"DULY SEALED" DOCUMENTS AND KNOWLEDGE OF DIRECTORS' BREACH OF FIDUCIARY DUTY

R CARROLL*

Section 164 of the Corporations Law, introduced in 1983,[1] was intended to codify and clarify certain aspects of the rule in *The Royal British Bank v Turquand*.[2] The statutory assumptions, set out in section 164(3), paragraphs (a) to (f), are intended 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 denials by the company that the persons purporting to act for it lacked authority".[3] Section 164(4) limits the protection provided by the section to persons dealing in "good faith", by disentitling a third party from relying on the statutory assumptions if they have actual knowledge that they are dealing with a person who does not have the authority of the company, or if, by reason of a connection or relationship they have with the company, they ought to know that the person with whom they are dealing does not have authority.

The aim of this note is to consider whether a document which has been "duly sealed" for the purposes of section 164(3)(e), nonetheless may be unenforceable if the person dealing with the company knows that the directors of the company have breached their fiduciary duties.

Section 164(3)(e) provides:

> [T]hat a document has been duly sealed by the company if:

---

* B Juris LLB (WA) BCL(Oxon); Lecturer, The University of Western Australia.

1. The Companies Act 1981 (WA) predecessor to s 164 of the Corporations Law was s 68A. Reference throughout will be to the s 164 equivalent provisions.
2. (1856) 6 El & Bl 327; 119 ER 886. The rule is otherwise known as the "indoor management" rule.
3. Explanatory Memorandum to the Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 (Cth), para 288.

> (i) it bears what appears to be an impression of the seal of the company; and
>
> (ii) the sealing of the document appears to be attested by 2 persons, being persons one of whom, by virtue of paragraph (b) or (c), may be assumed to be a director of the company and the other of whom, by virtue of paragraph (b) or (c), may be assumed to be a director or to be a secretary of the company;[4]

At common law, a principal is unable to deny an agent's authority merely because that agent has acted improperly in the performance of his or her duties.[5] Thus, a transaction entered into by a company's directors for their own or some other person's benefit and not to further any purpose of the company is not void.[6] However, a person who has notice of a breach of the fiduciary duty will be unable to establish that the agent with whom they have dealt had authority to act on the company's behalf and the transaction will be voidable against such a person.[7]

Now an assertion by a company that its directors lacked authority because of an improper use of power will bring the assumption in section 164(3)(f) into operation. Section 164(3)(f) provides that a person dealing with a company may assume

> [T]hat the directors, the principal executive officer, the secretaries, the employees and the agents of the company properly perform their duties to the company.

However, this assumption will be of no assistance to a person who has actual knowledge that the directors are acting improperly, or has constructive knowledge within the terms of section 164(4)(b).

The question raised by this note, to the writer's knowledge, has not been

---

4. S 164(3) ...

> (b) that a person who appears, from 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, the principal executive officer 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, by the principal executive officer 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;

5. *Hambro v Burnand* [1904] 2 KB 10; *Lloyds Bank Ltd v The Chartered Bank of India, Australia & China* [1929] 1 KB 40.
6. *Richard Brady Franks Ltd v Price* (1937) 58 CLR 112, Dixon J, 142.
7. Ibid.

considered directly by the courts. The interpretation of section 164(3)(e) in *Brick & Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*[8] (discussed below) may mean that the assumption in that section is available even if on the facts a party was disentitled from relying on the assumption in section 164(3)(f).

BRICK & PIPE: THE FACTS

Brick & Pipe Industries Ltd ("Brick & Pipe") was part of a group of companies controlled by Mr Goldberg. Brick & Pipe executed a guarantee and indemnity agreement ("the agreement") in favour of Occidental Life Nominees Pty Ltd ("Occidental") , which secured a bill facility provided by Occidental to companies within the Goldberg group. Money became payable under the agreement when the Goldberg group collapsed. Brick & Pipe sought a declaration that the agreement was void and unenforceable because of its irregular execution. Both parties subsequently agreed that the indemnity and guarantee agreement was not validly executed because its execution was not in accordance with Brick & Pipe's articles of association, was not authorised by a meeting of the board called in accordance with the articles, and because no proper meeting of the board as provided by the articles had been held.

Occidental counter-claimed for indemnity in accordance with the terms of the agreement, relying inter alia on section 164(3)(e). This ground was upheld, and on the facts Occidental was not disentitled pursuant to section 164(4) from relying on the assumption in paragraph (e). The Full Supreme Court of Victoria considered that actual knowledge of facts which may have prevented reliance upon the assumption in section 164(3)(a) that the company's constitution had been complied with, did not prevent reliance on the assumption in section 164(3)(e) that the document involved had been duly sealed.[9] The Full Court, agreeing with Ormiston J at first instance, considered paragraph (e) to be "discrete and confined to *due sealing*."[10] In the Court's view:

> The legislature could not be taken to have intended that an assumption as to due sealing is not available in circumstances like the present where there was actual knowledge of non-compliance with articles not concerned with authority to fix the

8. (1990) 3 ACSR 649 Ormiston J; (1991) 6 ACSR 464 (Full Ct).
9. This reasoning has been followed and applied in *ANZ Banking Group Ltd v Aust Glass & Mirrors Pty Ltd* (1991) 9 ACLC 702; and *Advance Bank Aust Ltd v Fleetwood Star Pty Ltd* (1991) 7 ACSR 387.
10. (1991) 6 ACSR 464, 478 (original emphasis).

company seal and attest it.

Brick & Pipe did not refute the authority of its directors (who attested the affixation of the common seal to the agreement) on the ground that they were acting in breach of their fiduciary duties to the company in causing the company to enter into the transactions. Therefore it was not necessary for the Court to consider the possible result had Occidental known not only of a failure to comply with the articles but also that the directors acting for the company in the transaction had been acting in breach of duty.

THE ROLLED STEEL CASE

In *Rolled Steel Ltd v British Steel Corporation*[11] ("*Rolled Steel*"), the enforceability of an apparently duly sealed document arose as an issue at common law. Rolled Steel Products (Holdings) Ltd provided a guarantee in favour of Colvilles Ltd, a company engaged in the production of steel. Colvilles was subsequently nationalised and its shares were vested in British Steel Corporation. The guarantee secured the obligations of a company called Scottish Steel Sheet Ltd. Rolled Steel and Scottish Steel had a common shareholding. At all material times a director of Rolled Steel and Scottish Steel owned the entire issued capital of Scottish Steel and had given a personal guarantee to secure Scottish Steel's obligations. Rolled Steel subsequently went into liquidation and the liquidators commenced actions against British Steel for a declaration that the guarantee was void.

The Court of Appeal accepted the finding of fact by Vinelott J that everybody on the plaintiff's side of the transaction proceeded on the footing that the guarantee would not only *not* be for the purposes or in the interests of Rolled Steel but would be positively injurious to it.[12] The Court held that Rolled Steel had the capacity to enter into the guarantee and debentures, and therefore that it was not acting ultra vires, but that it was beyond the authority of directors to enter into the guarantee in furtherance of purposes not authorised by Rolled Steel's memorandum of association. As British Steel knew of that lack of authority, they could acquire no rights under those transactions.[13] In his judgment, Slade LJ referred to the fact that a person

11. [1986] 1 Ch 246.
12. Id, Slade LJ, 281; Browne-Wilkinson LJ, 307; Lawton LJ, 309.
13. The fact that a company is not acting in its best interests does not affect the capacity of the company so to act: s 161(3). This subsection is specifically intended "to exclude the application of the *Rolled Steel* case" and to prevent argument that any doctrine of "wider ultra vires" still exists (Explanatory Memorandum to the Companies & Securities Legislation (Miscellaneous Amendments) Act 1985 (Cth), para 199). However it is

dealing with a company can usually presume that the directors have acted properly and for the purposes of the company. However, British Steel could not rely on this presumption because:

> [A] party dealing with a company cannot rely on the ostensible authority of its directors to enter into a particular transaction if it knows they in fact have no such authority because it is being entered into for improper purposes. Neither the rule in *Turquand's* case nor more general principles of the law of agency will avail him in such circumstances...[14]

The Court of Appeal further held that as British Steel knew the directors of Rolled Steel had breached their fiduciary duties in purporting to authorise and execute the guarantee when they received the assets of Rolled Steel, it was accountable to Rolled Steel as constructive trustee.

THE NORTHSIDE DEVELOPMENTS CASE

The point made by Slade LJ in *Rolled Steel* in the passage cited above was recognised but left unanswered by Brennan J in *Northside Developments Pty Ltd v Registrar-General*[15] ("*Northside Developments*"). He said:

> I should wish to reserve my opinion as to whether, in a case similar to *Rolled Steel Ltd*, the creditor might be precluded from enforcing the guarantee by reason of the unavailability of an estoppel as to its due execution (as I understand Slade LJ to hold) or by *reason of his taking a guarantee which, though its due execution may be assumed or established, is taken with notice that it is given in breach of the director's fiduciary duty.*[16]

Clearly an affirmative answer to this question would be consistent with the decision of the Court of Appeal in *Rolled Steel*. It would also be consistent with the reasoning applied by the Court of Queen's Bench in *The Royal British Bank v Turquand*.[17] There Campbell CJ clearly recognised that the ability of a person dealing with a company to rely on the due execution of a document of the company was dependent upon that person's lack of knowledge of any illegality or fraud by the company's directors.[18] That proposition

---

unlikely that the subsection prevents a transaction being avoided for abuse by directors of their authority. (On this point I agree with Sneddon, 66 LIJ 70, 71.) Failure to act in the company's best interests clearly remains significant to actions to enforce agreements. This is well illustrated by *ANZ Executors & Trustees Co Ltd v Qintex Aust Ltd* (1990) 8 ACLC 980.

14. Supra n 12, 292.
15. (1990) 64 ALJR 427.
16. Id, 444 (emphasis added).
17. (1855) 5 El & B1 248.
18. Id, 261.

was not questioned by the Court of Exchequer on appeal.[19] This is consistent with the approach taken by Dawson and Toohey JJ in *Northside Developments*, "that the indoor management rule cannot be used to create authority where none otherwise exists."[20] It must "be established independently that the person purporting to represent the company had actual or ostensible authority to enter into the transaction".[21]

Brennan J did not need to decide the question he raised in *Northside Developments* because the company was not seeking to be relieved of obligations arising under a deed executed by it. Furthermore, as the facts giving rise to the litigation occurred in 1979, section 164 did not apply. The interesting question today is whether the reasoning in *Brick & Pipe* means that the question posed by Brennan J in *Northside Developments* must inescapably be answered in the negative. Does the assumption in section 164(3)(e), when it applies, preclude argument by the company that the transaction is unenforceable for want of authority on other grounds?

THE AUSTRALIAN NATIONAL INDUSTRIES CASE

The ability of a person dealing with a company to rely on section 164(3)(e) in circumstances involving a breach of fiduciary duty by company directors arose as a potential issue in *Australian National Industries Ltd v Greater Pacific Investments Pty Ltd (in liquidation)*.[22] An action was brought by Australian National Industries Ltd ("ANI") against Greater Pacific Investments Pty Ltd ("GPI") under put and call deeds executed between those parties in November 1988. The deeds were entered into pursuant to arrangements made by Mr Maher, a director of ANI and a representative for ANI on the board of Spedley Securities Ltd ("SSL"), and Mr Yuill, managing director of SSL, for the purpose of obtaining an immediate injection of funds for SSL.

It was agreed that GPI, a company controlled by Mr Yuill and of which he was managing director, would sell certain shares in another company to ANI, with a put and call agreement in respect of those shares being entered into between ANI and GPI. GPI would lend the proceeds of the sale ($21 million) to SSL unsecured. SSL would guarantee to ANI the performance by GPI of any obligations arising in the event of the shares being put to GPI by ANI.

19. Supra n 2.
20. Supra n 16, 449.
21. Ibid.
22. (Unreported) Supreme Court of NSW 14 December 1990 (Cole J).

A document recording the terms of the agreement was executed under the common seal of GPI three days later. Further funds were required by SSL and the next day a similar arrangement was made between ANI, GPI and SSL in respect of shares held by GPI in other companies resulting in SSL receiving a further $14.1 million from ANI.

Pursuant to the agreements ANI sought to put back the shares to GPI. GPI and SSL were then in liquidation and did not honour the put agreement. ANI sold the shares and brought the action to recover, inter alia, a loss of $22 million on the sale. GPI sought to attack the put and call agreement on the ground that Mr Yuill had no authority on behalf of GPI to make the arrangements with Maher. It was also alleged by SSL that the guarantee was unauthorised and thus void.

GPI successfully cross-claimed that a constructive trust arose in respect of the property transferred by GPI to ANI. GPI alleged that the directors of the company, in causing GPI to enter the transactions it did, contravened section 229 of the Companies Code[23] and/or breached their fiduciary duties. The Court had no difficulty ascertaining that Mr Yuill completely disregarded the interests of GPI and thereby breached his duty to that company[24] and furthermore that the breach of duty occurred with the knowledge and involvement of ANI.

The Court concluded in respect of the sale agreements entered into by GPI with ANI that Mr Yuill had no actual authority, express or implied, and no apparent authority to enter into the transactions, and that ANI could not rely on section 164(3)(b) or (c) because entering into an agreement of this unusual nature was not the exercise of a power or the performance of a duty customarily exercised by a managing director. Thus, in the circumstances, section 164(4)(b) denied ANI the advantage of section 164(3)(b) or (c).

However, ANI was permitted to assume within the terms of section 164(3)(e) that the formal document comprising the put and call option agreement had been duly sealed, notwithstanding that no actual authority for the affixing or witnessing was given by the GPI Board. Cole J held that whilst the evidence would have established that ANI was "put on inquiry" and therefore unable to avail itself of the "indoor management" rule, this did not

23. Now Corporations Law s 232.

24. The inquiry as to whether a director has exercised a power for the benefit of the company may be particularly difficult where the company operates within a group. For discussion of the relevant principles in Australian law see *Equiticorp Financial Services Ltd v Equiticorp Financial Services Ltd* (1992) 9 ACSR 199; and J Stumbles "Corporate Benefit and the Guarantee" in G Burton (ed) *Directions in Finance Law* (Sydney: Butterworths, 1990) 204.

permit a finding that ANI "ought to have known" because of the "connection or relationship" between the companies that the put and call option had not been duly sealed.

It is significant that Cole J expressed concern at the seemingly "incongruous" result that although there may be no actual or apparent authority to enter a transaction such that section 164(3)(b) or (c) could not apply because of the third party's knowledge, nevertheless the transaction could become binding:

> [S]imply because a deed in fulfilment of the unauthorised transaction is deemed duly sealed because of [section 164(3)(e)], and [section 164(4)] does not operate to disqualify the assumed validity of the sealing, although it did operate to disqualify assumed authority to make the agreement itself.[25]

It is also of concern that a transaction assumed to be duly sealed because of section 164(3)(e) should be enforceable by a person who knows that the transaction is the direct result of a breach of duty by a director of the company.[26] It is suggested that this result would be avoided if knowledge of breach of fiduciary duty was seen not only as providing a basis for imposing a constructive trust on the third party, as in this case, but also as rendering the transaction voidable, notwithstanding section 164(3)(e).[27] In a case like *Australian National Industries*, this would provide a further ground to resist enforcement of an agreement.

CONCLUSION

It will no doubt be argued that to suggest that a deed sealed in the circumstances in which section 164(3)(e) applies may nonetheless be unenforceable is to introduce uncertainty to an area in which Parliament has demonstrated a clear intention to legislate for certainty. In response it might be said that neither is it likely that it was Parliament's intention to permit a person to enforce a transaction known to be entered into as result of a breach of fiduciary duty by the company's directors.

---

25. Supra n 2, 47.
26. Such a conclusion would require the court being satisfied of the existence of a causal connection between the breach of duty and the resultant deeds.
27. No reference is made in *Australian National Industries* supra n 22 to the decision in *Brick & Pipe* supra n 8, either at first instance or on appeal.