NOTES

THE REPORT OF THE ROYAL COMMISSION ON WOOL EXPORTERS PTY. LTD.

The Report of the Royal Commissioner appointed to enquire into all aspects of the trading activities of Wool Exporters Pty. Ltd. and associated companies[1] concluded with two recommendations for changing the law to deal with situations revealed by the enquiry. One recommendation has been acted upon and has resulted in amendments to the Companies Act[2] (though not in the form recommended by the Commissioner) while, so far, the other has not received the attention of the Legislature.

Wool Exporters Pty. Ltd. was engaged in private buying of wool direct from producers which it subsequently blended and sold to overseas buyers. Because there was a delay of some months between the time when it was required to make payment to the producers and the time when it received payment from its overseas buyers, considerable finance was needed each year to tide it over this period. This was obtained from a bank on appropriate security. In its final year of trading the company began with a considerable overdraft but nevertheless embarked on extensive trading, which in view of the Commissioner amounted to a speculation, as the only way to save the company.[3] The speculation was unsuccessful, the bank appointed a receiver and the company had "failed".[4]

The Commissioner found that in no one of the companies the subject of his enquiries was the business of the company carried on with the intent to defraud creditors.[5] He did, however, find that one of the officers caused the company to continue to trade and so incur

1 REPORT dated 30th April 1969 (hereafter referred to as REPORT). The Royal Commissioner was F. T. P. Burt, Q.C., now the Hon. Mr. Justice Burt, a Justice of the Supreme Court of Western Australia.

2 Companies Act Amendment Act 1969 (W.A.) Act No. 98 of 1969.

3 The speculation was that the price of wool would rise between the time when the company contracted to buy, at which time the price was fixed, and when the company would sell, which could have been seven or more months later. Instead of rising, prices fell.

4 In the REPORT the word "failed" was used to describe a company which had suffered such losses that it was unable to continue to trade and unable to pay its creditors, not necessarily a company which had lost its shareholders' funds.

5 REPORT, 84.

obligations and contract debts[6] at a time at which to the knowledge of that officer there existed no reasonable or probable expectation of the company being able to pay them. This he described as "reckless trading".[7]

As the Companies Act then stood, this conduct on the part of an officer constituted an offence only if it took place 'in the course of the winding up of a company'.[8] As the Commissioner pointed out, the policy behind confining the offence to this specific situation was unclear, but the evil of "reckless trading", which could cause loss and which the statute was designed to prevent, could arise in many situations other than during a winding up.

As one way of legislating to discourage or prevent this type of trading the Commissioner pointed to the precedent of the Companies (Defaulting Officers) Act 1966 of the State of Victoria which in one section provides:[9]

> If an officer of a company to which this section applies was knowingly a party to the contracting of a debt by the company and had, at the time the debt was contracted no reasonable or probable grounds of expectation after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt the officer shall be guilty of an offence against this Act.

The section is restricted in its application to a company which is being wound up, under official management, in respect of which a receiver or manager or an inspector has been appointed, or 'which has ceased to carry on business or is unable to pay its debts'.

The Commissioner recommended following the Victorian section, (if it was the policy of the legislature to expand the circumstances in which a person could be punished for trading recklessly) but with one reservation. In his view:[10]

> A contract when made may or may not create a debt. Whether it does so will depend upon its terms. Specifically a contract for the sale and purchase of goods will not unless it contains an express stipulation to the contrary, create a debt when the contract is made. The debt will not arise until the condition controlling the buyer's obligation to pay the purchase price has been satisfied

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6 Being the price payable by the company to farmers for wool it had agreed to purchase.

7 Citing Kitto J. in Hardy v. Hanson, (1959) 105 C.L.R. 451, 464.

8 See s. 303 (3).

9 s. 3 of Act No. 7501. This provision is now s. 374 C of the Companies Act, 1961 (Vic.).

10 REPORT, 84.

> and again under an open contract that condition is delivery—Section 28 Sale of Goods Act, 1895.

If this were the case, then as the Commissioner pointed out, in the situation he was dealing with, the contracts made with the farmers under which the company agreed to purchase the wool when shorn did not create any debt. The debt only arose when the wool was delivered.[11] However, he seemed to entertain some doubt as to whether this was the way in which the legislation would be interpreted. Accordingly, to overcome this difficulty he recommended redrafting the Victorian provision to read:[12]

> If a company to which this section applies carries on business at a time at which having regard to all the circumstances there exists no reasonable or probable grounds of expectation of the company being able to pay the debts then owed by it or to discharge obligations incurred by it in the course of such carrying on of its business then every officer of that company who was knowingly a party to carrying on of its business by the company is guilty of an offence against this Act.

In the event this recommendation was not followed, but the provisions of the Victorian Act were adopted.[13] That Act, however, dealt with a number of other matters concerning the conduct of officers of companies in addition to this provision relating to "reckless trading". Sections 300-305 of the present Companies Act are repealed, and in their place are introduced new sections 367 A to C and 374 A to G. These include a new section[14] giving wide powers of examining officers or former officers of companies as to their conduct and dealings as an officer of the company. The examination order is obtained by the Attorney-General and the examination does not,

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11 The position does not appear to be free from doubt. But see Inland Revenue Commissioners v. Port of London Authority, [1923] A.C. 507, 517-518; Weiss v. Sheet Metal Fabricators, (1955) 110 A. 2d. 671.

12 REPORT, 85.

13 The Victorian Act appears to have had its genesis in the meeting of the Standing Committee of the Attorneys-General of the States of the Commonwealth in 1964. It was introduced firstly as a private members' bill—which lapsed—and subsequently as a government measure, prompted it seems by the number of company liquidations that had recently taken place in that State leaving large deficiencies. See 281 VICTORIAN PARL. DEB. 3249 and 283 VICTORIAN PARL. DEB. 357. The reason given by the Minister for Justice for following the Victorian Act was that 'the control of companies, as far as possible, should be the same in all States because of the increasing number of companies which trade interstate'. See (1969) 11 WESTERN AUSTRALIAN PARL. DEB. 1438.

14 s. 367 A.

unless otherwise ordered, take place in open court. Creditors and members may be permitted to participate in the examination and the person examined is required to answer all questions.[15]

A recast section[16] enables the Attorney-General to apply to the Court for an order to examine into the conduct of a person who has taken part in the formation, promotion, administration, management or winding up of a company where it appears he has misapplied monies of the company or has been guilty of misfeasance, and also to obtain an order that he restore the money to the company or pay damages to the company in respect of the misfeasance. Another section[17] reproduces the list of offences which can be committed by an officer or former officer.

These sections are followed by the section[18] referred to by the Commissioner, dealing with "reckless trading", which also creates the offence of knowingly being a party to a company carrying on business with the intent of defrauding creditors of the company. However, the section in addition to creating offences, lifts the corporate veil to the extent that on a conviction for an offence under the section the Court may declare the person convicted responsible, without any limitation of liability, in the case of reckless trading for payment to the company of an amount up to the whole of the debt contracted, and in the case of carrying on business with intent to defraud creditors, for payment to the company for an amount up to that required to satisfy all or any of the debts of the company.

Of the remaining amendments one creates an offence where proper books of account have not been kept and the other is designed to ensure the impartiality of a liquidator, by making it an offence to give or offer any valuable consideration to secure the appointment of a person to that office.[19]

Perhaps the most significant innovation in these amendments is the extension of the class of companies in respect of which it is possible to commit these offences. Formerly, it was generally the case that such

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15 But if he would have been entitled to refuse to answer on the ground of self-incrimination the answer may not be used in subsequent criminal proceedings except for perjury in respect of the answer.

16 s. 367 B replacing the former s. 305.

17 ss. 374 A replacing the former s. 300. The main change is to increase the period during which the acts which constitute the offence can be committed from 12 months to five years from the 'relevant day' which is broadly when the company has gone into liquidation or become insolvent.

18 s. 374 C.

19 ss. 374 B & F.

conduct on the part of officers provided for in these amendments constituted an offence only if the company was in the course of being wound up. Now these offences can be committed not only if the company is in the course of being wound up but also if it is a company under official management, a company in respect of which an inspector or receiver or manager has been appointed, or a company which has ceased to carry on business or is unable to pay its debts.[20]

This extension of the classes of companies to which these provisions apply (as well as in particular the provision relating to "reckless trading") has brought forth the criticism that companies in financial difficulties may be unable to obtain good management because persons would be reluctant to become directors of such companies.[21] On the other hand, it could be said that the provision does not go far enough. Why should it be only in respect of a company that is commercially insolvent or in respect of which certain proceedings have been instituted that the personal liability arises on officers for "reckless trading"? If the company is financially sound at the time presumably no personal liability will arise if the officers cause the company to contract a debt which they had no reasonable grounds of expectation of the company being able to pay. It is in the nature of business to take risks. Reasonable risks must be accepted whether the company is in difficulties or not; the taking of unreasonable risks on the other hand which may lead to a "failure" of the company is the evil being attacked by this legislation[22] and it is difficult to understand why in this case the criteria for attaching or giving immunity from personal liability to officers taking such unreasonable risks is dependent upon the solvency of the company.

Another difficulty, bearing in mind the evil being attacked by the legislation, was to define "reckless trading". To legislate against acting 'with blameworthy irresponsibility' knowing that he was gambling

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20 See ss. 367 C and 374 E. Ceasing to carry on business and inability to pay debts are both given statutory meanings (see ss. 374 E (2) and 367 C (2)) which presumably are statutory extensions to their usual meanings. E.g., in the latter case this would continue to carry its normal meaning of commercial insolvency; see the cases cited in WALLACE AND YOUNG, AUSTRALIAN COMPANY LAW AND PRACTICE, 644-645.

21 See Campbell, *The Future of Limited Liability Companies and their Administration,* (1967) 41 A.L.J. 348, 355.

22 Particularly where the ultimate inability to pay creditors then becomes due to the company being undercapitalised, as it was in this case, and so in the words of the Commissioner made the gamble 'particularly vicious'. See also the Hon. R. J. Hamer, 283 VICTORIAN PARL. DEB. 358.

with creditors' money[23] obviously would not describe with sufficient certainty the conduct proscribed. Presumably this led to the adoption of the criterion of 'contracting a debt with no reasonable or probable ground of expectation . . . of being able to pay'.[24]

The other recommendation of the Commissioner was the establishment of a scheme to control the buying of wool before it was shorn, the purpose of which was to provide the seller with statutory protection against becoming the victim of a gamble such as that taken by the company under enquiry. The nature of the transaction known as "back buying",[25] the type of business the company was primarily engaged in, was that the farmer entered into a contract to sell the company the whole of his wool clip many months before the wool was shorn at an agreed price per pound. The contract required the farmer to deliver the wool to the buyer's store where it would be weighed and the price ascertained. Payment was normally then made within 14 days after delivery.

In a transaction of this sort, unless the seller had taken steps to protect his position, he was in a precarious position. The sale being a sale of future goods, unless otherwise stipulated the property in the wool passed to the buyer upon shearing, or upon delivery to a carrier, or at the latest upon delivery to the buyer.[26] If the seller had not been paid he was then for a period completely unsecured and at the mercy of the company, and its secured creditors should the occasion arise for the creditors to take steps under their security. However, even if there were a stipulation that the property was not to pass until payment there still remained one difficulty. Once the wool had been broken out of the bales and blended with other wool in the buyer's store the separate identification of any particular seller's wool became impossible. The seller would then be obliged to establish a proprietary interest in the bulk—which in turn could prove to be difficult.[27]

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23 See Kitto J. in Hardy v. Hanson, (1959) 105 C.L.R. 451, 464.

24 The problem of definition was well appreciated. See (1969) WESTERN AUSTRALIAN PARL. DEB. 1643. The definition has also been criticised, see Campbell, loc. cit. note 21 above.

25 For a full account of what was involved in this type of transaction both from the point of view of the seller and the company see REPORT, 33-44.

26 Being the various times, depending upon the circumstances in each case, when the goods might have been said to have been unconditionally appropriated to the contract. See Sale of Goods Act, 1895 (W.A.) ss. 60 & 18 Rule 5.

27 More from the practical point of establishing which bales of blended wool contained the wool he delivered rather than establishing an interest in the bulk. See Sandeman & Sons v. Tyzack, [1913] A.C. 680.

In view of the above, and the fact that this method of selling wool appeared to be attractive to a good many farmers in the State,[28] the Commissioner recommended that if this type of wool buying was to continue it should be controlled by special rules incorporated in a statute. His recommended rules began with three definitions: 'Producer', to mean the owner of sheep at the time they are shorn even though the sheep are subject to a security interest; 'Wool buyer', to mean a person who has agreed to buy wool from a producer at a time prior to the wool being shorn; and 'Wool Contract', to mean a contract whereby a wool buyer agrees to buy wool from a producer and at the time the contract is made the wool has not been shorn.

He then recommended that, despite any agreement to the contrary, the property in wool the subject of a wool contract was not to pass from the producer to the wool buyer until the purchase price was paid, and payment was not deemed to have been made until any cheque given in satisfaction of the price had been cleared.

Next, to overcome the problem of identification of a particular seller's wool where mixture had taken place, he recommended that the buyer be required to maintain a security store into which wool delivered to him pursuant to a wool contract was placed and kept at the buyer's risk, until the property in the wool passed to the buyer. Adequate records relating to identification and description of the wool delivered were to be kept.[29]

In days when most attention is being focused upon providing adequate protection for consumers it is interesting to read a Report which concludes with a recommendation which is concerned with providing protection for the producer or seller. One would have imagined that a prudent seller entering into a "back buying" contract could have gone a long way towards protecting himself by requiring terms in the contract ensuring that the risk and property passed at the latest possible time, i.e., upon payment of the price. If this term were broken, admittedly, the problem that would arise on a mixture taking place could be more difficult to solve by contractual terms. Provisions in the contract prohibiting dealing with the wool until payment would not assist the seller, if broken. He would still be left to establish an interest in a mass. However, this problem would only

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28 At the time that the bank appointed a receiver there was an overall deficiency in excess of $1.8 million of which in excess of $1.3 million was owing to approximately 170 growers representing the price of wool sold and delivered but not paid for.

29 See REPORT, 83-84.

arise if the seller did not insist on payment on delivery and before a mixture occurred.[30]

What this report reveals is that many sellers who entered into "back buying" contracts were apparently prepared to risk losing both the price of their goods and the property in them without taking any, or any adequate, steps to protect themselves. In these circumstances it is not without some hesitation that one can justify special legislative control of a paricular sale transaction of a particular commodity, which departs from the general rules governing sales. And this even more so when one takes into account two pertinent facts: Firstly, that within the framework of the existing legal rules it could be argued that it was possible for a prudent seller to obtain adequate protection; and secondly, that this was not a case of bargaining between two persons of unequal bargaining power 'whose only choice is either not to enter into the transaction at all or to enter it upon the terms of a standard agreement'.[31] There was on the one hand the availability of sales to the competitors of the company[32] and on the other hand there was the existing auction system which had been for many years the established method of marketing wool and which provided virtual certainty for the seller receiving his price for the wool sold.

I. McCALL

30 Could not rules governing the determination of proprietary interests in a bulk where mixture had taken place—including, perhaps, a discretionary power in a court to do justice to the parties—have been devised? If so this would have been all that was necessary and it seems would have been a much less drastic reform.

31 Per Diplock J. in Lowe v. Lombank, [1960] 1 W.L.R. 196, 201, 202.

32 See REPORT, 54.