggesting that this apply to partly owned subsidiaries.[27]

Similarly with type 1, the lender must corroborate the group connection from an independent source. Common directorships do not create a group in the sense of com-

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21 [1998] 3 VR 16.
22 [1998] 3 VR 133.
23 (1999) 17 ACLC 1665.
24 (1993) 11 ACLC 925.
25 *ANZ Executors & Trustee Company Ltd v Qintex Australia Ltd* [1991] 2 Qd R 360. See also G D Cooper and D B Robertson, 'Subsidiary Companies' Guarantees – Their Continued Existence' (1990) 1 *Journal of Banking and Finance Law and Practice* 284, 286; the Honourable Justice Paul de Jersey, 'Lending to Company Groups – The Problems of Corporate Power and Directors' Authority', Paper presented at the *9th Annual Banking Law and Practice Conference*, Gold Coast, April 1992, p 14; J Lambrick, 'Corporate Benefit in Financial Transactions: A Policy Perspective' (1997) 8 *Journal of Banking and Finance Law and Practice* 212, 223–225.
26 (1976) 137 CLR 1, 6 (Mason J).
27 CASAC, *Corporate Groups: Final Report* (May, 2000) [243]–[246].

mon ownership.[28] (See type 3 below). Corroboration reflects back to one of Priestley JA's comments in *Bank of New Zealand v Fiberi Pty Ltd*[29] relating to the ease of acquiring the information. Ownership is a matter of public record. The disputes litigated show two types of group structures:

1. the formal structure where ultimately a public company is involved as a holding company, leading to a high level of disclosure in the market about the public company's entities.[30] In cases such as *Equiticorp* and *Brick & Pipe*, the lenders were dealing with major corporate groups and this would be easy to corroborate from public information.
2. The informal structure, involving loose alliances usually of proprietary companies where outsiders have assumed that common directors equates to some formal group structure. This incorrect assumption is evident for example in *Fiberi*. In these situations, confirmation of the genuine group connection may be more difficult given the absence of financial reporting by proprietary companies,[31] but share allotment information is available from the ASIC[32] and the registers are public documents.[33]

Type 3: directors proffering "other" security for their personal loans

The common director connection between the borrower and the third party company adds another factor to the third party security matrix. This factor has a facet of inevitability about it, because if the lender is going to enforce any signed documents, then under s 129(5) and (6), the lender should know who the officers are. The existence of the common director then raises the suspicion that corporate benefit is lacking, or is this factual connection merely "idle wondering"? To have information on the common director connection is verging on wilful blindness if the lender fails to pursue it. Failure to pursue the connection was instrumental to the due inquiry exception in *Northside Developments Pty Ltd v Registrar-General*,[34] but has also been significant in the statutory cases. Cases such as *Bank of New Zealand v Fiberi Pty Ltd*,[35] *Pyramid Building Society v Scorpion Hotels Pty Ltd*,[36] and *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*[37] show that sole reliance on the common director for corroboration of the connection is unsatisfactory. The type of connection that the lender needs to corroborate includes that the common directorship arises through a genuine group structure, such as in *Equiticorp Finance Ltd v Bank of New Zealand*,[38] (and preferably downflow or intra-group, not upflow between subsidiary and holding company, see type 2 above) or some other mutual trading interest between unrelated companies. For example, in *Story v Advance Bank Australia Ltd*,[39]

28 *Walker v Wimborne* (1976) 137 CLR 1, 6 (Mason J). His Honour said that to speak of the companies in that case as a group was "something of a misnomer" where there is not interlocking shareholdings, just common directors.
29 (1994) 12 ACLC 48, 59.
30 AASB1024 "Consolidated Accounts" requires reporting entities to present consolidated accounts of all entities controlled by it.
31 Although this excludes large proprietary companies, which are required by s 292 to prepare financial reports.
32 Section 254X.
33 Section 173.
34 (1990) 11 ACLC 611.
35 (1994) 12 ACLC 48, 59.
36 (1996) 14 ACLC 679.
37 [1998] 3 VR 16.
38 (1993) 11 ACLC 952.
39 (1993) 11 ACLC 629.

the Court was satisfied that the company, Fleetwood Star Pty Ltd, derived financial benefit from Mr Story's dealings with the bank in his other capacities.[40]

Type 4: trust assets as security

Trust assets as security are a special case, whether or not the security is a third party security. The indoor management rule does not allow the lender to assume that the trust has the power to grant security. If it does, there is a further level of inquiry to check if the trustee has the power to grant a third party security. Even if it does, access to the indoor management rule may be denied if there is an accumulation of the factors of third party security for an entity controlled by a common director and no corporate benefit. *Koorootang Nominees Pty Ltd v ANZ Banking Group Ltd*[41] illustrates how this scenario triggers the "reasonable and prudent" banker test to make enquiries regarding the matter sought to be assumed. That case also highlights the further exposure of outsiders to the risk of constructive trusteeship when dealing with a corporate trustee.

Conclusion

Does the new statutory indoor management rule decrease the burden of inquiry for lenders dealing with corporate borrowers and security providers? The Explanatory Memorandum issues the instruction to disregard the common law burden of due inquiry. The standard of commercial morality imposed by judges requires the lender to be alert to whether a corporate borrowing transaction balances too far in favour of facilitating corporate fraud through inadequate inquiry. Applying this theme leads to the likelihood that the reasonable and prudent banker standard[42] will survive the transition into the new provisions. The ramification is that the new provisions do not change the threshold problems of corporate dealing involving identifying the corporate officers and ascertaining their authority. The Explanatory Memorandum expressed the intention to impose a "stricter test". This intention may be achieved through a change in emphasis in the factors already identified in the past cases as comprising good conduct by outsiders, rather than imposing a major doctrinal shift. That is, there may now be a more careful analysis of the factors in a particular factual matrix to trigger suspicion that the assumption is not correct, than may have been the case under the former provision. The factors in the matrix, however, still comprise those that have been identified from previous cases and highlighted in Table 5.2 in Chapter 5.

40 "The intermingling of the financial affairs of Mr Story and the company, which was known to the people who were the sole shareholders and sole directors, and the ultimate application of part of the loan funds for the purposes of the company, make the facts of the case significantly different from those in *Northside Developments*." (1993) 11 ACLC 629, 638 (Gleeson CJ).

41 [1998] 3 VR 16.

42 Per Priestley J in *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48.

Chapter 10

Overview

Introduction

This final chapter provides our summary of the issues and our research findings, including a restatement of the research's significance to commercial practice involving financing contracts with companies.

This chapter is structured as follows: first, it provides a brief overview and summary of the research context of corporate contracts. Following the summary, we present a comprehensive guide to the findings, particularly in relation to the interpretation and operation of the statutory reforms analysed in the earlier chapters. Whilst chapter 9 contains our analysis of necessary guidelines to maximise the statutory protection to outsiders and their contracts, these recommendations are restated in a summarised form. Finally, we present conclusions drawn from the findings, primarily areas of reform worthy of reconsideration or renewed attention.

In presenting our conclusion, it is worthwhile to note perceived limitations within this work. We have examined the corporate law issues surrounding corporate contracts, involving the existence of corporate power and the exercise of corporate power by the company's officers. Tangential issues not considered in this monograph include:

- The exercise by shareholders of corporate power, both in terms of ratifying directors' actions or subverting directors' authority;
- Contract law doctrines, such as unconscionability and misrepresentation, that may also give rise to remedies due to the circumstances surrounding the formation of contracts;
- Subsequent events to the circumstances of the formation, such as insolvency, that may render a contract vulnerable.

We have touched on the relevance of fiduciary duties affecting the scope of officers' authority and the relevance of participatory liability where a contract is entered into in breach of duty or trust. However, we do not present in this work a comprehensive analysis of either the substantive content of directors' fiduciary duty nor of the principles of participatory liability and constructive trusts.

The monograph focuses on corporate debt finance and corporate security transactions. However, even though such transactions often involve dealings in land, we have not digressed to consider the effect on outsiders of the various state land titles registration systems and indefeasibility of title.

Summary

The purpose of this monograph is to examine the regulatory rules designed to facilitate the formation of external contracts and to comment on the efficacy of legislative reform. We have reviewed both general law developments prior to statutory intervention and the statutory reforms. The current phase of statutory reform is contained in the *Corporations Act* provisions inserted in 1998[1] covering the reforms to corporate power and ultra vires and the changes to the wording of the statutory indoor management rule.

Companies may only enter into contracts through agents, usually its officers. The terms of the officers' appointment, meaning the grant of authority, is not required to be disclosed and is not discernible to the outsider. The common law and s 129 provide default rules for officers' authority that arises as a matter of law. By virtue of the principles of agency, there are three types of authority that an agent may possess: actual, customary and apparent. In particular, the rules of customary authority are useful in company law, as officers appointed to a certain position are automatically granted the authority that customarily goes with that position. This is consolidated in s 129(2)(3).

The scope of officers' authority is constrained by the requirement to exercise the company's powers for a corporate purpose. Further, officers are subject to fiduciary constraints when exercising their authority. Together, these constraints operate to define the limits of authority to exercise corporate power. The advantage from the outsider's point of view is that the law sets out the default rules of customary authority and fiduciary duty that are well established. The disadvantage is that issues of non-compliance with authority and fiduciary duty may affect the validity of contracts entered into with outsiders on behalf of the company.

The preceding chapters examined the general law and recent legislative reform that affects the formation of corporate contracts. There are two potential threats to finance contracts: first, where the company lacks power to enter into the contract, so that it is void ab initio, and second, where the company has power, but there is some abuse by officers in exercising the power. The usual result in the second case is that contracts are voidable.

Whilst the *Corporations Act* overcomes the void effect of the first threat, ultra vires, whether the external contract's enforceability is enhanced by the ultra vires statutory reforms also depends upon the application of the indoor management rule. The rule is designed to allow outsiders to make certain assumptions regarding the officers' exercise of corporate power, for example that the procedural preconditions to the exercise of power have been complied with. The rule has two main limitations affecting the extent to which it assists outsiders enforcing contracts.

1. It is not comprehensive in overcoming all problems associated with dealing with agents. For example, it is not possible to assume that officers have not acted illegally, nor is it possible to assume, from a person's assertion alone, that they are an officer of the company. Accordingly, the outsider must ascertain from an external source, usually ASIC records, the identity of the company's officers.
2. The rule has express exceptions where the assumptions are not available, based on the knowledge of the outsider.

Chapter 6 reinforces the relevance of the outsider's knowledge of the officers' abuse of authority. The outsider is affected by their degree of knowledge of the circumstances of the abuse, either because their knowledge of lack of corporate purpose:

1 Part 2B.1 – Company powers and how they are exercised, Part 2B.2 – Assumptions people dealing with companies are entitled to make and Part 2B.4 – Replaceable rules and constitution inserted as a result of the *Company Law Review Act 1998*, operational 1 July 1998. The sections are set out in Appendix I.

- precludes the statutory protection of the indoor management rule in enforcing contracts; or
- invokes participatory liability. Despite the recent reforms to the *Corporations Act*, the statute does little to protect the outsider from the application of equitable principles imposing constructive trust liability.

These are the main limits to the scope of protection provided to the outsider by the legislation. Below, we comment on the effect of the specific statutory reforms.

The abolition of ultra vires

Classic ultra vires refers to contracts with outsiders being void due to lack of corporate capacity. This arises because the contract is outside the objects clause of the constitution. Due to the impracticality of the void effect on outsiders, the common law classic ultra vires operated unfairly or inconsistently on outsiders. As discussed in chapter 5, the legislature has effectively abolished the doctrine of ultra vires. This is achieved by a combination of:

- the simplification of the registration requirements with the absence of a mandatory constitution (ss 117 & 118);
- the express grant of contractual capacity in s 124(1);
- the express recognition in s 124(2) that an act for a non-corporate purpose (expressed as "the company's interests are not, or would not be, served") does not affect the company's capacity ;
- the provision in s 125 that the exercise of a power by the company is not invalid merely because it is contrary to an express restriction or prohibition in the company's constitution; and
- abolishing constructive notice of corporate documents, except for registered charges (s 130).

The statutory reform addresses the direct effects of classic ultra vires, that is, that contracts will not be void for lack of capacity. Although s 124 may be subject to ad hoc interpretations of limitation,[2] this will not affect actual contractual capacity. The susceptibility of s 124(1) to ad hoc limitation has been reduced since the 1998 reforms, as unlike the former s 161(1), s 124(1) is no longer expressly "subject to" the *Corporations Act*. This change reduces the likelihood that a company's capacity is affected if that type of contract otherwise contravenes some other provision of the *Corporations Act*.

However, the reform cannot relieve outsiders of all indirect effects that may flow from disputes as to capacity. Even though a constitution is no longer required for registration since 1 July 1998, it is quite feasible that outsiders will be dealing with companies that still have a specific constitution. This circumstance may arise either because the company was registered pre-1 July 1998 and it has not repealed its constitution under s 136(2), or it is a No Liability (s 112(2)(b)) or charitable company (s 150) that still require a constitution. Some companies formed for specific purposes also wish to specifically state precise objects. In any event, the replaceable rules are part of the definition of "constitution" in s 134. The outsider's rights under the contract (as opposed to the contract itself) may be indirectly affected by internal validity disputes, if shareholders take action

2 For example, *Bay Marine Pty Ltd v Clayton Country Properties Pty Ltd* (No 2) (1987) 5 ACLC 38 held that a company did not have the capacity to represent itself in legal proceedings.

to enforce the constitution. For example, chapter 5 showed that an "ultra vires" transaction entered into by officers is still relevant in other actions involving:

1. a winding up application;
2. the oppression remedy;
3. proceedings under statute against officers for breach of the Act;
4. a common law action for damages against officers for breach of constitution (as the constitution forms the terms of the contract between members and officers, s 140).

Although these effects do not directly affect enforcement of the external contract, they can disrupt or inconvenience the outsider's rights, especially in the winding up situation.

The indoor management rule reforms

Ultra vires in the classic sense refers to corporate capacity. The indoor management rule was not designed to cure defects in the company's capacity to contract. Therefore, application of the rule is subject to first satisfying inquiry as to the existence of corporate capacity.[3]

The common law indoor management rule was developed since the mid nineteenth century as a rule of procedural convenience, so that external parties dealing with companies were entitled to assume that the company's officers were complying with the company's constitution. The Rule in *Turquand's* case prevented outsiders from being affected by internal irregularities of which they had no means of discovering. Logical exceptions to the rule developed, based on the knowledge of the external party. Accordingly, if the outsider knew of the internal non-compliance, or knew facts that would lead a reasonable person to inquire further, then the rule was not available. However, by the early twentieth century, the rule was considered "moribund or at least seldom applicable."[4] Some of the reasons for this were posited in earlier chapters, for example:

- Misapplication of the doctrine of constructive notice[5] preventing the rule's operation, as a proviso to Rule in *Turquand's* case was that the outsider could not assume regularity where the assumption was inconsistent with the public documents.
- A forgery exception was also developed, as the outsider could not assume regularity in relation to forgeries. However, the case law was inconsistent as to what forgery meant. The rule was inapplicable if the contract was forged in the sense of a false signature,[6] but the exception was also applied were the signatures were genuine, but the contract was a forgery in the sense of unauthorised by the company.[7] This extension of the forgery exception was an unnecessary complication to the rule's operation.

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3 *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 619 (Mason CJ): "Of course, in applying the rule, account must be taken of the doctrine of ultra vires and the constitution of the company".

4 *Northside Developments Pty Ltd v Registrar-General* (1987) 5 ACLC 642, 648 (Young J at first instance) citing H Street, *A Treatise on the Doctrine of Ultra Vires* (1930).

5 Constructive notice means notice of the contents of the public documents.

6 *Ruben v Great Fingall Consolidated* [1906] AC 439.

7 *Kreditbank Cassel GmbH v Schenkers* [1927] 1 KB 826.

- The nature of the common seal, and its importance in early common law doctrine that considered the seal as being the only method of expression of the company's assent.[8]

Although the first statutory efforts in 1983 to set out the rule stated that the legislature was simply clarifying and codifying the existing law[9] in *Royal British Bank v Turquand*,[10] comparisons between the old law and the statutory law were inevitable. Immediate differences between the common law and the 1983 statutory version of the rule were:

- Formal qualifying circumstances were drafted into the rule. That is, a person had to have "dealings with the company" and be involved in "proceedings in relation to those dealings", to access the rule.
- The statutory rule enumerated the assumptions that could be made. Apart from the first assumption (compliance with the constitution) the other specific statutory assumptions were not clearly derived from the common law rule at all. Rather, they represented the statutory adoption of procedural assumptions analogous to the rule, for example, from the rules of agency.
- The common law exceptions of actual and due inquiry were redrafted, initially as actual knowledge or "connection or relationship with the company" such that the outsider ought to have known that the assumption was incorrect.
- The common law exception of forgery was clarified, so that the rule applied regardless of allegations of forgery, although subject to the outsider's actual knowledge of forgery.

Given the statutory redrafting in 1998, similar issues require examination, giving rise to five main uncertainties regarding the rule's current statutory form. These arise from:

1. The qualifying circumstances to relying on the statutory rule;
2. The revised rule as to forgeries;
3. The scope of the knowledge exceptions;
4. The scope of the specific assumption in s 129(4) that officers "properly perform their duties to the company"; and
5. The scope of the specific assumptions in s 129(6) and (7) relating to execution of documents with or without the seal and whether this relates to substantive authority or merely procedural authority to enter into contracts.

These uncertainties, and suggested resolutions, are discussed below.

1. The pre-conditions to reliance in ss 128(1) and (2)

The drafting of the former statutory provision suggested three pre-conditions for the outsider to meet before they could access the rule. The outsider had to have:

- "dealings" with the company,
- in "proceedings in relation to those dealings"
- where the company asserted matters contrary to the assumption.

8 K E Lindgren, 'The Negative Corporate Seal Rule and Exceptions Thereto' (1974) 9 *Melbourne University Law Review* 411.

9 Explanatory Memorandum, *Company and Securities (Miscellaneous Provisions) Act 1983*, [188].

10 (1856) 119 ER 886.

The new streamlined drafting of s 128(1) and (2) suggests only one element for the outsider to prove: "dealing" with the company. Previous case law has given a wide meaning to "dealing". Removal of the second and third element, while superficially a drafting simplification, may actually make the rule more accessible.

2. The protection against forgery in s 128(3)

To the extent that the statutory provisions modify the forgery rule, this now refers to "forgery" in the strict sense only. This statutory modification protects outsiders more than the common law rule that rendered forgeries void. Under the statutory rule, a forgery can be assumed to be valid execution, subject to the rule's exceptions.

However, the *Company Law Review Act* 1998 effects both new drafting of the forgery rule and a re-structure of the provision. There are three main differences. The forgery rule is now found in s 128(3) (instead of in its own self contained section as with former s 166). It appears before the exceptions in s 128(4) instead of after the exceptions in former s 164(4). It no longer contains the express proviso of being subject to the outsider's actual knowledge. The re-ordering of the forgery provision now suggests that the forgery assumption is subject to the same "know or suspect" exception is s 128(4) that the assumptions in s 129 are subject to. Formerly the forgery assumption was only subject to the actual knowledge exception, but there was debate about the meaning of actual knowledge in former s 166.[11]

3. The exception "to suspect" in s 128(4)

The wording of the first statutory version of the knowledge exception, depended both upon what the outsider actually knew and what they ought to know, based on their "connection or relationship" with the company. When enacted in 1983, this wording prompted comparison with the common law constructive knowledge exception of due inquiry.

Similarly, the redrafting of s 128(4) to substitute "suspect" for "connection or relationship" such that the outsider "ought to know" requires comparison. To "suspect" something is a test that is found in other commercial applications. However, "suspect" in these other contexts is usually treated as objective because it is used in conjunction with the specific qualifier of reasonableness. For the purposes of s 128(4), the main uncertainty is the extent to which "suspect" will be treated as an objective test, particularly in the absence of express words such "reasonable" or "ought to know". To have, or not to have, a suspicion is to have a subjective belief. At least in an evidentiary sense, it would be difficult for a court to accept someone's belief when surrounded by many factors that make that belief unsustainable.

In this respect, the "factual matrix" concept referred to by Priestley JA in *Bank of New Zealand v Fiberi Pty Ltd*[12] (and discussed in detail in chapter 8) still has a role to play in building a case against the outsider's reliance on the assumptions in s 129. The "factual matrix" concept as described by Priestley JA describes the suspicion that a reasonable and prudent "banker",[13] placed in the factual matrix of the case, would need to find out more. The factual matrix comprises the factors from *Northside* and other cases, including *Fiberi*, which initiate an obligation of inquiry by the outsider. These factors include (sourced from Table 5.2 in chapter 5):

11 See P Lipton, *The Authority of Agents and Officers to Act for a Company: Legal Principles* (1996) 57.
12 (1994) 12 ACLC 48.
13 Priestley JA expressed the test using the word "banker", as the external party was a bank.

- third party security;
- no indication that the loan transaction is related to the company's business;
- the person deriving the benefit from the transaction is the director proffering the company's assets as security for loans for the director's personal or external interests;
- the assets secured are trust assets; and/or
- no indication that the company derives any benefit from the loan transaction.

This first group of factors primarily shows lack of corporate purpose. This demonstrates that whilst corporate purpose is not a positive factor that an outsider needs to be concerned about in every transaction, evidence of lack of corporate purpose can operate negatively, in the sense of denying the benefit of the rule's assumptions.

Other factors that may comprise the factual matrix include:

- the outsider makes no searches or enquiries about the company;
- the company is not a trading entity, but merely owns assets;
- the outsider has no previous dealings or relations with the company;
- the general circumstances giving rise to the requirement of the financing transaction, such as the desperation of the borrower, the urgency with which the transaction is conducted, or the quantum of the loan;
- a corporate group is involved (does the outsider independently confirm the companies' relationship?);
- purported dealings with a "managing director" are involved (does the outsider independently confirm their authority?);
- similarly, dealings with several different officers may be involved (does the outsider mistakenly believe they are dealing with the board?);
- the outsider has sought further information, but relies on a non-authoritative source for confirmation, or does not follow up requests for information;
- the outsider disregards the public information;
- the ease with which the outsider can access information about the corporate security provider;
- whether there exists an independent duty between the outsider and the company that creates a requirement for inquiries to be made. For example, *Beach Petroleum*[14] involved the non-availability of the statutory assumptions to the company's solicitor, where the fiduciary duty between the solicitor and the company obliged the solicitor to make inquiries.

The factual matrix concept remains important to the new statutory rule, either:

- because a court will hold that Priestley JA's "reasonable and prudent" outsider test survives the redrafting of the rule; or
- in a less extreme view, it may be that the factual matrix concept is relevant in the evidentiary sense in proving the outsider's suspicion.

4. The assumption as to performance of duties in s 129(4)

Since the statutory rule was enacted in 1983, there has been uncertainty regarding the ambit of the particular assumption that refers to proper performance of *duties*. The new provision, s 129(4), retains the existing wording. However, the wide view can be argued

14 *Beach Petroleum NL v Abbott Tout Russell Kennedy* (1999) 33 ACSR 1.

as a logical consequence of the process of clarifying and codifying the common law rule. Outsiders would benefit more from an interpretation of the statutory rule that maximised the scope of the assumption. It does not ignore the interests of the company's shareholders in favouring a wide interpretation, as the rule is subject to exceptions based on whether the outsider has actual knowledge or suspected directors' breach of fiduciary duty. Further, the company can pursue remedies in equity for breach of fiduciary duty. The statute does not expressly provide that the assumption in s 129(4) is subject to the equitable rules, so it is unlikely that the rule of procedural regularity overcomes the equitable remedies for breach of fiduciary duty.[15]

5. The assumption as to execution of documents in s 129(5) and (6)

The assumptions as to execution of documents in s 129(5) and (6) were substantially redrafted in 1998. This redrafting was due to two factors flowing from other *Company Law Review Act* 1998 reforms:

1. the change to an optional common seal (s 123); and
2. the simplification of the former s 182 that set out in detail the rules for the formation and execution of company contracts directly, indirectly and by agents with authority.[16] The rules for execution of contracts have now been simplified in s 127. Contracts may be executed without a seal, by the signature of two officers, or under seal, witnessed by two officers.

Ramsay, Stapledon and Fong examined the significance of the redrafted s 127, and its effect on the correlative assumptions in s 129(5) and (6).[17] Ramsay, Stapledon and Fong discuss whether this change in drafting has rendered a substantive change in the ambit of the indoor management rule. They distinguish between substantive authority to enter into contracts and formal authority to affix the seal. The former provision (s 68A) did not cure defects in authority,[18] nor was the common law indoor management rule intended to create authority where there was none. [19]

Accordingly, Ramsay, Stapledon and Fong conclude that the redrafted assumptions only relate to formal authority, so that s 129(6) does not overcome lack of substantive authority.

The above discussion summarises the highlights of the analysis of statutory reform in relation to ultra vires and the indoor management rule. The efficacy of the provisions is analysed below by examining some typical safeguards. Further, the extent to which the statutory provisions could be enhanced with additional changes, is addressed at the end of this chapter.

Typical Safeguards in Dealing with Abuse of Corporate Authority

In analysing the statutory protection, we have adopted the perspective of an external party ("the lender") entering into a contract with a corporate borrower or security provider. This perspective is compelling for two reasons:

15 L Law and J Pascoe, 'Financiers and Constructive Trusts: Protection Versus Liability' (2000) 11 *Australian Journal of Corporate Law* 219, 245.

16 Former s 182 is set out in Appendix I.

17 I Ramsay, G Stapledon and K Fong, 'Affixing of the Company Seal and the Effect of the Statutory Assumption in the Corporations Law' (1999) 10 *Journal of Banking and Finance Law and Practice* 38.

18 *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1991) 9 ACLC 324, 343 (Ormiston J).

19 *Northside Developments Pty Ltd v Registrar-General* (1990) 8 ACLC 611, 641 (Dawson J).

1. Much of the litigation over the last decade has involved disputes arising from corporate lending and security transactions. This allows a more specific and meaningful focus.
2. The corporate lending transaction would be considered by most industry participants to be an important decision in the life of a company and one attended by much formality. The nature of the risks and the quantum in such transactions illustrate the tension involved in balancing the interests of the external parties against the interests of the borrower's shareholders when assigning loss for the outcome in abuse of corporate power.

Chapter 9 presents detailed guidelines and justifications. Below is a summary of the main elements to the lender's successful enforcement of corporate contracts.

The certificate of registration

The lender needs to know the name of the company and the date of its registration. The certificate of registration provides this information. The date is important, is it indicates the date from which the company has the power to enter into contracts (s 119). Otherwise, pre-registration contracts are enforced subject to the rules in Part 2B.3 *Corporations Act*.

The name of the company indicates the type of company according to the liability of its members. The name is significant because:

- A proprietary company may legitimately have only one director (s 201A). Accordingly, it is contemplated by s 127 that such a company may execute documents by one signatory. Pursuant to s 198E (a replaceable rule), the single director has the authority to exercise the powers of the company.
- A public company must have at least three directors (s 201A). Accordingly, under s 127 a public company would execute documents by two signatories. Pursuant to s 198A (a replaceable rule), the business of a company is to be managed by all of its directors collectively.
- A public company that is a No Liability company is expressly required to have a constitution that restricts it purpose to mining: s 112(2). Dealing with a No Liability company is covered under the heading "*Particular circumstances*" below.
- A company that has no abbreviation after its name is a charitable company, which under s 150 is restricted to charitable purposes only. Dealing with a charitable company is covered under the heading "*Particular circumstances*" below.

The registered office

A company has a registered office from the date of registration (s 117(2)(g), s 121) and all companies must notify ASIC of changes: s 142. The significance is that all documents can be sent to the company's registered office: s 109X.

The corporate constitution

The corporate constitution does not have any effect on the lender, so the lender does not need to obtain a copy. It has been an entrenched commercial practice for many years for lenders, particularly banks, to collect these documents. It serves no purpose now to acquire that information, and if the lender does, it can create additional problems. If the lender already has these documents, then the significance of knowledge attribution was discussed in chapter 4 and summarised below.

If a bank insists on a copy of the constitution, for those companies that do not have one, consider submitting a copy of s 141 (a table that signposts the replaceable rules), or, for more detail, submit a summary of the content of the replaceable rules, available from ASIC.[20]

It is important to emphasise that any information contained in the company's constitution is not required for any of the specific assumptions in s 129(1)–(7).

The company's officers

Relying on the company's officers to bind the company requires the lender to identify the officers. This enables the lender to know who has the authority to exercise corporate power and enables the lender to access the assumptions as to officers' authority and as to proper execution.

The most reliable source of information on the officers' identity is the ASIC database. Discount any risk that the regulator's information is inaccurate. Exclude any assertions inconsistent with the ASIC database. If the lender is pressured to accept a copy of a form to be lodged changing the ASIC database, this cannot be accepted without some evidence that it had been lodged (such as an ASIC receipt) prior to the execution of the contract.

If the lender deals with someone not named on the ASIC database, or relies on inconsistent assertions, then the lender, in any dispute, will have to rely on the doctrine of apparent authority. This involves proving that the person who made the contrary assertion had the actual authority to do so. This can be difficult. Lenders have not been successful, for example, where they relied on the company's accountant for information,[21] or where they relied on self-proclaimed managing directors.[22]

The lender does not need to prove that they actually identified the officers before they rely on the procedural assumptions in the indoor management rule. It is expected that lenders identify the officers, but it is also expected that once obtained, this information will not be disregarded.

The form of the contract

The lender is usually in the position to dictate the form of the contract. Loans and security transactions are invariably written documents. The practice is usually for them to be signed under common seal, although it should be noted that since 1998, companies are not required to have a seal. In lieu of a seal, a contract may still be executed under the signature of the company's officers: s 127(1).

Regardless of whether the contract is sealed or not, the lender should first cross-reference the signatories to the ASIC search information (see the heading "The company's officers", above). Also, the seal should comply with s 123 by accurately recording the company's full name, the expression "Australian Company Number" and that number.

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20 ASIC's information sheet on "Replaceable rules outlined" is reproduced in Appendix II. Obtained from the ASIC website: www.asic.gov.au.

21 *National Australia Bank v Sparrow Green Pty Ltd* (1999) 17 ACLC 1665.

22 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 48, *Pyramid Building Society v Scorpion Hotels Pty Ltd* (1996) 14 ACLC 679, *Sixty-Fourth Throne Pty Ltd v Macquarie Bank Ltd* [1998] 3 VR 133 and *National Australia Bank v Sparrow Green Pty Ltd* (1999) 17 ACLC 1665.

Corporate purpose

On balance, it is difficult to sustain any counsel other than that the lender must ascertain, in general terms, the purpose of the loan or the security provision. Such a routine disclosure can be seen in a positive light, as the assertions by the borrower at the time of the loan application may be useful in discounting the effect of lack of corporate purpose.

The lender does not need to prove corporate purpose. However, as a matter of practicality, evidence of corporate purpose may be useful to have on file, to counter any attack that may subsequently be made by the company, whether the company is seeking to avoid the contract, or whether the company is seeking a remedy against the lender for participating in a breach of the directors' fiduciary duty (constructive trusts). Nothing in the *Corporations Act* prevents the company taking action on the contract, seeking to avoid the contract, or seeking remedies under constructive trust law. Lack of corporate purpose is relevant because of:

1. The voidability of contracts in equity: a company can avoid a contract that is entered into by abuse of power (whether in the sense of directors exceeding the scope of their authority due to non-corporate purpose, or the sense of breach of fiduciary duty). The remedy is not sustainable against the lender who acted in good faith, for value and without notice of the abuse of power. Although equity uses the term "notice" here, notice at least refers to "constructive knowledge", in the sense of what the lender reasonably ought to have known about the transaction. Therefore, the company will be successful in avoiding the contract if it can prove that the lender ought reasonably to have had knowledge of the lack of corporate purpose.
2. The imposition of constructive trust liability on an lender who receives "trust" property, with knowledge of an underlying breach of fiduciary duty: liability under *Barnes v Addy*[23] depends upon the claimant proving that the recipient reasonably ought to have known that the property was transferred to and acquired by them in breach of the company's officers' fiduciary duty. Therefore, the company will be successful in imposing constructive trust liability on a lender where it can prove that the lender received the company's assets in circumstances where the lender knew or reasonably ought to have had knowledge of directors' failure to act in the interests of the company as a whole.
3. Even where the indoor management rule may assist the lender to assume corporate purpose (e.g. s 129(4)), lack of corporate purpose is relevant to the factual matrix concept. Lack of corporate purpose is one of the factors in the matrix for the reasonable and prudent banker test that triggers the second exception to the rule, rendering the specific procedural assumptions unavailable.

The register of charges

The doctrine of constructive notice still applies to charges: s 130(2). For purposes other than reliance on the rule, (for example, to check whether a prior charge prohibits the creation of subsequent charges) the lender needs to know the existence and terms of prior registered charges.

23 (1874) LR 9 Ch App 244.

Knowledge attribution

In corporate lending and finance transactions, the lender itself is usually a company. The lender's officers deal face to face with the company. The identity of the lender's officers may change, or there may be a hierarchical structure to decision making in relation to the contract. At various levels, the lender will have acquired information about the corporate borrower. As constructive (not actual) knowledge of lack of corporate purpose is all that is required to expose the lender to risk, then the lender invariably has an information management problem. The significance is that the law will attribute the knowledge collected from disparate sources to the corporate outsider. Once the lender knows certain information about the company, then this will trigger the reasonable obligation to inquire further (constructive knowledge) or at least accumulate the factors under the factual matrix concept that triggers the rule's exception. Whether they have sought the information or not, some facts will come to the attention of the lender from other sources. The types of information that the lender must not disregard, even where they have not sought it, it summarised under "Particular situations", below.

Particular situations

Situations where lenders particularly need to be wary of lack of corporate purpose are listed below.

1. No liability and charitable companies

As the *Corporations Act* requires No Liability and charitable companies to have constitutions, it may be argued that the company type constitutes express notice of corporate purpose. However, more than notice of the mandatory constitution would be required to prove that the lender had knowledge of the non-corporate purpose in their particular transaction. Further, for No Liability companies, s 112(5) provides protection, as a contract is not invalid merely because it is outside the company's mining purposes.

2. Third party security

By the very nature of the third party security transaction, the lender will know that the borrower and the security provider are not the same person. The third party security is merely one factor towards lack of corporate purpose, not conclusive. It is suggested that the lender act a little more proactively in the third party security situation, by at least corroborating the connection between the borrower and the security provider. This corroboration should be from a source other that the borrower or the borrower's solicitor. Direct contact with the security provider is a logical step; the response by the security provider generates evidence of corporate purpose.

3. The group situation

A particular subset of the third party scenario is the intra-group transaction, where the lender may be more relaxed about corporate purpose, but where some proactive steps are still recommended. The main recommendation is to corroborate the group structure, from some independent source. *Equiticorp Finance Ltd v Bank of New Zealand*[24] illustrates that financing transactions involving genuine corporate groups have sufficient corporate purpose to take them out of the factual matrix concept. Note that *Equiticorp* did not involve a guarantee. *ANZ Executors and Trustee Ltd v Qintex Australia Ltd*[25] illustrates

24 (1993) 11 ACLC 952.
25 [1991] 2 Qd R 360.

that guarantees are considered a gift of assets, and at least in insolvency situations, will be regarded as an abuse of corporate power by company officers.

4. Directors proffering "other" security for their loans

In another variation on the third party security scenario, the lender's risk is increased where the borrower is a director of the third party security provider and the director is proffering the company's assets as security for their personal loans. This connection adds another factor to the factual matrix concept. The lender's risk increases, because the transaction alerts suspicion as to lack of corporate purpose in the sense of the breach of fiduciary duty. Suspicion of a breach of fiduciary duty indicates a risk of voidability of the contract, a risk of participatory liability and a risk that the rule's assumptions will not be available. Due to the increased risk of exposure, it is suggested that the lender adopt a more inquiring stance. The only real safeguard is for the lender to demand direct evidence of corporate purpose from the third party security provider, such as a board minute or, more conclusively, a shareholder resolution approving the third party security.

5. Trust assets as security

Trust assets as security are a special case, whether or not the security is a third party security. The *Corporations Act* does not allow the lender to assume that the trustee has the power to grant security. In this case, there are ultra vires issues regarding the trust, as well as factors that add to the factual matrix concept that may inhibit access to the assumptions as to due execution. In view of the extra risk, the lender needs to make inquiry, primarily perusing a copy of the trust deed.

Conclusion

By analysing the new provisions in detail, the law reform achieves a fair balance between outsiders' and stakeholders' interests. However, the law reform should not be attributed with any major change from prior legislative attempts. Abuse of corporate authority is relevant in several respects and short of expressly attacking the general law remedies available to companies aggrieved by the actions of their officers in exercising power, the *Corporations Act* provides useful presumptions to facilitate contract enforcement.

Although statutory intervention in the rules relating to corporate contracts has been ongoing for the last twenty years, our findings suggest there are matters in the *Corporations Act* that could benefit from some reappraisal or clarification. These are:

1. The simplified format of s 125, with the complete absence of any explicit effects of non-compliance with the corporate constitution, leaves a gap. The Explanatory Memorandum states that non-compliance with the constitution may still be asserted or relied upon in other actions under the Act (for example breach of the statutory duties, oppression remedy and winding up). The *Company Law Review Act 1998* represents a new streamlined drafting style that elsewhere includes notes and tables signposting to other relevant provisions. Section 125 could have benefited from such a drafting technique.
2. Section 129(4) could benefit from an express description of the "duties", for example "fiduciary" or "substantive" to overcome the debate that the assumption is restricted to some formalistic notion of administrative duties.

3. Section 129 as a whole could be improved by an express reservation that the assumptions apply, but not in derogation of general law remedies. This drafting technique is used elsewhere, for example, in directors' duties (s 185) and prospectus disclosure liability (s 729(4)). The advantage is that s 129 is signalled as a rule of procedural regularity only, and does not interfere with the company's other remedies in equity, such as to avoid the contract or constructive trusts.

Appendix I

The major statutory provisions relevant to the monograph, before and after the *Company Law Review Act 1998* changes

CORPORATIONS ACT SINCE 1 JULY 1998

SECTION 123 COMPANY MAY HAVE COMMON SEAL

123(1) [Common seal] A company may have a common seal. If a company does have a common seal, the company must set out on it:

(a) for a company that has its ACN in its name the company's name; or

(b) otherwise the company's name, the expression "Australian Company Number" and the company's ACN.

Note 1: A company may make contracts and execute documents without using a seal (see sections 126 and 127).

Note 2: For abbreviations that can be used on a seal, see section 149.

123(2) [Duplicate] A company may have a duplicate common seal. The duplicate must be a copy of the common seal with the words "duplicate seal", "share seal" or "certificate seal" added.

123(3) [Prohibition] A person must not use, or authorise the use of, a seal that purports to be the common seal of a company or a duplicate if the seal does not comply with the requirements set out in subsection (1) or (2).

CHAPTER 2B BASIC FEATURES OF A COMPANY

PART 2B.1 COMPANY POWERS AND HOW THEY ARE EXERCISED

SECTION 124 LEGAL CAPACITY AND POWERS OF A COMPANY

124(1) [Capacity and powers] A company has the legal capacity and powers of an individual both in and outside this jurisdiction. A company also has all the powers of a body corporate, including the power to:

(a) issue and cancel shares in the company

(b) issue debentures

(c) grant options over unissued shares in the company

(d) distribute any of the company's property among the members, in kind or otherwise

(e) give security by charging uncalled capital

(f) grant a floating charge over the company's property

(g) arrange for the company to be registered or recognised as a body corporate in any place outside this jurisdiction

(h) do anything that it is authorised to do by any other law (including a law of a foreign country).

A company limited by guarantee does not have the power to issue shares.

Note:
For a company's power to issue bonus, partly-paid, preference and redeemable preference shares, see section 254A.

124(2) [Company's interests] A company's legal capacity to do something is not affected by the fact that the company's interests are not, or would not be, served by doing it.

SECTION 125 CONSTITUTION MAY LIMIT POWERS AND SET OUT OBJECTS

125(1) [Limitations in constitution] If a company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of any of its powers. The exercise of a power by the company is not invalid merely because it is contrary to an express restriction or prohibition in the company's constitution.

125(2) [Company's objects] If a company has a constitution, it may set out the company's objects. An act of the company is not invalid merely because it is contrary to or beyond any objects in the company's constitution.

SECTION 126 AGENT EXERCISING A COMPANY'S POWER TO MAKE CONTRACTS

126(1) [Acting on company's behalf] A company's power to make, vary, ratify or discharge a contract may be exercised by an individual acting with the company's express or implied authority and on behalf of the company. The power may be exercised without using a common seal.

126(2) [Non-application] This section does not affect the operation of a law that requires a particular procedure to be complied with in relation to the contract.

SECTION 127 EXECUTION OF DOCUMENTS (INCLUDING DEEDS) BY THE COMPANY ITSELF

127(1) [Execution without seal] A company may execute a document without using a common seal if the document is signed by:

(a) 2 directors of the company; or
(b) a director and a company secretary of the company; or
(c) for a proprietary company that has a sole director who is also the sole company secretary – that director.

Note:
If a company executes a document in this way, people will be able to rely on the assumptions in subsection 129(5) for dealings in relation to the company.

127(2) [Execution with seal] A company with a common seal may execute a document if the seal is fixed to the document and the fixing of the seal is witnessed by:
(a) 2 directors of the company; or
(b) a director and a company secretary of the company; or
(c) for a proprietary company that has a sole director who is also the sole company secretary that director.

Note:
If a company executes a document in this way, people will be able to rely on the assumptions in subsection 129(6) for dealings in relation to the company.

127(3) [Execution as a deed] A company may execute a document as a deed if the document is expressed to be executed as a deed and is executed in accordance with subsection (1) or (2).

127(4) [No limitation] This section does not limit the ways in which a company may execute a document (including a deed).

PART 2B.2 –ASSUMPTIONS PEOPLE DEALING WITH COMPANIES ARE ENTITLED TO MAKE

SECTION 128 ENTITLEMENT TO MAKE ASSUMPTIONS

128(1) [Entitlement] A person is entitled to make the assumptions in section 129 in relation to dealings with a company. The company is not entitled to assert in proceedings in relation to the dealings that any of the assumptions are incorrect.

128(2) [Title to property] A person is entitled to make the assumptions in section 129 in relation to dealings with another person who has, or purports to have, directly or indirectly acquired title to property from a company . The company and the other person are not entitled to assert in proceedings in relation to the dealings that any of the assumptions are incorrect.

128(3) [Fraud or forgery] The assumptions may be made even if an officer or agent of the company acts fraudulently, or forges a document, in connection with the dealings.

128(4) [Knowledge or suspicion] A person is not entitled to make an assumption in section 129 if at the time of the dealings they knew or suspected that the assumption was incorrect.

SECTION 129 ASSUMPTIONS THAT CAN BE MADE UNDER SECTION 128

129(1) Constitution and replaceable rules complied with. A person may assume that the company's constitution (if any), and any provisions of this Law that apply to the company as replaceable rules, have been complied with.

129(2) Director or company secretary. A person may assume that anyone who appears, from information provided by the company that is available to the public from ASIC, to be a director or a company secretary of the company:

(a) has been duly appointed; and

(b) has authority to exercise the powers and perform the duties customarily exercised or performed by a director or company secretary of a similar company

129(3) Officer or agent. A person may assume that anyone who is held out by the company to be an officer or agent of the company:

(a) has been duly appointed; and

(b) has authority to exercise the powers and perform the duties customarily exercised or performed by that kind of officer or agent of a similar company.

129(4) Proper performance of duties. A person may assume that the officers and agents of the company properly perform their duties to the company.

129(5) Document duly executed without seal. A person may assume that a document has been duly executed by the company if the document appears to have been signed in accordance with subsection 127(1). For the purposes of making the assumption, a person may also assume that anyone who signs the document and states next to their signature that they are the sole director and sole company secretary of the company occupies both offices.

129(6) Document duly executed with seal. A person may assume that a document has been duly executed by the company if:

(a) the company's common seal appears to have been fixed to the document in accordance with subsection 127(2); and

(b) the fixing of the common seal appears to have been witnessed in accordance with that subsection.

For the purposes of making the assumption, a person may also assume that anyone who witnesses the fixing of the common seal and states next to their signature that they are the sole director and sole company secretary of the company occupies both offices.

129(7) Officer or agent with authority to warrant that document is genuine or true copy. A person may assume that an officer or agent of the company who has authority to issue a document or a certified copy of a document on its behalf also has authority to warrant that the document is genuine or is a true copy.

129(8) [Application of assumptions] Without limiting the generality of this section, the assumptions that may be made under this section apply for the purposes of this section.

SECTION 130 INFORMATION AVAILABLE TO THE PUBLIC FROM ASIC DOES NOT CONSTITUTE CONSTRUCTIVE NOTICE

130(1) [Information available from ASIC] A person is not taken to have information about a company merely because the information is available to the public from ASIC.

130(2) [Registrable charge] Subsection (1) does not apply in relation to a document that has been lodged with ASIC to the extent that the document relates to a charge that is registrable under this Act.

130(3)
(Repealed by No 61 of 1998, Sch 1 (effective 1 July 1998)

PART 2B.4 – REPLACEABLE RULES AND CONSTITUTION

SECTION 134 INTERNAL MANAGEMENT OF COMPANIES

134 A company's internal management may be governed by provisions of this Act that apply to the company as replaceable rules, by a constitution or by a combination of both.

Note:
There are additional rules about internal management in ordinary provisions of this Act and also in the common law.

SECTION 135 REPLACEABLE RULES

135(1) Companies to which replaceable rules apply. A section or subsection (except subsection 129(1), this section and sections 140 and 141) whose heading contains the words:

(a) replaceable rule applies as a replaceable rule to:
  (i) each company that is registered after the commencement of this Part; and
  (ii) any company registered before that commencement that repeals its constitution after that commencement; and

(b) replaceable rule for proprietary companies and mandatory rule for public companies applies:
  (i) as a replaceable rule to any proprietary company that is registered after the commencement of this Part; and
  (ii) as a replaceable rule to any company that is registered after that commencement and that changes to a proprietary company (but only while it is a proprietary company); and
  (iii) as a replaceable rule to any proprietary company registered before that commencement that repeals its constitution after that commencement; and
  (iv) as an ordinary provision of this Act to any public company whenever registered.

The section or subsection does not apply to a proprietary company while the same person is both its sole director and sole shareholder.

Note 1:
See section 224B for the special provisions that apply to a proprietary company while the same person is both its sole director and sole shareholder.

Note 2:
A company may include in its constitution (by reference or otherwise) a replaceable rule that does not otherwise apply to it.

135(2) Company's constitution can displace or modify replaceable rules. A provision of a section or subsection that applies to a company as a replaceable rule can be displaced or modified by the company's constitution.

135(3) Failure to comply with replaceable rules. A failure to comply with the replaceable rules as they apply to a company is not of itself a contravention of this Act (so the provisions about criminal liability, civil liability and injunctions do not apply).

Note:
Replaceable rules that apply to a company have effect as a contract (see section 140).

SECTION 136 CONSTITUTION OF A COMPANY

136(1) [Adoption] A company adopts a constitution:

(a) on registration – if each person specified in the application for the company's registration as a person who consents to become a member agrees in writing to the terms of a constitution before the application is lodged; or

(b) after registration – if the company passes a special resolution adopting a constitution.

Note 1:
The memorandum and articles of a company immediately before the commencement of this Part are taken together to make up the company's constitution after commencement (see section 1415).

Note 2:
The Life Insurance Act 1995 has rules about how benefit fund rules become part of a company's constitution and about amending those rules. They override this Act. Consequential amendments to the rest of the company's constitution can be made under that Act or this Act. See Subdivision 2 of Division 4 of Part 2A of that Act.

136(2) [Modification or repeal] The company may modify or repeal its constitution, or a provision of its constitution, by special resolution.

136(3) [Further requirement] The company's constitution may provide that the special resolution does not have any effect unless a further requirement specified in the constitution relating to that modification or repeal has been complied with.

136(4) [Modification or repeal of further requirement] Unless the constitution provides otherwise, the company may modify or repeal a further requirement described in subsection (3) only if the further requirement is itself complied with.

136(5) [Public company] A public company must lodge with ASIC a copy of a special resolution adopting, modifying or repealing its constitution within 14 days after it is passed. The company must also lodge with ASIC within that period:
(a) if the company adopts a constitution – a copy of that constitution; or
(b) if the company modifies its constitution – a copy of that modification.

This also applies to a proprietary company that has applied under Part 2B.7 to change to a public company, while its application has not yet been determined.

SECTION 137 DATE OF EFFECT OF ADOPTION, MODIFICATION OR REPEAL OF CONSTITUTION

137(1) [Date of effect] A special resolution adopting, modifying or repealing a company's constitution takes effect:
(a) if no later date is specified in the resolution – on the date on which the resolution is passed; or
(b) on a later date specified in, or determined in accordance with, the resolution.

Note:
The Life Insurance Act 1995 has rules about when approved benefit fund rules (which become part of the company's constitution), and amendments to them, take effect. It also has rules about when consequential amendments to the rest of the company's constitution made under that Act take effect.

They override this Act. See Subdivision 2 of Division 4 of Part 2A of that Act.

137(2) [Change of name etc] Subsection (1) does not apply to the date of effect of a special resolution passed in connection with a change of name, change of type or a variation or cancellation of class rights.

Note:
For the date of effect of these changes, see subsection 157(3) (name), subsection 164(5) (type) and subsection 246D(3) and section 246E (class rights).

SECTION 138 ASIC MAY DIRECT COMPANY TO LODGE CONSOLIDATED CONSTITUTION

138 ASIC may direct a company to lodge a consolidated copy of its constitution with ASIC.

SECTION 139 COMPANY MUST SEND COPY OF CONSTITUTION TO MEMBER

139 A company must send a copy of its constitution to a member of the company within 7 days if the member:
(a) asks the company, in writing, for the copy; and
(b) pays any fee (up to the prescribed amount) required by the company.

SECTION 140 EFFECT OF CONSTITUTION AND REPLACEABLE RULES

140(1) [Contract] A company's constitution (if any) and any replaceable rules that apply to the company have effect as a contract:
(a) between the company and each member; and
(b) between the company and each director and company secretary; and
(c) between a member and each other member;
under which each person agrees to observe and perform the constitution and rules so far as they apply to that person.

140(2) [Modification of constitution] Unless a member of a company agrees in writing to be bound, they are not bound by a modification of the constitution made after the date on which they became a member so far as the modification:
(a) requires the member to take up additional shares; or
(b) increases the member's liability to contribute to the share capital of, or otherwise to pay money to, the company; or
(c) imposes or increases restrictions on the right to transfer the shares already held by the member, unless the modification is made:
  (i) in connection with the company's change from a public company to a proprietary company under Part 2B.7; or
  (ii) to insert takeover approval provisions of a kind referred to in section 671.

SECTION 198A POWERS OF DIRECTORS (REPLACEABLE RULE — SEE SECTION 135)

198A(1) [Management of business] The business of a company is to be managed by or under the direction of the directors.

Note:
See section 198E for special rules about the powers of directors who are the single director /shareholder of proprietary companies .

198A(2) [Exercise of powers] The directors may exercise all the powers of the company except any powers that this Act or the company's constitution (if any) requires the company to exercise in general meeting.

Note:
For example, the directors may issue shares, borrow money and issue debentures .

SECTION 198B NEGOTIABLE INSTRUMENTS (REPLACEABLE RULE—SEE SECTION 135)

198B(1) [Execution of negotiable instrument] Any 2 directors of a company that has 2 or more directors, or the director of a proprietary company that has only 1 director , may sign, draw, accept, endorse or otherwise execute a negotiable instrument.

198B(2) [Directors may determine different execution] The directors may determine that a negotiable instrument may be signed, drawn, accepted, endorsed or otherwise executed in a different way.

SECTION 198C MANAGING DIRECTOR (REPLACEABLE RULE—SEE SECTION 135)

198C(1) [Conferral of powers] The directors of a company may confer on a managing director any of the powers that the directors can exercise.

198C(2) [Power can be revoked or varied] The directors may revoke or vary a conferral of powers on the managing director.

SECTION 201M EFFECTIVENESS OF ACTS BY DIRECTORS

201M(1) [Effectiveness of acts]
An act done by a director is effective even if their appointment, or the continuance of their appointment, is invalid because the company or director did not comply with the company's constitution (if any) or any provision of this Act.

201M(2) [Ramifications not addressed] Subsection (1) does not deal with the question whether an effective act by a director:
(a) binds the company in its dealings with other people; or
(b) makes the company liable to another person.

Note:
The kinds of acts that this section validates are those that are only legally effective if the person doing them is a director (for example, calling a meeting of the company's members or signing a document to be lodged with ASIC or minutes of a meeting). Sections 128–130 contain rules about the assumptions people are entitled to make when dealing with a company and its officers.

EQUIVALENT PROVISIONS OF THE CORPORATIONS ACT PRIOR TO 1 JULY 1998

PART 2.3 LEGAL CAPACITY, POWERS AND STATUS

Division 1 Legal capacity and powers

SECTION 159 INTERPRETATION [66B]

159 In sections 160, 161 and 162:

(a) a reference to the doing of an act by a company includes a reference to the making of an agreement by the company and a reference to a transfer of property to or by the company; and

(b) a reference to legal capacity includes a reference to powers.

SECTION 160 OBJECT OF SECTIONS 161 AND 162 [66C]

160 The object of sections 161 and 162 is:

(a) to abolish the doctrine of ultra vires in its application to companies; and

(b) 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;

and those sections shall be construed, and have effect, accordingly.

SECTION 161 LEGAL CAPACITY [67]

161(1) [Company to have legal capacity of a natural person] A company has, both within and outside this jurisdiction, the legal capacity of a natural person and, without limiting the generality of the foregoing, has, both within and outside this jurisdiction, power:

(a) to issue and allot fully or partly paid shares in the company;

(b) to issue debentures of the company;

(c) to distribute any of the property of the company among the members, in kind or otherwise;

(d) to give security by charging uncalled capital;

(e) to grant a floating charge on property of the company;

(f) to procure the company to be registered or recognised as a body corporate in any place outside this jurisdiction; and

(g) to do any other act that it is authorised to do by any other law (including a law of a foreign country).

161(2) [Effect of subsec (1)] Subsection (1) has effect in relation to a company:

(a) subject to this Law (other than subsection 162(2));

(b) in a case where the company's constitution contains an express or implied restriction on, or an express or implied prohibition of, the exercise by the company of any of its powers despite any such restriction or prohibition;

(c) in a case where the memorandum of the company contains a provision stating the objects of the company despite that fact; and

(d) despite subsection 162(2).

161(3) [Actions not in company's best interests] The fact that the doing of an act by a company would not be, or is not, in its best interests does not affect its legal capacity to do the act.

SECTION 162 RESTRICTIONS ON COMPANIES [68]

162(1) [Restriction or prohibition in constitution] A company's constitution may contain an express restriction on, or an express prohibition of, the exercise by the company of a power of the company.

162(2) [Power exercised contrary to restriction or prohibition] Where:

(a) a company exercises a power contrary to an express restriction on, or an express prohibition of, the exercise of that power, being a restriction or prohibition contained in the company's constitution; or

(b) the memorandum of a company contains a provision stating the objects of the company and the company does an act otherwise than in pursuance of those objects;

the company contravenes this subsection.

162(3) [Officer in contravention] An officer of a company who is involved in a contravention by the company of subsection (2) contravenes this subsection.

162(4) [Contravention not an offence] A person who contravenes subsection (2) or (3) is not guilty of an offence.

162(5) [Action not invalid by contravention] Where, by exercising a power as mentioned in paragraph (2)(a), or by doing an act as mentioned in paragraph (2)(b), a company contravenes subsection (2), the exercise of the power, or the act, as the case may be, is not invalid merely because of the contravention.

162(6) [Act of officer not invalid] An act of an officer of a company is not invalid merely because, by doing the act, the officer contravenes subsection (3).

162(7) [Reliance on fact of act] The fact that:

(a) by exercising a power as mentioned in paragraph (2)(a), or by doing an act as mentioned in paragraph (2)(b), a company contravened, or would contravene, subsection (2); or

(b) by doing a particular act, an officer of a company contravened, or would contravene, subsection (3);

may be asserted or relied on only in:

(c) a prosecution of a person for an offence against this Law;

(d) an application for an order under section 230;

(e) an application for an order under section 260;

(f) an application for an injunction under section 1324 to restrain the company from entering into an agreement;

(g) proceedings (other than an application for an injunction) by the company, or by a member of the company, against the present or former officers of the company; or

(h) an application by the Commission or by a member of the company for the winding up of the company.

162(8) [Court may order damages] Where, if subsection (7) had not been enacted, the Court would have power under section 1324 to grant, on the application of a person, an injunction restraining a company, or an officer of a company, from engaging in particular conduct constituting a contravention of subsection (2) or (3), as the case may be, the Court may, on the application of that person, order the first-mentioned company, or the officer, as the case may be, to pay damages to that person or any other person.

SECTION 164 PERSONS HAVING DEALINGS WITH COMPANIES ETC.[68A]

164(1) [Certain assumptions not to be denied by companies] A person having dealings with a company is, subject to subsection (4), entitled to make, in relation to those dealings, the assumptions referred to in subsection (3) and, in any proceedings in relation to those dealings, any assertion by the company that the matters that the person is so entitled to assume were not correct shall be disregarded.

164(2) [Persons entitled to assume good title from company] A person having dealings with a person who has acquired or purports to have acquired title to property from a company (whether directly or indirectly) is, subject to subsection (5), entitled to make, in relation to the acquisition or purported acquisition of title from the company, the assumptions referred to in subsection (3) and, in any proceedings in relation to those dealings, any assertion by the company or by the second-mentioned person that the matters that the first-mentioned person is so entitled to assume were not correct shall be disregarded.

164(3) [Persons entitled to make certain assumptions when dealing with company] The assumptions that a person is, by virtue of subsection (1) or (2), entitled to make in relation to dealings with a company, or in relation to an acquisition or purported acquisition from a company of title to property, as the case may be, are:

(a) that, at all relevant times, the company's constitution has been complied with;

(b) that a person who appears, from notices or returns lodged under section 242 or 335 or with a person under a previous law corresponding to section 242 or 335, to be a director or a secretary of the company has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by a director or by a secretary, as the case may be, of a company carrying on a business of the kind carried on by the company;

(c) that a person who is held out by the company to be an officer or agent of the company has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by an officer of the kind concerned;

(d) that an officer or agent of the company who has authority to issue a document on behalf of the company has authority to warrant that the document is genuine and that an officer or agent of the company who has authority to issue a certified copy of a document on behalf of the company has authority to warrant that the copy is a true copy;

(e) that a document has been duly sealed by the company if it bears what appears to be an impression of the company's seal and either:

(i) the sealing of the document appears to be witnessed by 2 people, one of whom may be assumed to be a director of the company because of paragraph (b) or (c) and the other of whom may be assumed to be a director or a secretary of the company because of those paragraphs; or

(ii) the sealing of the document appears to be witnessed by one person who may be assumed to be a director and a secretary of the company because of paragraph (b) or (c) but only if it is stated next to the signature that the person witnesses the sealing in the capacity of sole director and sole secretary of the company;

164(4) [Exception where actual knowledge] Despite subsection (1), a person is not entitled to make an assumption referred to in subsection (3) in relation to dealings with a company if:

(a) the person has actual knowledge that the matter that, but for this subsection, the person would be entitled to assume is not correct; or

(b) the person's connection or relationship with the company is such that the person ought to know that the matter that, but for this subsection, the person would be entitled to assume is not correct;

and where, by virtue of this subsection, a person is not entitled to make a particular assumption in relation to dealings with a company, subsection (1) has no effect in relation to any assertion by the company in relation to the assumption.

164(5) [No assumption to good title where actual knowledge to contrary] Despite subsection (2), a person is not entitled to make an assumption referred to in subsection (3) in relation to an acquisition or purported acquisition from a company of title to property if:

(a) the person has actual knowledge that the matter that, but for this subsection, the person would be entitled to assume is not correct; or

(b) the person's connection or relationship with the company is such that the person ought to know that the matter that, but for this subsection, the person would be entitled to assume is not correct;

and where, by virtue of this subsection, a person is not entitled to make a particular assumption in relation to dealings with a company, subsection (2) has no effect in relation to any assertion by the company or by any other person in relation to the assumption.

SECTION 166 EFFECT OF FRAUD [68D]

166 Section 164 operates:

(a) to entitle a person to make the assumptions referred to in subsection (3) of that section in relation to dealings with a company; or

(b) to entitle a person to make the assumptions referred to in subsection (3) of that section in relation to an acquisition or purported acquisition (whether direct or indirect) of title to property from a company;

even if a person referred to in paragraph 164(3)(b), (c) or (e) or an officer, agent or employee of the company referred to in paragraph 164(3)(d) or (f):

(c) has acted or is acting fraudulently in relation to the dealings, or in relation to the acquisition or purported acquisition of title to property from the company, as the case may be; or

(d) has forged a document that appears to have been sealed on behalf of the company;
unless the person referred to in paragraph (a) or (b) of this section has actual knowledge that the person referred to in paragraph 164(3)(b), (c) or (e), or the officer, agent or employee of the company referred to in paragraph 164(3)(d) or (f), has acted or is acting fraudulently, or has forged a document, as mentioned in paragraph (c) or (d) of this section.

SECTION 125 ARTICLES OF ASSOCIATION [74]

125(1) [Articles to be registered] There may, in the case of a company limited by shares (other than a Table A proprietary company) or a no liability company, and there shall, in the case of a company limited by guarantee, a company limited both by shares and by guarantee or an unlimited company, be registered with the memorandum, articles signed by the subscribers to the memorandum prescribing regulations for the company.

125(2) [Subscribers may sign articles] At any time before the registration under this Division of a Table A proprietary company, the subscribers to the company's memorandum may sign articles prescribing regulations for the company.

125(3) [Table A proprietary companies] Where, as at the registration under this Division of a Table A proprietary company, no articles prescribing regulations for the company have been signed under subsection (2), the company may, at any time after that registration, make such articles by special resolution.

125(4) [Articles to be printed, etc.] Articles shall be:

(a) printed;

(b) divided into numbered paragraphs; and

(c) unless made under subsection (3) signed by each subscriber to the memorandum in the presence of at least one witness (not being another subscriber).

125(5) [Witness] A witness to a signature to the articles of a subscriber to the memorandum shall attest the signature and add the address of the witness.

125(6) [Articles to state share capital] In the case of an unlimited company that has a share capital, the articles shall state the amount of share capital with which the company proposes to be registered and the division of that share capital into shares of a fixed amount.

SECTION 172 ALTERATIONS OF MEMORANDUM [73]

172(1) [Alteration by special resolution] Subject to this section, a company may, by special resolution, alter the memorandum of the company:

(a) if the memorandum contains a provision stating the objects of the company by altering or omitting that provision;

(b) if the memorandum does not contain a provision stating the objects of the company by inserting in the memorandum a provision stating the objects of the company; or

(c) in any case by altering, omitting or inserting any other provision with respect to the objects of the company or any provision with respect to the powers of the company.

172(2) [Provision which could be in articles] Subject to this section, subsection 180(3) and section 260, if a provision of the memorandum of a company could lawfully have been contained in the articles of the company, the company may, by special resolution, alter the memorandum:

(a) unless the memorandum prohibits the alteration of that provision by altering that provision; or

(b) unless the memorandum prohibits the omission of that provision by omitting that provision.

172(3) [Restriction on effect of special resolution] The memorandum of a company may provide that a special resolution altering, adding to or omitting a provision contained in the memorandum, being a provision that could lawfully have been contained in the articles of the company, does not have any effect unless and until a further requirement specified in the memorandum has been complied with.

172(4) [Examples of requirement] Without limiting the generality of subsection (3), the further requirement referred to in that subsection may be a requirement:

(a) that the relevant special resolution be passed by a majority consisting of a greater number of members than is required to constitute the resolution as a special resolution;

(b) that the consent or approval of a particular person be obtained; or

(c) that a particular condition be fulfilled.

172(5) [Particular class rights] Nothing in subsection (2) permits the alteration or omission of a provision of the memorandum of a company that relates to rights to which only members in a particular class of members are entitled.

172(6) [Persons entitled to notice] Notice of a general meeting specifying the intention to propose, as a special resolution, a resolution for the alteration of the memorandum of a company, being an alteration provided for by subsection (1), shall be given:

(a) to all members;

(b) to all trustees for debenture holders; and

(c) if there are no trustees for, or for a particular class of, debenture holders to all debenture holders, or all debenture holders in that class, as the case may be, whose names are, at the time of the posting of the notice, known to the company.

172(7) [Court may dispense with notice] The Court may, in the case of any person or class of persons, for such reasons as seem sufficient to the Court, dispense with the notice referred to in subsection (6).

172(8) [Cancellation of alteration] If an application for the cancellation of an alteration of the memorandum of a company is made to the Court in accordance with this section by:

(a) in the case of an alteration provided for by subsection (1) the holders of not less than 10% in nominal value of the company's debentures; or

(b) in any case the holders of not less, in the aggregate, than 10% in nominal value of the company's issued share capital or any class of that capital or, if the company is not limited by shares, not less than 10% of the company's members;

the alteration does not have any effect except so far as it is confirmed by the Court.

172(9) [Application to be made within 21 days] The application shall be made within 21 days after the date on which the resolution altering the memorandum of the company was passed, and may be made, on behalf of the persons entitled to make the application, by such one or more of their number as they appoint in writing for the purpose.

172(10) [Power of Court] On the application, the Court shall have regard to the rights and interests of the members of the company or of any class of them as well as to the rights and interests of the creditors and may do any or all of the following:

(a) adjourn the proceedings so that an arrangement may be made to the satisfaction of the Court for the purchase (otherwise than by the company or a subsidiary of the company) of the interests of dissentient members;

(b) give directions and make orders for facilitating or carrying into effect any such arrangement;

(c) make an order cancelling the alteration or confirming the alteration either wholly or in part and on specified terms and conditions.

172(11) [Interpretation] A reference in this section to a provision of the memorandum of a company that could lawfully have been contained in the articles of the company is, in the case of a memorandum of a Division 2 or 3 company, a reference to a provision of the memorandum of the company that could lawfully have been contained in the articles of the company if the memorandum and articles of the company had originally been registered under this Law.

SECTION 173 LODGING, AND TAKING EFFECT, OF RESOLUTIONS PASSED UNDER SECTION 172 [73]

173(1) [Overriding provision] Where a resolution altering a company's memorandum as provided by subsection 172(1) or (2) is passed, this section has effect despite any other provision of this Law.

173(2) [Lodgment of resolution] If this Law requires a copy of the resolution to be lodged, the company shall:

(a) if no application is made to the Court in accordance with section 172 lodge such a copy within 14 days after the end of the period of 21 days after the day on which the resolution is passed; or

(b) otherwise lodge such a copy, together with an office copy of the order of the Court, within 14 days after:

  (i) the end of that period of 21 days; or

  (ii) the Court determines the application;

whichever happens later.

173(3) [When resolution takes effect] Otherwise, the resolution shall not take effect before the end of 21 days after the day on which the resolution is passed.

SECTION 174 EFFECT OF MEMORANDUMS OF CERTAIN DIVISION 2 COMPANIES

174(1) [Definitions] In this section:
"entrenchable provision" , in relation to the memorandum of a body corporate, means a provision of the memorandum that could lawfully have been contained in the body's articles;
"translation day" , in relation to a company, means the prescribed day.

174(2) [Alteration of entrenchable provisions] Where, throughout the period beginning immediately before a Division 2 company's translation day and ending immediately before its registration day, the company's memorandum:
(a) prohibited the alteration of an entrenchable provision; or
(b) provided as mentioned in a previous law corresponding to subsection 172(3) in respect of a special resolution altering or adding to an entrenchable provision;
then, so long as it continues so to prohibit, or so to provide, the company's memorandum is taken:
(c) also to prohibit the omission of the entrenchable provision; or
(d) also to provide the same effect in respect of a special resolution omitting the entrenchable provision;
as the case may be.

174(3) [Effect of subsection] Subsection (2) has effect in relation to a memorandum except so far as the memorandum expressly provides to the contrary.

SECTION 175 ARTICLES ADOPTING TABLE A OR B [75]

175(1) [Adoption] Articles may:
(a) in the case of a company other than a no liability company adopt all or any of the regulations contained in Table A; or
(b) in the case of a no liability company adopt all or any of the regulations contained in Table B.

175(2) [Company limited by shares] Where a Division 1 company is a company limited by shares, the regulations contained in Table A, except in so far as they are excluded or modified by articles of the company that are registered, or signed or made, as the case requires, under section 125, shall be, so far as applicable, the company's articles in the same manner, and to the same extent, as if they were contained in registered articles.

175(3) [Regulations deemed to be included in Articles] Except in so far as the regulations contained in Table A are excluded or modified by, or are otherwise inconsistent with, provisions that are proved for the purposes of a proceeding in an Australian court to be included (otherwise than by virtue of subsection (2)) at a particular time in the articles of a Table A proprietary company, those regulations shall be deemed for the purposes of that proceeding to have been included in the company's articles at that time.

175(4) [No liability company] In the case of a Division 1 company that is a no liability company, if articles are not registered, or if articles are registered then in so far as they do not exclude or modify the regulations contained in Table B, those regulations shall, so far as applicable, be the articles of the company in the same manner, and to the same extent, as if they were contained in registered articles.

SECTION 176 ALTERATION OF ARTICLES

[76]

176(1) [Alteration by special resolution] Subject to this Law, a company may by special resolution alter or add to its articles.

176(2) [Restrictions on effect] The memorandum of a company may provide that a special resolution altering or adding to the articles of the company does not have any effect unless and until a further requirement specified in the memorandum has been complied with.

176(3) [Examples of requirements] Without limiting the generality of subsection (2), the further requirement referred to in that subsection may be a requirement:
(a) that the relevant special resolution be passed by a majority consisting of a greater number of members than is required to constitute the resolution as a special resolution;
(b) that the consent or approval of a particular person be obtained; or
(c) that a particular condition be fulfilled.

176(4) [Validity of addition or alteration] Subject to this Law, an alteration or addition so made in the articles is, on and from the date of the special resolution or such later date as is specified in the resolution, as valid as if originally contained in the articles and is subject in like manner to alteration by special resolution.

176(5) [Power to amend by adoption of Table A or Table B] Subject to this section, a company has the power, and shall be deemed always to have had the power, to amend its articles:
(a) unless it is a no liability company by the adoption of all or any of the regulations contained in Table A; or
(b) if it is a no liability company by the adoption of all or any of the regulations contained in Table B;
by reference only to the regulations in the Table or to the numbers of particular regulations contained in the Table, without being required in the special resolution effecting the amendment to set out the text of the regulations so adopted.

SECTION 180 OPERATION OF MEMORANDUM AND ARTICLES

[78]

180(1) [Memorandum and articles in contract] Subject to this Law, the constitution of a company has the effect of a contract under seal:
(a) between the company and each member;
(b) between the company and each eligible officer; and
(c) between a member and each other member;
under which each of the above-mentioned persons agrees to observe and perform the provisions of the constitution as in force for the time being so far as those provisions are applicable to that person.

180(2) [Money payable by member of debt] Subject to section 385, any money payable by a member of a company to the company under the company's constitution is a debt from the member to the company and is of the nature of a specialty debt.

180(3) [Member not bound by alteration] A member of a company, unless either before or after the alteration is made the member agrees in writing to be bound by it, is not bound by an alteration of the constitution made after the date on which the member became a member so far as the alteration:

(a) requires the member to take or subscribe for more shares than the number held by the member at the date of the alteration;

(b) in any way increases the member's liability as at the date of the alteration to contribute to the share capital of, or otherwise to pay money to, the company; or

(c) increases, or imposes, restrictions on the right to transfer the shares held by the member at the date of the alteration.

180(4)

(Omitted by No 115 of 1995, Sch 4 (effective 9 December 1995).)

180(5) ["eligible officer"] In this section, "eligible officer", in relation to a company, means a director or a secretary of the company.

SECTION 182 CONFIRMATION OF CONTRACTS AND AUTHENTICATION AND EXECUTION OF DOCUMENTS

182(1) [Power to make, vary or discharge contracts] So far as concerns the formalities of making, varying or discharging a contract, a person acting under the express or implied authority of a company may make, vary or discharge a contract in the name of, or on behalf of, the company in the same manner as if that contract were made, varied or discharged by a natural person.

182(2) [Effectiveness] The making, variation or discharging of a contract in accordance with subsection (1) is effectual in law and binds the company and other parties to the contract.

182(3) [Affixation of common seal] A contract or other document executed, or purporting to have been executed, under the common seal of a company is not invalid merely because a person attesting the affixing of the common seal was in any way, whether directly or indirectly, interested in that contract or other document or in the matter to which that contract or other document relates.

182(4) [Use of common seal] This section does not prevent a company from making, varying or discharging a contract under its common seal.

182(5) [Operation of section] This section does not apply in relation to a Division 2, 3 or 4 company in relation to the making, variation or discharging of a contract before the company's registration day, but applies otherwise in relation to such a company whether it gives its authority before, on or after that day.

182(6) [No effect on law requiring consent] This section does not affect the operation of a law that requires some consent or sanction to be obtained, or some procedure to be complied with, in relation to the making, variation or discharge of a contract.

182(7) [Authentication by signature of officer] A document or proceeding requiring authentication by a company may be authenticated by the signature of an officer of the company and need not be authenticated under the common seal of the company.

182(8) [Appointment of agent or attorney] A company may, by writing under its common seal, empower a person, either generally or in respect of a specified matter or specified matters, as its agent or attorney to execute deeds on its behalf, and a deed signed by such an agent or attorney on behalf of the company and under his, her or its seal or, subject to subsections (10) and (11), under the appropriate official seal of the company, binds the company and has the same effect as if it were under the common seal of the company.

182(9) [Duration of authority] The authority of an agent or attorney empowered under subsection (8), as between the company and a person dealing with him, her or it, continues during the period (if any) mentioned in the instrument conferring the authority or, if no period is so mentioned, until notice of the revocation or termination of his, her or its authority has been given to the person dealing with him, her or it.

182(10) [Official seals] A company may, if authorised by its articles, have for use in place of its common seal outside the State or Territory where its common seal is kept one or more official seals, each of which shall be a facsimile of the common seal of the company with the addition on its face of the name of every place where it is to be used.

182(11) [Use of official seals] The person affixing such an official seal shall, in writing signed by the person, certify on the instrument to which it is affixed the date on which and the place at which it is affixed.

182(12) [Deemed sealed with common seal] A document sealed with such an official seal shall be deemed to be sealed with the common seal of the company.

SECTION 219 PUBLICATION OF COMPANY'S NAME AND REGISTRATION NUMBER

219(1) [Company name and number on seal] A company shall set out in legible characters on its common seal, and on each of its other seals, its name followed by, unless its registration number is part of its name, the expression "Australian Company Number" and its registration number.

219(2) [Name on documents] A company shall set out its name, in legible characters, on:

(a) every public document of the company that is signed, issued or published; and
(b) every eligible negotiable instrument of the company that is signed or issued.

219(2A) [Name and number on documents to be lodged] On every public document of a company that, when it is signed, issued or published:
(a) is intended to be lodged; or
(b) is required by or under this Law or the ASC Law to be lodged;
the company must, unless its registration number is part of its name, set out in legible characters, after the company's name where it first appears, the expression "Australian Company Number" and the company's registration number.

219(3) [Number on documents] On:

(a) every public document of a company that is signed, issued or published; and
(b) every eligible negotiable instrument of a company that is signed or issued;
after 31 December 1991, the company must, unless its registration number is part of its name, set out in legible characters, after the company's name where it first appears, the expression "Australian Company Number" and the company's registration number.

219(3A) [Limited effect] Subsection (3) has effect subject to Division 2 of Part 4.2.

219(4) [Permitted abbreviations] A company may comply with subsection (1), (2), (2A) or (3) by setting out:

(a) the abbreviation "Aust." instead of the word "Australian";

(b) the abbreviation "Co." instead of the word "Company";

(c) the abbreviation "No." instead of the word "Number"; or

(d) the abbreviation "A.C.N." instead of the expression "Australian Company Number".

219(5) [Prohibition against non-compliance of subsec (1), (2), (2A) or (3)] A person (whether or not an officer of the company) shall not, on a company's behalf:

(a) use, or authorise the use of, a seal that purports to be a seal of the company but contravenes subsection (1); or

(b) issue, sign or publish a public document of the company that contravenes subsection (2), (2A) or (3).

219(6) [Prohibition against non-compliance of subsec (2)] A person (whether an officer of the company or not) shall not sign or issue, or authorise to be signed or issued, on a company's behalf, an eligible negotiable instrument of the company that contravenes subsection (2).

219(7) [Person in contravention liable] A person who contravenes subsection (6) is liable to the holder of the eligible negotiable instrument for the amount due on it unless that amount is paid by the company.

219(8) [Signs] A company shall paint or affix and keep painted or affixed, in a conspicuous position and in letters easily legible, on the outside of its registered office and of every office and place at which its business is carried on and that is open and accessible to the public:

(a) its name; and

(b) in the case of its registered office the expression "Registered Office".

SECTION 226 VALIDITY OF ACTS OF DIRECTORS AND SECRETARIES [224]

226(1) [Defect in appointment or qualification] The acts of a director or secretary of a company are valid notwithstanding any defect that may afterwards be discovered in his or her appointment or qualification.

226(2) [Vacation of office] Where a person whose office as director of a company is vacated pursuant to subsection 224(1) or was vacated pursuant to a corresponding previous law purports to do an act as a director of the company, that act is as valid, in relation to a person dealing with the company in good faith and for value and without actual knowledge of the matter because of which the office of the first-mentioned person was vacated, as if that office had not been vacated.

Appendix II

The summary of the replaceable rules, prepared by ASIC, that companies without a constitution may download and use as their "hardcopy" constitution.
Source: www.asic.gov.au/info4companies.htm
Refer: chapter 5

Replaceable rules outlined

A company's internal management may be governed by provisions of the Corporations Act 2001 (the Act) that apply to the company as replaceable rules, by a constitution or by a combination of both. There are additional requirements concerning internal management contained in ordinary provisions of this Act and also in common law.

Replaceable rules apply to companies registered after the commencement of Section 135(1) and to companies registered prior to the commencement that repeal their constitution after 1 July 1998.

A company may modify some or all of the replaceable rules by adopting a constitution.

(See also the Information Sheet 'Constitution and Replaceable Rules' for more information on the actual operation of these concepts.)

Replaceable rules do not apply to sole member/director companies if the member/director is the same person. Please see section –198E, 201F, 202C, for special provisions that apply to these companies.

This information sheet is to be used as a guide only. You should consult the Act and Corporations Regulations 2001 (the Regulations) on any specific matter of law.

Please note: The text quoted for each section in this information sheet is only that part of the section which is the replaceable rule. The full section needs to be read in some instances as other conditions may need to be met subsequently to following a replaceable rule.

The following table sets out the provisions of the Act that apply as replaceable rules (Section 141) as at the date of this Information Sheet. Readers should note that the Act outlining these rules may be altered and companies should always refer to a current version of the Act for a definitive reference to the replaceable rules at any given time.

Provisions that apply as replaceable rules	Section No
Officers and Employees	
1 Director interested in contract with proprietary company	**194** If a director of a proprietary company has a material personal interest in a matter that relates to the affairs of the company and: (a) under section 191 the director discloses the nature and extent of the interests and its relation to the affairs of the company at a meeting of the directors; or

Provisions that apply as replaceable rules	Section No
	(b) the interest is one that does not need to be disclosed under section 191; then (c) the director may vote on matters that relate to the interest; and (d) any transaction that relate to the interest may proceed; and (e) the director may retain benefits under the transaction even though the director has the interest; and (f) the company cannot avoid the transaction merely because of the existence of the interest. If disclosure is required under section 191, paragraph (e) and (f) apply only if the disclosure is made before the transaction is entered into. Note: A Director may need to give notice to the other directors if the director has material personal interest in a matter relating to the affairs of the company (see section 191)
2 Powers of directors	**198A** The business of the company is to be managed by or under the direction of the directors. The directors may exercise all the powers of the company except any powers that this Law or the company's constitution (if any) requires the company to exercise in a general meeting. For example, the company may issue shares, borrow money and issue debentures.
3 Executing negotiable instruments	**198B** Any two directors of a company that has two or more directors, or the director of a proprietary company that has only one director, may sign, draw, accept, endorse or otherwise execute a negotiable instrument. The directors may determine that a negotiable instrument may be signed, drawn, accepted, endorsed or otherwise executed in a different way.
4 Managing director	**198C** The directors of a company may confer on a managing director any of the powers that the directors can exercise. The directors may revoke or vary a conferral of powers on the managing director.
5 Company may appoint a Director	**201G** A company may appoint a person as a director by resolution passed in general meeting

Provisions that apply as replaceable rules	Section No
6 Directors may appoint other directors	**201H** The directors of a company may appoint a person as a director. A director can be appointed as a director in order to make up a quorum for a directors' meeting even if the total number of directors of the company is not enough to make up that quorum. The appointment must be confirmed by resolution within 2 month after the appointment by a proprietary company, and at the next AGM for public company.
7 Appointment of managing directors	**201J** The directors of a company may appoint 1 or more of themselves to the office of managing director of the company for the period, and on the terms (including as to remuneration), as the directors see fit.
8 Alternate directors	**201K** With the other directors' approval, a director may appoint an alternate to exercise some or all of the director's powers for a specified period. The appointment and terms of appointment must be notified to ASIC (refer to s.205B)
9 Remuneration of directors	**202A** The directors of a company are to be paid the remuneration that the company determines by resolution. The company may also pay the directors' travelling and other expenses that they incur in attending meetings and in conjunction with the company's business. (Refer also to chapter 2E for public companies)
10 Director may resign by giving written notice to company	**203A** A director of a company may resign as a director of the company by giving a written notice of resignation to the company at its registered office.
11 Proprietary company may remove director	**203C** A proprietary company may by resolution remove a director from office and appoint another person as a director instead.
12 Termination of appointment of managing director	**203F** A person ceases to be managing director if they cease to be a director. The directors may revoke or vary an appointment of a managing director.

Provisions that apply as replaceable rules	**Section No**
13 Terms of office determined by directors	**204F** A secretary holds office on the terms and conditions (including the remuneration) that the directors determine

Inspection of books

14 Company or directors may allow member to inspect books	**247D** The directors of a company, or the company by a resolution passed at a general meeting, may authorise a member to inspect the books of the company.

Directors' Meetings

15 Circulating resolutions	**248A** The directors of a company may pass a resolution without a directors' meeting being held if all the directors entitled to vote on the resolution sign a document containing a statement that they are in favour of the resolution set out in the document. Separate copies of a document may be used for signing by directors if the wording of the resolution and statement is identical in each copy and the resolution is passed when the last director signs.
16 Calling directors' meetings	**248C** A directors' meeting may be called by a director giving reasonable notice individually to every other director. A director who has appointed an alternate director may ask for the notice to be sent to the alternate director
17 Chairing directors' meetings	**248E** The directors may elect a director to chair their meetings. The directors may determine the period for which the director is to be the chair. The directors must elect a director present to chair a meeting or part of it, if: a) a director has not already been elected to chair the meetings; and b) a previously elected chair is not available or declines to act, for the meeting or the part of the meeting.

Provisions that apply as replaceable rules	Section No
18 Quorum at directors' meetings	**248F** Unless the directors determine otherwise, the quorum for a directors' meeting is two directors and the quorum must be present at all times. For resolutions of single director proprietary companies without meetings see S 248B For special quorum rules for public companies, see section 195
19 Passing of directors' resolutions	**248G** A resolution of the directors must be passed by a majority of the votes cast by directors entitled to vote on the resolution. The chair has the casting vote, if necessary, in addition to any vote they have in their capacity as a director.
Meetings of Members	
20 Calling of meetings of members by a director	**249C** A director may call a meeting of the members
21 Notice to joint members	**249J(2)** Notice to joint members must be given to the joint member named first in the register of members.
22 When notice by post or fax is given	**249J(4)** A notice of meeting sent by post is taken to be given three days after it is posted. A notice of meeting sent by fax, or other electronic means, is taken to be given on the business day after it is sent.
23 Notice of adjourned meetings	**249M** When a meeting is adjourned, new notice of the resumed meeting must be given if the meeting is adjourned for one month or more
24 Quorum	**249T** The quorum for a meeting of the company's members is two members and the quorum must be present at all times during the meeting.
25 Chairing meetings of members	**249U** The directors may elect an individual to chair meetings of the company's members
26 Business at adjourned meetings	**249W(2)** Only unfinished business is to be transacted at a meeting resumed after an adjournment.

Provisions that apply as replaceable rules	**Section No**
27 Who can appoint a proxy? (proprietary co. only)	**249X** A member of a company who is entitled to attend and cast a vote at a meeting of the company's members may appoint a person as the member's proxy to attend and vote for the member at the meeting.
28 Proxy vote valid even if member dies, revokes appointment etc	**250C(2)** Unless the company has received written notice of the matter before the start or resumption of the meeting at which a proxy votes, a vote cast by the proxy will be valid even if, before the proxy votes: a) the appointing member dies; or b) the member is mentally incapacitated; or c) the member revokes the proxy's appointment; or d) the member revokes the authority under which the proxy was appointed by a third party; or e) the member transfers the shares in respect of which the proxy was given. A proxy's authority to vote is suspended while the member is present at the meeting (see subsection 249Y(3).)
29 How many votes a member has	**250E** Subject to any rights or restrictions attached to any class of shares, at a meeting of members of a company with a share capital. a) on a show of hands each member has one vote; and b) on a poll each member has one vote for each share they hold.
30 Jointly held shares	**250F** If a share is held jointly and more than one member votes in respect of that share, only the vote of the member whose name appears first in the register of members counts.
31 Objection to right to vote	**250G** A challenge to a right to vote at a meeting of a company's members may only be made at the meeting and must be determined by the chair, whose decision is final.

Provisions that apply as replaceable rules	Section No
32 How voting is carried out	250J A resolution put to the vote at a meeting of a company's members must be decided on a show of hands unless a poll is demanded. Before a vote is taken the chair must inform the meeting whether any proxy votes have been received and how the proxy vote must be cast. On a show of hands, a declaration by the chair is conclusive evidence of the result provided that the declaration reflects the show of hands and the votes the proxies received. Neither the chair or the minutes need to state the number or proportion of the votes recorded in favour or against.
33 When and how polls must be taken	**250M** A poll demanded on a matter other than the election of a chair or the question of an adjournment must be taken when and in the manner the chair directs. A poll on the election of a chair or on the question of an adjournment must be taken immediately.
Shares	
34 Pre-emption for existing shareholders on issue of shares in proprietary company	**254D** Before issuing shares of a particular class, the directors of the proprietary company must offer them to the existing holders of the shares of that class. As far as practicable, the number of shares offered to each shareholder must be in proportion to the number of shares of that class that they already hold (subsection 1) To make the offer, the directors must give the shareholders a statement setting out the terms of the offer including the number of shares offered and the period for which it will remain open. The directors may issue shares not taken up under the offer under subsection 1 as they see fit. The company may by resolution passed at a general meeting authorise the directors to make a particular issue of shares without complying with subsection 1.
35 Other provisions about paying dividends	**254U** The directors may determine that a dividend is payable and fix the amount, the time for payment and the method of payment. The methods of payment may include the payment of cash, the issue of shares, the grant of options and the transfer of assets.

Provisions that apply as replaceable rules	Section No
36 Dividend rights for shares in proprietary companies	**254W(2)** Subject to the terms on which shares in a proprietary company are on issue, the directors may pay dividends as they see fit.
Transfer of shares	
37 Transmission of shares on death	**1091AA** If a shareholder who does not own shares jointly dies, the company will recognise only the personal representative of the deceased shareholder as being entitled to the deceased shareholder's interest in the shares.
38 Transmission of shares on bankruptcy	**1091AB** If a person entitled to shares because of the bankruptcy of a shareholder gives the directors the information they reasonably require to establish the persons entitlements
39 Transmissions of shares on mental incapacity	**1091B** If a person entitled to shares because of the mental incapacity of a shareholder gives the directors the information they reasonably require to establish the person's entitlement to be registered as the holder of the shares a) the person may: (i) by giving a written and signed notice to the company, elect to be registered as the holder of the shares; or (ii) by giving a completed transfer form to the company, transfer the shares to another person; and b) the person is entitled, whether or not registered as the holder of the shares, to the same rights as the shareholder.
40 Registration of transfers	**1091D** A person transferring shares remains the holder of the shares until the transfer is registered and the name of the person to whom they are being transferred is entered in the register of members in respect of the shares.
41 Additional general discretion for directors of proprietary companies to refuse to register transfers	**1091E** The directors of a proprietary company may refuse to register a transfer of shares in the company for any reason.

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