

## **CHAPTER 4**

# **COMPANY MANAGEMENT AND CONTRACTING**

## **CONTENTS**

### **4.1 Company Management**

- ◆ Introduction
- ◆ Division of Powers Within a Company
- ◆ The Management Powers of the Board
- ◆ Proceedings of the Board
- ◆ Types of Directors
- ◆ Company Secretary
- ◆ Members' Powers at a General Meeting
- ◆ General Meeting Cannot Interfere in Management

### **4.2 Company Contracting**

- ◆ Introduction
- ◆ Execution of Documents
- ◆ Organic Theory
- ◆ Contracts Made by Agents
- ◆ Actual Authority
- ◆ Apparent Authority
- ◆ Outsiders' Rights of Assumption
- ◆ Customary Authority of Officers
- ◆ Limitations to Assumptions

## OBJECTIVES

- To understand how a company is managed and the division of power between the board of directors and the members in general meeting;
- To know the different types of directors and secretary and their appointments;
- To understand how a directors' board meeting operates;
- To understand the different ways in which a company can enter into contracts and the assumptions outsiders are entitled to make.

## IMPORTANT SECTIONS

[see Corporations Act 2001]

### Company Management

- Ss 198A-D, 1072F-G, 249C, 249CA, 203C-D, 201G-H, 9(director), 9(officer), 201A-B, 202A.

### Company Contracting

- Ss 123 to 130.

## IMPORTANT CASES

[see text below –references in bold]

### Company Management

- *Automatic Self-Cleansing Syndicate v Cunninghame* [1906];
- *John Shaw (Salford) Ltd v Shaw* [1935];
- *NRMA v Parker* (1986).

### Company Contracting

- *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915];
- *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons* [1957];
- *Tesco Supermarkets Ltd v Nattras* [1972];
- *Brambles Holdings Ltd v Carey* (1976);
- *Hely-Hutchison v Brayhead Ltd* [1968];
- *Freeman and Lockyear v Buckhurst Park Properties (Mangal) Ltd* [1964];
- *Royal British Bank v Turquand* (1856);
- *Northside Developments Pty Ltd v Registrar-General* (1990);
- *Bank of New Zealand v Fiberni* (1994).

**SUPPORTING SECTIONS**

[see Corporations Act 2001]

**Company Management**

Ss 140(1), 127, 136, 142, 145, 201E-F, 201K-L, 202A, 202B, 203A, 204A-B, 204D-F, 205B, 206B-G, 230, 232, 248A-G, 249D, 251A, 254B, 254D, 254U, Div 2 Part 2D.2, 319, 345.

**Company Contracting**

Ss 130, 136(5), 198A-B, 201J.

**SUPPORTING CASES**

[see text below]

**Company Management**

*Petsh v Kennedy* [1971]; *Mitropoulos v Greek Orthodox Church* (1993); *Jenashare Pty Ltd v Lemrib Pty Ltd* (1993); *Mistmorn Pty Ltd v Yaseen* (1996); *Standard Chartered Bank of Australia Ltd v Antico* (1995); *AWA v Daniels* (1992); *Kelly v Wolstenholme* (1991); *Whitehouse v Carlton Hotel Pty Ltd* (1987); *Daniels v Anderson* (1995); *Levin v Clark* [1962]; *Commissioner of Corporate Affairs v Bracht* (1989); *Commr for Corporate Affairs v Ekamper* (1987); *ASIC v Adler* (2002); *Re Duomatic Ltd* [1969].

**Company Contracting**

*Entwells Pty Ltd v National and General Insurance Co Ltd* (1991); *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995]; *Donato v Legion Cabs (Trading) Co-operative Soc Ltd* (1966); *Federal Commr of Taxation v Whitfords Beach Pty Ltd* (1982); *Re Chism Services Pty Ltd* (1982); *SPP Ltd v Chew Beng Gim* [1993]; *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd* (1992); *Chew Hock San v Connaught Housing Development Sdn Bhd* [1985]; *Crabtree-Vickers Pty Ltd v Australian Direct Mail* (1976); *Koh Nai Chye v Tong Loong Pte Ltd* (1992); *Banque Bruxelles Lambert v Puvaria Packaging Industries (Pte) Ltd* [1994]; *Chew v R* (1992); *British Thomson-Houston Co Ltd v Federated European Bank Ltd* [1932]; *Re Qintex Ltd* (1991); *Dart Sum Timber (Pte) Ltd v Bank of Canton Ltd* [1982]; *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971].

## 4.1 COMPANY MANAGEMENT

### Introduction

Like any individual, a company needs to make decisions from time to time. These decisions can range from the day-to-day operations, hiring of employees, appointment of officers, entering into contracts with outsiders, decisions about company's fundraising, and constitutional decisions as to how the company will be governed internally.

This chapter examines the decision-making powers of a company - who it is within a company that has the power to make decisions and the type of decisions they can make. Different legal considerations apply to determining who has decision-making powers within a company, compared with the exercise of the company's decision making powers in transactions that affect outsiders. Here both are examined - the division of powers within a company, and how the company contracts with outsiders.

### *Acting through individuals*

Although a company is a separate legal entity, it is an artificial entity and therefore needs individuals to act on its behalf. These individuals can be either organs or agents of the company.

Organs are part of the company itself (no different from the organs of a human person) and they are considered to be the directing mind and will of the company. As such, their decisions and actions are the company's decisions and actions. The organs of the company are the board of directors (whose meetings are described as 'board' or 'directors' meetings) and the members in general meeting ('general meeting' is a term meaning a meeting of members). The company's decision-making power is split between these two organs. The organs of the company often grant power to an agent to act for and on behalf of the company. Thus the company, as the principal acting through its organs, appoints agents who in turn may bind the company with a third party in contract.

*A company is legally inseparable from its organs. However, an agent is a separate legal entity from a company.*

### **Division of powers within a company**

A company is an artificial entity, with legal capacity and powers. It requires natural persons to exercise those powers. It is normally the organs of the company that bind the company to the outsiders (see *organic theory company contracting* below).

The organs of a company are:

- *the board of directors, and*
- *the members in general meeting.*

### Division of Power

The CA and the constitution divide the power between the board of directors and members in general meeting.

The division of power in the constitution has to be observed by each party, since the constitution creates a statutory contract between the members, the company and the directors and secretary (S140 – see chapter 3). A most important principle that arises from this contractual relationship is:

*If the memorandum and articles grant management power to the board of directors, the members must not interfere in the management of that company – to do so would be unconstitutional and a breach of contract.*

The CA and the replaceable rules generally divide the powers as follows:

<b>Powers–Board of Directors</b>	<b>Powers–Members general meeting</b>
RR S198A - management power	RR S201G – appoint directors
RR S198A(1) - issue shares, debentures, borrow	RR S203C, S203D-remove directors
RR S198B - execute negotiable instruments	RR S202A - remunerate directors
RR S1072F-G -refuse transfer of shares	Ss 249E,F - call members' meeting
RR S249C - convene meetings	S249N – members' resolution
RR S254U - determine dividend	S136 - alter company's constitution

### *Examples of division of power*

In *Automatic Self-Cleansing Syndicate v Cunninghame* the members in general meeting resolved that the company should sell some of its property. The directors with general management power under the company's constitution refused to act as the members ordered. The court found that the members could not interfere in the company's management in breach of the company's constitution.

In *John Shaw (Salford) Ltd v Shaw* a majority of the directors decided to instigate legal action against two of the company's directors. These two directors had sufficient support amongst the members such that the members passed a resolution ordering the directors to

discontinue the company's legal action. The directors refused the order and the court supported their management power (which includes the power to initiate legal proceedings) as granted to them by the company's constitution.

In *NRMA v Parker* the directors had the power to select a returning officer when a ballot for the appointment of directors was held. The returning officer had the power to determine the method of distributing the ballot papers. The members requested an election of directors as they were entitled to do under the company's constitution. However, part of their request selected the returning officer and chose a method of distributing the ballot papers. This was considered interference in the director's management power provided by the constitution and as such, was invalid.

## **The management powers of the board**

### **Broad Powers**

If a company does not have a constitution, the replaceable rules apply and **RR S198A**, provides the board of directors with broad management power. If a company has a constitution, the constitution may give the board of directors general or restricted management powers. Management power includes the power to make decisions about the company's operations and the company's capital. The company's board of directors normally exercises management power at the company's board meetings. However, individual directors, such as the managing director may have been delegated with powers to implement the board's policies.

It is most unusual to overly restrict directors' management powers through a constitution as to do so would require members engaging in a role (management) that is foreign to the purpose for which they became members (investment). Also, if the members engage in too much day to day management they may themselves be classified as directors, attracting all the duties and responsibilities of such a position.

It is thus usually only the constitutions of closely held proprietary companies (such as a family company where the members are much closer to the activities), that restrict directors' management powers by requiring members' approval in general meeting. Such restriction is usually limited to significant irregular events so that there is little prospect of the members attracting the status of directors. For example, a family company, where the members had given personal guarantees over the company's debts, may have a rule requiring members' approval before further loans can be incurred.

Also, for companies listed on the ASX, the listing rules also introduce some restrictions on directors' management powers. An example is the requirement for members to approve an issue of shares if it is over a prescribed percentage (currently this is 15% of issued shares but it is proposed to increase it to 20%).

The following powers are generally conferred on the board of directors by the company's constitution (and are also found in the replaceable rules):

### *Management*

**RR S198A(1)** gives the board of directors the general power to manage the company's business. This would include the power to borrow money, charge a company's property, and issue debentures and issue shares (see footnote to **RR S198A**). Note that power is granted to the directors collectively for the making of board decisions and not to an individual director (see *Calling meetings* below for the only example where power is granted to an individual director).

### *Delegation of powers*

**RR S198C** allows the directors of a company to appoint a managing director (the chief executive of the company). The board can delegate any of its powers to the managing director. **RR S198D** also allows directors to delegate their powers to committees of directors (e.g. an audit committee).

### *Issue shares*

The directors' power to issue shares or make a call on shares is derived from the broad management power **RR S198A**. In exercising this power, the directors would determine the terms of the issue and the rights and restrictions attached to the shares **S254B**. **RR S254D** states that before issuing shares of a particular class, the directors of a proprietary company must first offer them to the existing holders of that class. This is known as a *pre-emption* clause and it ensures that members can retain their existing proportionate shareholding if they wish to take up their share of the new share issue. A rule such as this could be used by a public company in its own constitution but it is not usually suitable for such a company where an offer of shares to existing members will normally require the very expensive preparation of a prospectus; whereas, a single placement of shares with an investor may be able to attract an exemption (see fundraising chapter 9).

### *Transfer of shares*

**RR S1072F** generally permits members to transfer their shares to any person they wish. This is consistent with the concept of a share being an item of personal property **S1070A(1)**. A transfer requires a proper instrument of transfer. **RR S1072F(3)** however permits directors to refuse a transfer of shares if the shares are not fully paid up or the company has a lien on the shares. This reflects the fact that the company has an interest in who owns its partly paid shares as it would not wish to have the shares transferred to a person who is less able to meet a call than the current holder. This should not be thought of as the company still having an ownership interest in the partly paid shares – rather, under the principle of separate legal existence the shares are owned by the member and the liability to meet the call rests with that person. It is a contractual right that the

company has that would permit it to force forfeiture and resale of the shares, if a call is not paid.

Under the replaceable rules, proprietary company directors have the power to refuse the transfer of shares for any reason whatsoever **RR S1072G**. This may be popular with tightly held family companies. For a company with a governing director, a rule that one person has control over all transfers might be used.

Public company directors could also have this power if a constitution so provided it but it is not very suitable for such companies where the right to sell shares to any person adds value to the shareholding. Companies listed on the ASX are not permitted by the listing rules to restrict the rights of shareholders to transfer their shares.

### *Calling meetings*

**RR S248C** permits a director to call a directors' meeting by giving reasonable notice. **RR S249C** also grants power to a director to call a meeting of the members. This is a mandatory rule under **S249CA** for a listed public company director. Section 249D permits a prescribed number of members to request the directors to call a general meeting (see chapter 7 members' meetings).

### *Dividends*

Dividends are paid by a company from its profits to its members. They are nearly always paid in cash and are thus a cash flow item that would properly be a matter for directors to decide. Subject to the constitution, the directors have the full authority to determine and pay both interim and final dividends. **RR S254U** states that the directors may determine the amount, time and method of payment of a dividend. For companies that still have a constitution based upon the old Table A articles, the members would be required to declare (approve) the directors recommended dividend.

### *Execute documents*

A company may execute a document with or without a company seal **S127**. If a document is executed using the company's seal, 2 directors or a director and a company secretary must witness it. If a document is executed without a company seal, then it must be signed by 2 directors or a director and a company secretary.

## **Proceedings of the board**

### **Directors' Meetings**

Part 2G.1 deals with meetings of directors. **RR S248C** enables a director to call a board meeting. It is at the board meeting the directors exercise their powers and make decisions. Decisions at board meetings are made by passing resolutions.

A directors' meeting does not have to be held at one place. Subject to the constitution, directors could meet by telephone or by the use of video – to "meet" means to be intentionally and mentally present rather than physically present. Section 248D provides that a meeting of directors may be called or held using any technology consented to by all the directors. A directors' meeting is chaired by a person elected as chairperson by the directors RR S248E.

### ***Resolutions***

RR S248G(1) provides that a resolution of the directors must be passed by a majority of the votes cast by directors entitled to vote on the resolution. This recognises that some directors may not be entitled to vote, especially if the directors have personal interests in the matter being discussed. The chairperson has a casting vote at the directors' meeting under RR S248G(2).

### ***Resolutions without meetings***

RR S248A allows resolutions to be passed without actually holding directors' meetings. This can be done by circulating the resolution and each director signing in favour of the resolution set out in the document. More than one copy of the resolution can be circulated, so long as the wordings in each copy are identical. When the last director has signed, the resolution passes at that time.

Single director proprietary companies pass a director's resolution by recording the resolution and then signing the record s248B.

### ***Notice of meetings***

RR S248C states that a director can call a meeting giving reasonable notice individually to every director. There is no requirement for this notice to be in writing. However, all the directors must be given notice of the board meeting *Petsh v Kennedy*. In *Mitropoulos v Greek Orthodox Church*, the court held a board committee meeting invalid, when notice of the meeting was not given to a director who was overseas.

The length of notice of a directors' meeting depends upon any provision in the company's constitution (which would be unusual), or if nothing is stated it simply must be reasonable. The notice must contain details of the business to be discussed at the meeting. A meeting was held void in *Jenashare Pty Ltd v Lemrib Pty Ltd* when the notice of a meeting did not include details of the business to be discussed.

### ***Quorum***

A quorum is the minimum number of directors required to attend in order to constitute a valid board meeting. RR S248F provides that unless the directors determine otherwise, the quorum for a directors' meeting is two. Under RR S248F, the quorum is required to

be present at all times during the meeting. Obviously if the quorum is two, failure to maintain this number would also result in the meeting adjourning due to the failure to maintain the meeting (with only one person being left present). Only the directors who are eligible to vote at a meeting constitute a quorum. A director who has a personal interest in a matter being considered, may be ineligible to vote and would therefore not be counted to make up the quorum.

### ***Minutes***

Section 251A provides that companies must keep minute books and record the resolutions of directors' meetings within one month of the proceedings. The chairperson must sign these minutes within a reasonable time and it then becomes *prima facie* evidence of the proceedings S251A(6). The minutes should also record resolutions passed without a meeting and in the case of a single member proprietary company, the making of any declarations by the director.

## **Types of directors**

### **Director**

The term "director" is defined in S9 as a person occupying or acting as a director, by whatever name called and whether properly appointed or not. Thus, the definition includes "shadow directors" (those who are not appointed but give orders to the directors). In *Mistmorn Pty Ltd v Yaseen*, Yaseen was held to be a shadow director of a family company when he conducted himself as a director, although not formally appointed.

### ***Only individuals***

Although S201B(1) provides that a body corporate cannot be appointed a director (i.e. only individuals can be appointed), in *Standard Chartered Bank of Australia Ltd v Antico*, a company was held to be a shadow director. Here, the directors of a subsidiary company customarily followed the instructions of the holding company and the holding company was held to be the shadow director of the subsidiary.

### ***Managing director***

The board can appoint one or more of them as managing directors RR S198C. This description is somewhat misleading as it suggests that all directors are appointed first and then the managing director is selected. The managing director is the chief executive officer of a company and is recruited for their executive skills with their directorship being part of their job requirements. It is common for companies that require their directors to stand for re-election on a rotating basis, not to include the managing director in that process.

The managing director is sometimes referred to as the third organ of the company, exercising the powers directly conferred on them by the board of directors. Their primary function is to implement the decisions of the board. An important secondary function is to ensure that the board is fully informed of developments that occur within the company.

### ***Chairperson of directors***

RR S248E allows directors to appoint one of them as “chair” (this book uses the more inclusive term “chairperson” although linguistically the correct term is “Chairman”). The role of a chairperson includes exercising control over a board meeting such as the agenda (the business discussed at the meeting), the discussion and decision making procedure, etc. In *AWA v Daniels*, Roger CJ said that a primary responsibility of the chairperson included the selection of matters and documents to be brought to the board’s attention.

A board meeting cannot proceed without a chairperson. In *Kelly v Wolstenholme*, a meeting without a chairperson was held to be void.

### ***Governing director***

Proprietary companies, especially family companies, may appoint a governing director to maintain absolute control over the company’s affairs. The constitution would spell out the power, authority and discretion vested in the governing director. It is not unusual for the governing director of a proprietary company to have power over every director and member decision, including being the sole member entitled to appoint or remove directors. In *Whitehouse v Carlton Hotel Pty Ltd*, the governing director had the power to issue shares without referring the matter to other directors.

### ***Executive and non-executive directors***

Executive directors are full time employees of the company and, in their executive capacity, carry out the day to day management of the company’s business. The managing director is an executive director.

Non-executive directors are non-employees who attend board meetings and other directors’ activities such as committee meetings, but do not otherwise participate in the ordinary business of the company. The purpose of the non-executive directors is to bring an independent view to the board. Their role is not to engage in day to day management but to have a more distant relationship in what is the peak decision making forum responsible for the overall direction and policies of the company and its financial well-being. In *Daniels v Anderson*, the court held that non-executive directors owe the same standard of care as executive directors.

### ***Alternate directors***

If a director cannot attend a board meeting, they may be entitled to appoint an alternate director (sometimes also known as a substitute director) to take their place RR S201K.

An alternate director can only be appointed if the constitution so provides and it usually requires the other directors to approve the alternate.

An alternate director only has powers when they are acting in place of the director for whom they are the alternate. An alternate director owes the same duty as any other director at the meetings they attend. It is thus an onerous position to occupy as they may not be as familiar with the company's affairs as the regular directors.

Assignment of office is a different procedure and means that the director has the right to actually transfer their position to an assignee on a permanent basis. This unusual power normally would require the constitution to expressly provide such a right.

### *Associate director*

An associate director is appointed to the board for their special expertise. Some companies appoint junior executives as associate directors. An associate director may have limited powers, but is subject to the same duties as any other director in the exercise of those powers.

### *De facto and shadow directors*

A *de facto* director is a person who acts as a director, and the company holds him out as a director, even though not formally appointed as such. This could arise where there has been a failure to appoint the director in the manner required by the company's constitution.

A shadow director is a person who gives instructions with which the directors are accustomed to act. Here both the company and the director are trying to conceal the real role performed by the person. This arrangement might be found where the person has been banned from being a director due to a disqualification such as being an undischarged bankrupt, and they are trying to breach the order.

However, both of these types of directors fall within the definition of director under S9.

### *Nominee directors*

Nominee directors are appointed to represent the interests of an outside party, usually a particular group of shareholders or creditors. A nominee director's duty under corporate law is primarily owed to the company and duty to any outside party should be of secondary consideration. However this priority of duty can be set aside. In *Levin v Clark*, a nominee director acted in the interests of a mortgagee and this was properly regarded as being in the interests of the company, as the company's constitution allowed for such an appointment and diversion of duty. In such circumstances, a company would not succeed in an action against a director for acting in the interest of the outside party as the constitution has the effect of a contract between the parties (see chapter 3).

### *Committees of directors*

**RR s198D** allows directors to delegate their powers to committees of directors. Listed public companies may have a large number of directors on their board and forming committees helps a smaller number of directors to concentrate on a specific task. For example, an audit committee may have the job of monitoring the accounting functions within a company, including the activities of the internal (if any) and external auditors of the company. Any directors, (excluding the executive directors for corporate governance reasons), with a background of accounting skills would be suitable members of such a committee.

### **Company secretary**

#### **Role**

A secretary works with the board of directors providing guidance over the company's regulatory compliance and corporate governance. The secretary attends board meetings and although not a participant in the decision making, they are commonly asked for advice. All (directors' and members') meeting arrangements commonly fall under the secretary's duties. Often for small companies the secretary may also be the chief accounting officer but with bigger listed companies these two roles are usually separated.

Under case law the secretary has been found to be the chief administrative officer of a company *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*. An act of a secretary can be regarded as an act of the company, if it relates to the administration of the company *Donato v Legion Cabs (Trading) Co-operative Soc Ltd*. Generally, a secretary has no authority to enter into commercial transactions required for the day to day running of the company, unless they are of an administrative nature. A secretary's authority extends to counter-signing the affixing of the company's seal.

Under the CA, some of the secretary responsibilities are:

- Maintenance of the company's registered office Ss 142, 145
- Lodging the company's annual return S345
- Lodging annual reports with ASIC S319.

#### **Appointment**

All public companies must have at least one secretary S204A who is appointed by the directors on such terms and conditions as they determine Ss 204D, 204F. A person may act both as a director and a secretary. Both the CA and the replaceable rules are silent as to who has the power to remove a secretary. This power is likely to fall within the board's management power.

#### ***Who may be appointed as a company secretary***

A secretary must be at least 18 years of age S204B(1) and reside in Australia S204A(1).

## Members' powers at a general meeting

### Members' Forms of Control

The members in general meeting have the power to indirectly control the board of directors by:

- (i) altering the constitution which confers the power on the board [members' statutory right S136]; and/or
- (ii) removing directors and appointing new ones [director removal is a statutory right for public company members **S203D(1)** but only a constitutional right for proprietary company members **RR S203C**; director appointment is a constitutional right for members of both types of companies **RR S201G**].

### Alteration of Constitution

Although the board of directors may have the management power, the members in general meeting can create a constitution, or alter a constitution and restrict the board's management power S136. For example, the members can have a clause in the constitution that if the directors want to borrow more than a certain amount, the board must obtain approval from the members in general meeting.

### Appointment of Directors

**RR S201G** provides that a company (members in general meeting) can appoint a director by resolution at a general meeting. Public company directors have to be individually appointed by separate members' resolutions unless the S201E procedures are observed. Sections 205B and 201L require a company to lodge personal details of the director to ASIC within 28 days after they are appointed.

**RR S201H** states that directors can appoint a person as a director. This may occur where there is a vacancy. The person appointed, holds office until the next AGM for public companies, when the appointment needs to be confirmed by the members. Most directors are firstly appointed by the directors, rather than by a person challenging a retiring director in an election by the members. For proprietary companies, the members must confirm the appointment within 2 months of the appointment. Many proprietary companies would find this an unsuitable rule, particularly if the same persons are both directors and members.

A single director/shareholder proprietary company may appoint a director by recording the appointment and signing the record S201F.

### ***Who may be appointed as a director?***

A director must be at least 18 years of age and must be an individual **S201B**. From 1 July 2003 there has been no upper age limit or requirements for the directors of public (or proprietary) companies under the CA. The company's constitution could however, provide restrictions.

A proprietary company must have at least 1 director and 1 director who is resident in Australia **S201A(1)**. A public company must have 3 directors, 2 of whom must be resident in Australia **S201A(2)**.

### ***Persons disqualified from acting as director***

Certain persons are disqualified from acting as a director. These include undischarged bankrupts and convicted persons **S206B**. However, the court has the power to grant leave to allow a person to manage the corporation **Ss 201B(2), 206G**. Managing a corporation involves policy and decision-making, but excludes mere clerical and administrative acts *Commissioner of Corporate Affairs v Bracht*. Sections 324CI-J prevent an auditor of a company becoming a director until 2 years have elapsed since the audit. This is to promote auditor independence.

The court can order a person not to manage a corporation where the relevant officer fails to take action when the company repeatedly breaches the CA, or the relevant officer personally repeatedly breaches the CA, **S206E(1)**. A director who had repeatedly failed to lodge an annual return was disqualified under **S230** in *Commr for Corporate Affairs v Ekamper*. The court can also prohibit a person from managing a corporation for up to 10 years, if they have been a director of 2 or more insolvent companies in the last 7 years **S206D(1)**. For breaches of duties of good faith, conflict and profiting to the detriment of the company, a director was banned from the management of a company for 20 years *ASIC v Adler*.

Part 2D.6 states the circumstances when a director loses their office. These include:

- Bankruptcy of director **S206C(3)**;
- Conviction where the company is substantially affected **S206B(1)**;
- Subject to court orders under **Ss 206C-E**;
- Subject to ASIC orders **S206F**.

Some companies have a constitutional requirement for directors to have limited terms of office or a requirement for directors to be reappointed on a rotational basis. Companies listed on the ASX are required to have one third of their directors (excluding the managing director), stand for re-election each year.

### *Termination of appointment as director*

A director may be appointed for a limited term. The office would therefore terminate at the end of that term. A director may resign as a director by giving notice S203A.

### *Removal of directors*

The company (members in general meeting) may be able to remove a director anytime. This is a replaceable rule for a proprietary company **RR S203C** but a statutory right for the members of a public company **S203D**. This means that members in a public company can *always* remove a director, and the constitution of the company cannot alter this statutory right **S203E**. However, a proprietary company's constitution can provide restrictions in removing its directors and may even entrench a director in their position.

The board cannot remove public company directors. Only the members have control over their removal. However, **S203D** requires the members to give the company 2 months notice before the meeting is held to remove the directors. The company must then forward a copy of the notice to the director concerned who has a right to give a written statement or be heard at the meeting. Note that under **S203D** a nominee director appointed to represent the interests of a class of shareholders or debenture holders can not be removed from office until their successor has been appointed. For proprietary companies, it is permitted for the constitution to provide the directors with a right to remove other directors.

### *Remuneration of directors*

**RR S202A** provides that the members shall determine the remuneration of directors by resolution. Expenses incurred in conducting their office may be reimbursed to directors as an additional sum that does not require approval **RR S202A(2)**.

### **General meeting cannot interfere in management**

**RR S198A** confers the management power on the board of directors. The general rule is that if power is conferred on the directors by the constitution, the members are bound to comply and not interfere with the exercise of that power by the directors.

This rule was established in *Automatic Self-Cleansing Syndicate v Cunninghame*. In this case, the members in general meeting ordered the directors to sell the company's property. The directors refused. The courts held that since the constitution gave the board of directors the power to deal with the company's property, the members could not interfere with the directors' decision as they were contractually bound by the constitution **S140(1)**.

In the case of *John Shaw (Salford) Ltd v Shaw*, 3 brothers were directors of a family company. They entered into an agreement to appoint 3 new directors and 2 of the brothers refused to comply with the agreement. The independent directors decided to take legal action. The brothers at the general meeting passed resolution in an attempt to stop the legal action. The court held that the general meeting could not usurp the powers the constitution vested in the directors any more than the directors can usurp the powers vested by the constitution in the general body of shareholders.

The inability of the general meeting to interfere with the powers of the directors that were conferred upon the directors by the constitution was affirmed in the case of *NRMA v Parker*. In this case, the members tried to pass a resolution to control the appointment of a returning officer for a directors' election and to change the way ballot papers were used. It was held that these powers were vested in the directors and not in the members, by the constitution.

### **Ratification by General Meeting**

The board of directors should also refrain from exercising powers that the constitution has vested in the general meeting. For example, the constitution may state that the directors cannot enter into a transaction without the approval of the general meeting. If the directors fail to obtain the approval of the general meeting, they are acting beyond their power. However, where the directors act *ultra vires* their power, the general meeting can ratify or adopt the transaction, if it is *intra vires* (within) the members' power.

### **Separation of Ownership and Management**

In small companies, especially family companies, the shareholders are the directors and there is no real separation of ownership and management. Although, the CA maintains a legal practical separation of power between ownership and management for all companies the court has set this aside on occasions. In *Re Duomatic Ltd* the company had 3 directors who were the only holders of voting shares in the company. The company's constitution required the members to determine directors' fees but this was not done and the payment of fees was decided at directors' meetings. The High Court (England) found that the members had given their informal assent even though they had been acting in their capacity as directors when making the decisions. This outcome would have been different if not all directors/members had been involved and it is obviously desirable to properly follow procedure and hold separate directors' and members' meetings if and when required.

For large companies it would be impractical for a large number of shareholders to interfere and participate in the management of the corporation.

## 4.2 COMPANY CONTRACTING

### Introduction

There are 3 ways in which companies are capable of forming contracts with outsiders:

- By applying the company's common seal (if it has one);
- By applying the organic theory that the organ's actions are the company's actions;
- By applying the principle of agency law.

### Execution of documents

#### Common Seal

At common law, the traditional position was that a company could only enter into contracts by affixing its common seal. However, **S123** has made a common seal optional and **S126** provides that a company may make contracts without using a common seal.

**Section 126** identifies two ways in which a person acting under the authority of a company may enter into contracts:

- in the name of the company (organic theory); and
- on behalf of the company (agency principle).

**Section 127** provides how a company should execute a document with or without the use of a common seal.

### Organic theory

#### The Theory

The organs of a company are:

- The members in general meeting; and
- The board of directors.

An organ is more than a mere agent. The state of mind of an organ is the state of mind of the company (its directing mind and will). An act of an organ is an act of the company.

The organic theory originated from the case of *Lennard's Carrying Co Ltd v Asiatic Petroleum Co Ltd*. Dawson J in the case of *Northside Developments Pty Ltd v Registrar-General*, said that an organ is an extension of an agent. This means that before an agent can be considered to be an organic part of a company (to be the state of mind of the company) they must first have authority, actual or apparent.

In *Lennard's* case, an un-seaworthy boat whilst carrying oil for Asiatic Petroleum caught fire and the cargo was destroyed. Asiatic Petroleum sued the owner of the ship. The owner would be exempted from liability under the relevant statute if they could show they were not at fault. The sunken ship had operated under the management of another company appointed by the owner and the managing director of the management company had been responsible for permitting the unseaworthy boat to sail. The courts held the failure of the management company and its managing director was imputed to the owner which was thus not entitled to exemption from liability under the statute. The management company acting through its chief executive was treated as the directing mind of the owner under the circumstances and therefore their action was considered to be the owner's action. If it had only been a junior employee of the managing company that made the decision, this would not have been considered the directing mind and will of the owner and liability would have been avoided.

In *Entwells Pty Ltd v National and General Insurance Co Ltd* a company had three directors/shareholders. Whilst no directors' meetings were held two of the directors worked as executives and made all the decisions. Even though not formally appointed as managing director, one of the two was considered a joint managing director in substance and their actions were considered to be the company's actions. This was important as the company had suffered loss as a result of a fire lit by the joint managing director and the insurance policy excluded deliberate acts of employees and agents but not the acts of the company itself.

### **Who is a company's directing mind and will?**

#### ***The "brains"***

In *HL Bolton (Engineering) Co Ltd v TJ Graham & Sons*, Lord Denning likened a company to a human body, needing brains, arms and limbs. Some people in the company are just the arms and limbs: "...the mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind and will". More senior persons however may be in a position of control: "... directors and managers who represent the directing mind and will of the company and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such."

In this case the issue was whether the company could have formed an intention to occupy certain premises. The general meeting or the board had not met to consider this issue. It was held that the state of the mind of the directors and managers (who controlled the company) was the state of mind of the company.

***When is a manager's act the act of the company?***

The intention of a company is derived from the intention of its officers and agents. Some managers have significant powers to act and make decisions without supervision and commonly their decisions and acts are considered to be the company's decisions and acts.

However in a notable departure from the usual, a store manager was held not to be the controlling mind of the company in *Tesco Supermarkets Ltd v Nattras*. In this case, the store manager had advertised goods falsely and the question was whether the company was liable through his actions. If he was considered the directing mind of the company, then the company would be liable. The company conducted its affairs in such a strict and rigorous manner, that a breach of policy by the store manager was considered by the Court to be so contrary to the company's usual pattern of behaviour that it would be wrong to treat that act as being that of the company. It was held that the store manager was not the controlling mind of the company and as such, the company was not liable. Lord Reid said that the directing mind and will of the company are normally the board of directors, managing director and superior officers, and also includes management fully delegated by the board to act on its behalf without further instructions.

The decision in *Tesco Supermarkets Ltd v Nattras* may have application in situations where extensive corporate governance practices are exercised but otherwise, as in *Brambles Holdings Ltd v Carey*, it is more common to treat a manager (such as a store manager) as being senior and independent and thus the directing mind and will of the company when carrying out their function.

In *Brambles Holdings Ltd v Carey*, the company was charged with an offence of carrying more than the maximum legal load in its truck. This responsibility rested with the driver, supervisor and manager. However, the main driver was sick and the new driver did not know the loading instructions. The supervisor was considered to have made an honest or reasonable mistake but the manager was held to have known, or ought to have known, that proper instructions had not been given (leading to the prospect of a truck being overloaded). It was held that the manager was the directing mind and will of the company and so the company was in breach of the regulations. Unlike the case of *Tesco Supermarkets Ltd v Nattras*, the court was not persuaded that the company had such a high standard of due diligence and extensive corporate governance practice that the conduct of the manager could be distinguished from the conduct of the company.

In *Meridian Global Funds Management Asia Ltd v Securities Commission* two senior officers of Meridian each acquired on their employer's behalf, shares in another company which, when combined, required Meridian under securities law to announce its holding. Meridian's directors and managing director were not aware of these acquisitions but nevertheless the action and knowledge of its senior officers were attributed to it and thus it was found to have breached the law.

It should be noted when considering case such as those above, that statute commonly makes the act of an employee the responsibility of the company regardless of the seniority of the employee. That is, there is often no requirement to ascertain whether the person was a directing mind or will of the company or not. The principle applied is that the company has primary liability for the action of its staff and as the board of directors (an organ of the company) has ultimate management authority, including responsibility for staffing and proper processes and procedures within the company, it is appropriate that the company should be held accountable.

### Change in management

The company may change its mind with a change in its controllers *Federal Commr of Taxation v Whitfords Beach Pty Ltd*. In this case a company acquired land to enable the shareholders to engage in fishing. The shares in the company were sold and the new shareholders wanted to subdivide and sell the land. The intention of the new shareholders was considered to be the intention of the company, as they had become its directing mind and will. Note that it is unusual for members to have management power that would allow them to be considered to be the directing mind and will of the company.

### Can the knowledge of many managers be aggregated?

In a large company where the business is delegated to a number of executives and managers, the directing mind and will of the corporation may be determined from the state of mind of more than one person *Brambles Holdings Ltd v Carey*.

The knowledge and belief of various officers could be aggregated to determine the mind and will of the company *Re Chism Services Pty Ltd*. In this case, the information held by officers in the bank's head office was aggregated with the knowledge of the branch manager to determine the company's knowledge.

## Contracts made by agents

### The Law of agency

The principles of agency law apply to companies. There are three parties in an agency relationship and two legal relationships:

Parties	Legal Relationships
<ul style="list-style-type: none"> <li>• Principal (the company)</li> </ul>	<ul style="list-style-type: none"> <li>• Between principal and agent</li> </ul>
<ul style="list-style-type: none"> <li>• Agent</li> </ul>	
<ul style="list-style-type: none"> <li>• Outsider</li> </ul>	<ul style="list-style-type: none"> <li>• Between principal and outsider</li> </ul>

## Contracting through an Agent

The agent acts as a conduit through which the principal and the outsider enter into a contract. It is not the intention to bind the agent to the outsider in contract.

### Authority Required

In order for the agent to bind the principal to the outsider the agent requires authority from the principal. If there is no authority the "agent" would not be an agent in a legal sense and any contract would be between the outsider and the "agent" who would be acting in a personal capacity. If the outsider cannot obtain performance under the contract from the "agent" in such a situation, they could sue the "agent" for the tort of breach of warranty of authority. *Authority can only be conferred by a principal that possesses such authority.*

### Types of Authority

A relationship between the principal and the agent can be created by:

- Actual authority (which can be of two types)
  - express
  - implied
- Apparent (also known as ostensible) authority.

### Actual authority

Actual authority can be *express* or *implied*.

#### Express Actual Authority

Express actual authority is the express conferral of authority. The form of the authority could be written, verbal or by conduct.

Express actual authority can arise in a number of ways:

- Firstly, statute can provide such authority e.g. as provided by the CA to a registered company liquidator to undertake various functions.
- Secondly, the company's constitution can expressly provide authority e.g. as may be provided to a governing director over all the company's affairs.
- Thirdly, an organ of the company can confer the authority e.g. the board of directors may authorise the managing director to purchase an asset.

- Fourthly, an agent of the company who has been granted authority confers this onto another agent, who in turn may delegate this to another agent e.g. a managing director who has authority from the board of directors (an organ) to spend up to \$1M on capital equipment, confers part of this on the production manager by granting authority to spend up to \$250,000 on capital equipment and the production manager, in turn, confers part of his authority on to the production supervisor to spend up to \$10,000 on capital equipment.

This fourth example is the common model for any company that has employees engaged in the usual line management structure. For authority to properly flow, it requires the manager who confers a level of authority upon his subordinate, to actually possess that level of authority. It can be seen that the possessors of authority at the higher levels (the board of directors and the managing director) get further and further away from the decision making at the lower levels. Nevertheless the principal (the company) is just as bound by a transaction entered into by an agent at the lowest level in the company's hierarchy (no different as if it had been undertaken by the board of directors) as long as it has been undertaken with appropriate authority.

### **Implied Actual Authority )**

Implied actual authority is authority that can be implied from the conduct of the parties and the circumstances.

Where a type of transaction has been conducted in the past with the tacit approval of the principal, such past conduct could be reasonably relied upon to infer that implied authority exists for the agent to enter into such a transaction again. This inference would require the absence of any knowledge or instructions to the contrary and is more persuasive if there had been multiple transactions of this type in the past.

Implied actual authority from circumstances can be found in three situations:

- Firstly, the authority to undertake whatever is customary for the position that the agent actually occupies (this is also known as *usual authority*) – see *Hely-Hutchison v Brayhead Ltd* below.
- Secondly, the authority to undertake whatever is necessary or incidental to the attainment of a task that the agent has been given express authority to undertake.
- Thirdly, to exercise the authority that arises from the acquiescence of the holder of the authority – see *SPP Ltd v Chew Beng Gim* below.

Thus with implied actual authority the agent does not require a specific conferral of authority before undertaking a particular action, in order to bind the principal in contract with an outsider.

An agent or outsider is entitled to assume that an office held by a person (the agent), confers upon that officeholder all the power that is customary (usual) for such a position. For example, an agent appointed to completely manage a business, has all the powers customarily associated with holding the office of managing director. In *Hely-Hutchison v Brayhead Ltd* the outsider had the right to assume the agent held all the power customary for the managing director's position that they held and any restrictions on that power imposed by the company did not diminish the outsider's rights of assumption.

The application of this concept in South East Asian jurisdiction can be seen in the Singapore case of *SPP Ltd v Chew Beng Gim*, where the directors permitted the managing director to manage the affairs of the company with little if any reference to the board. The managing director authorised two executive directors to enter into personal guarantees to secure business for the company and undertook that the company would indemnify those two directors. The managing director and the two directors lost their positions and later the guarantees were exercised against the two directors. The company refused to honour its indemnity. The court found that the managing director had implied actual authority to grant the indemnity on behalf of the company due to the conduct of the board of directors in allowing the managing director to exercise power without reference to them. Thus, an act of acquiescence can result in the conferral of implied actual authority.

It is a common occurrence with small family companies for there to be one director that manages everything, often with another director being completely passive. In such circumstances the managing director is considered to have the implied actual authority to undertake any matter in behalf of the company.

### **Customary**

An outsider can assume that the agent who has implied actual authority can exercise all the powers that are *usual* or *customary* for the position held. Each case is a question of fact. Customarily, complete management power is granted to the board of directors through the company's constitution (see RR S198A). The power is conferred upon the board of directors as a collective body. An individual director has no customary authority to transact on behalf of the company and it would require a delegation of power from the board in order for the individual director to bind the company.

A managing director derives authority from their chief executive's role (not from their directorship). The office of managing director customarily confers complete management powers on the incumbent as was seen in *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*.

Any other executive director similarly derives authority from their executive position (not from their director's office). Thus, a finance director, who also holds an executive position as financial controller of the company, would bind the company in a contract to purchase an accounting software system by virtue of their executive (financial controller's) role - that type of transaction being customary for the office held.

However, if a person held only the position of director; or alternatively held the positions of director and marketing manager, or alternatively just held the executive position of marketing manager – then in all these circumstances the purchase of an accounting software system would not be customary for the position(s) held and the outsider could not rely on implied actual authority in their attempt to enforce the contract against the company. It would require the presence of express actual authority to enforce the contract against the company in such circumstances.

A company secretary has been found to be the chief administrative officer and customarily is not a *manager* for the purposes of the company's external activities such as trading or manufacturing.

An agent (without instruction to the contrary) can assume they possess all the implied actual authority necessary to undertake the task assigned to them. For instance if the factory manager is authorised by the managing director to purchase a new production machine, without instruction to the contrary, the factory manager can assume that they could reasonably incur costs (say, to travel to view the machine in a working environment) as part of that process.

Any limitation to the customary role of an agent can be overcome by conferring actual express authority. For instance, an individual director (customarily holding no authority) could be granted authority by the board of directors to undertake any transaction that comes within the authority of the board. Similarly, a production manager could be given actual express authority by the financial controller to purchase an accounting software system on behalf of the company and the company would be bound in contract to the outsider under such circumstances.

For further details, refer paragraph *Customary/usual authority of officers* below for more details.

## **Apparent (ostensible) authority**

### **Appearance of Authority**

Apparent or ostensible authority occurs where an agent does not actually have authority to carry out a transaction but the principal conducts itself in such a manner that it gives the agent an appearance of possessing the office or holding the necessary authority and the outsider, relying on this appearance, enters into the transaction with the principal (through the agent) in good faith. ① Holding out

It must be the principal that holds out the purported agent to the outsider if the principal is to be held liable. In the Malaysian case, *Chew Hock San v Connaught Housing Development Sdn Bhd*, a clerk entered into a contract on behalf of the housing development, without express actual authority. The clerk's position did not reasonably permit implied actual authority as the contract was not usual for a clerk and it could not be shown that the housing development had held out the clerk as having authority. Therefore, the contract was not enforceable against the housing authority.

### ② reliance

It is also important that the outsider *relies* on the representation made by the principal. Even though the company conducts itself in a manner that would reasonably lead an outsider to believe an agent has authority, where a particular outsider knows or suspects that the purported agent does not have that authority, then the company will not be estopped from denying that the agent lacked authority – as the outsider did *not rely* on the holding out.

### ③ Doctrine of Estoppel

It is difficult for an outsider to know whether an agent has authority. The outsider normally relies on the representations made by the principal that the agent has the authority. If the principal has made such representations, and the outsider has relied on those representations, then the *doctrine of estoppel* applies and will prevent the principal from denying to the outsider that the agent did not have the authority. In order to bind the company as principal to the outsider, a person acting on behalf of the company and giving the agent an appearance of authority, must have actual authority covering that type of transaction. That is, a person must have authority in order to confer it on another.

#### Types of Representation

A principal may either expressly make a representation to the outsider, or may impliedly make a representation by allowing an agent to occupy a particular position or to carry out an act beyond the agent's customary authority; e.g. there is a defect in the appointment of the agent but the principal acts as if the appointment had been properly made.

In *Freeman and Lockyear v Buckhurst Park Properties (Mangal) Ltd*, Kapoor and Hoon formed a company. Hoon was often overseas and Kapoor acted as managing director and appointed an architect. The outsiders could rely on the apparent authority of the "managing director" to engage a firm of architects on the company's behalf, since the board of directors had allowed the person to act as managing director, even though they had not formally appointed him as such. The act of the company in allowing Kapoor to perform the role of managing director held out (represented) to outsiders that he held that office and had all the authority customary for such a position. It is essential that it is the principal that holds out the agent – the agent holding himself out, will not bind the principal to the outsider.

#### Limit to conferring authority

An agent holding only apparent authority cannot confer apparent authority on another agent and bind the principal *Crabtree-Vickers Pty Ltd v Australian Direct Mail*. However, a defacto managing director considered to be the mind and will of the company (i.e. is the company itself and considered to hold actual authority) can hold out another as having apparent authority *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*.

## **Outsiders' rights of assumption**

### **Delegation of Authority**

The company's constitution provides the allocation of power (authority) between the organs (the members in general meeting and the board of directors). It is usually not practicable for the members to retain general powers of management and these are customarily conferred on the board of directors (see RR S198A). It is similarly not practicable for the board of directors to actually undertake the exercise of all authority granted to it. It is commonplace for there to be delegation of a considerable part of the board's authority down to the chief executive officer (the managing director) and through that office to the other levels of management and staff. Thus, the exercise of a company's powers may be spread by delegation over the company's hierarchical management and staff structures with actual and customary authority varying considerably from office to office.

### ***Breach of authority***

If an agent has not acted within actual authority delegated, the appropriateness of their action could be challenged on the grounds of whether it is customary for their position - this assessment is a responsibility imposed on the outsider. However, where there has been a breach of an internal procedure - such as a board meeting improperly convened, a quorum not present at the meeting, or the company seal improperly applied - the outsider is not in a position to necessarily know of the existence of the procedure, let alone if it has been observed correctly or not.

### **Actual and Constructive Knowledge**

If it happens that the outsider has actual knowledge that a company procedure has not been complied with and as a consequence the agent lacks authority, then the outsider may lose their right to enforce the contract.

If the necessary company contracting procedure is contained in a company's constitution, which is available to the public by inspection at ASIC, is an outsider dealing with the company considered to have knowledge of what is in that public document? This type of imputed knowledge from the public availability of information is known as "constructive knowledge" (see chapter 3).

Such constructive knowledge could only apply to the constitutions of public companies as only they are required to lodge them S136(5). However statute has set aside the common law doctrine of constructive notice for most company documents, including a lodged constitution. **Section 130(1)** now states that a person is not taken to have information about a company merely because the information is available to the public from ASIC. Thus, **S130(1)** abolishes the doctrine of constructive notice for the purposes of this discussion. Note that constructive notice is not abolished for registrable charges S130(2), a most important exception considered later in loan capital, chapter 8.

### The Indoor Management Rule in *Turquand's* case

When the doctrine of constructive notice was widely applied, a deemed knowledge of a requirement within the memorandum and articles did not provide the outsider with knowledge of whether the company's organs or agents had actually complied with that requirement. At common law the rule in *Royal British Bank v Turquand* operated in favour of outsiders, to allow them to assume that the internal proceedings of a company had been properly carried out. In *Turquand's case*, the board of directors could borrow money only if the general meeting approved. When the company borrowed without the necessary approval of the general meeting, it was held that the bank could assume that the required resolution of the members had been passed.

In *Koh Nai Chye v Tong Loong Pte Ltd* (1992), the managing director of a company which had previously only borrowed from banks, borrowed funds in the company's name from a different party. The High Court, Singapore found that the lender could not have known, and was not expected to have known, that the company had internal rules covering such a matter and that they had not been complied with.

The right of the outsider to assume that the internal rules of the company have been observed, is referred to as the *indoor management rule*. It has been codified in S129 and allows outsiders to assume that the constitution and the replaceable rules have been complied with at all times and that company officers perform their duties properly.

### Exception to the indoor management rule in *Turquand's* case

A significant exception to the rule in *Turquand's case* is where the outsider has actual knowledge of the irregularity or is put upon inquiry, but fails to make inquiries.

This was illustrated in the case of *Northside Developments Pty Ltd v Registrar-General*, where the lender could not rely on the assumptions that the internal proceedings of the company has been complied with, since the lender failed to exercise reasonable care where suspicion of an irregularity was reasonably apparent and worthy of inquiry. In this case, Sturgess a director of Northside borrowed money from Barclays Bank, using a mortgage over the company's land as security for the loan. The loan documents were witnessed by Sturgess son, purporting to be the company secretary. The other directors were not aware of the transaction. There was no benefit to the company in the transaction and there was nothing that indicated that this would be so. It was held that the lender, Barclays Bank, should reasonably have been put upon inquiry and should have queried the loan, since the transaction was outside Northside's usual business and was secured on Northside's major asset without any apparent beneficial reason.

The decision in the Northside's case can be contrasted with *Banque Bruxelles Lambert v Puvaria Packaging Industries (Pte) Ltd* [1994] where a bank took security over a company's assets following a transaction entered into by company officers breaching their internal authority. However, due to the transaction resembling an ordinary business deal for the parties, the court applied the indoor management rule in finding the loan

enforceable against the company. There was not sufficient matters of concern to put a reasonable person on inquiry.

The exception to the rule in *Turquand's* case arising from the objective standard of reasonable conduct by the outsider as applied in the *Northside's* case, has been adopted by statute but later amended so that now the provision of **S128(4)** only applies the exception in restricted form (see limitations to assumptions below).

### **The statutory assumptions - S129**

The rule in *Turquand's* case has now been incorporated in **S128(1)**, (subject to the limitations in **S128(4)** – see below). **Section 129** lists the following assumptions that can be made under **S128**:

#### ***Compliance with the constitution***

A person may assume that the company's constitution and the replaceable rules have been complied with **S129(1)**. In *BNZ v Fibern Pty Ltd*, the company seal was affixed to a mortgage in breach of the company's constitution. It was held that the lenders could assume that the company seal had been affixed in accordance with the company's constitution.

#### ***Person named as officer in public documents***

An outsider may assume that persons who appear in public documents lodged with ASIC as a director or company secretary, have been duly appointed and have the authority customarily exercised by that position **S129(2)**. By naming those officers in public documents like the constitution, the company is holding out those officers to the outsiders as having the customary authority arising from those positions. The outsiders will be able to make the assumption, whether or not the officers have been duly appointed and whether or not the outsiders are aware of the contents of the public document. Outsiders only have to show that the officer's name appears in a public document and that the officer is acting within their customary authority. Outsiders do not have to prove that the outsider had actually read that public document or relied upon its representation.

#### ***Person held out as officer or agent***

A person can assume that anyone held out as an officer or agent of the company has been duly appointed and has the authority customarily exercised by that position **S129(3)**. Unlike **S129(2)**, the outsiders in **S129(3)** have to prove that they relied on the company's representation that the person was an officer or agent and that the agent or officer was exercising a power within the customary authority of that position. As stated in *Freeman and Lockyear v Buckhurst Park Properties (Mangal) Ltd*, only persons with actual authority can hold out an officer or agent to an outsider. Persons with apparent authority cannot do so.

### ***Officers and agents properly perform their duties***

A person is entitled to assume that officers and agents have properly performed their duties **S129(4)**. The proper performance of duty in **S129(4)** includes fiduciary duty, statutory duty and tasks delegated by those with authority, see *Chew v R* chapter 5.

### ***Document duly executed***

If the company's documents have been executed in accordance with **S127**, a person can assume that the documents are duly executed. Under **S127**, a document can be executed without using a common seal if it is signed by two directors, or a director and a company secretary. If a company seal is affixed on the document, then it must be witnessed by two directors, or a director and a company secretary. The outsiders can make the assumption that the document has been executed in accordance with **S127**, even if the persons signing or witnessing have not been duly appointed *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*.

### ***Warranting documents genuine***

Outsiders can assume that officers in the company who have the authority to issue a document, e.g. a share certificate, also have the authority to warrant that it is genuine.

### ***The effect of fraud or forgery***

Even if an officer or agent is fraudulent or has forged a document, a person can make the assumptions in **S129** in relation to that officer's or agent's dealings with the company **S128(3)**.

## **Customary/usual authority of officers**

### **Analysis of Authority**

Under **Ss 129(2)** and **(3)**, outsiders can only make the assumptions if the officers and agents are acting within their *customary* authority. "Customary" here means usual, common, normal or regular. Customary authority is analysed below.

### ***Individual directors***

Normally individual directors do not have the authority to bind the company. It is the board of directors (a collective body) which is the organ of the company. However, if an individual director has been delegated with actual express authority or has been held out to have an apparent authority, then the individual director can bind the company in that matter. Note that a managing director's authority arises from the chief executive position occupied, not from their directorship. The same applies to any other executive directors. For instance, in a transaction with an executive finance director, who is also the

company's financial controller, the outsider should only rely on the customary authority for a financial controller.

Individual directors have power to witness the application of the company's seal S127(2), and to sign the company's negotiable instruments S198B.

### ***Managing director***

RR S201J allows the board of directors to appoint one of themselves as a managing director. The managing director then has all the customary authority to do the acts relating to managing the company, e.g. employing staff - *Freeman and Lockyear v Buckhurst Park Properties (Mangal) Ltd*, or borrowing money - *British Thomson-Houston Co Ltd v Federated European Bank Ltd*. The managing director's authority is regarded as being very extensive although they may not have the customary authority to sell the entire business of the company. In *Re Qintex Ltd*, the managing director did not have the authority to appoint solicitors to oppose a winding up petition.

### ***Chairperson***

It was held in *Hely-Hutchinson v Brayhead Ltd* that the chairperson only has the same customary authority as any individual director.

In the Singapore case, *Dart Sum Timber (Pte) Ltd v Bank of Canton Ltd* the outsider assumed that the company's chairman and largest shareholder was the controlling manager of the company and was able to enter into a written guarantee on the company's behalf. However, the company had a managing director to perform the chief executive role; the chairman's position, being a non-executive one on the board, does not have executive authority; and, membership does not give rise to management power - thus, the High Court, Singapore found it was wrong to infer that the chairman would have authority to contract on behalf of the company.

### ***Company Secretary***

The role of a company secretary is an administrative role. In *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd*, it was held that the customary authority of a company secretary included entering into contracts pertaining to the administrative nature of a company's affairs, such as employing staff and ordering cars. The company secretary does not have the customary authority to mortgage a company's land, but can countersign the affixing of the company's seal *Northside Developments Pty Ltd v Registrar-General*.

## Limitations to assumptions

The assumptions in S129 are subject to limitations. A person cannot make the assumptions in S129 where the person *knew* or *suspected* that the assumptions were incorrect S128(4). A person's suspicion does not have to be based on their connection with the company.

In the case of *Northside Developments Pty Ltd v Registrar-General* discussed above, the court applied an objective standard of conduct on the outsider. The outsider could not assume the company officers were acting with proper authority if the circumstances would lead a reasonable person to be put on inquiry – reasonable inquiry should then be made and concerns satisfied before the outsider proceeded. Previous statute encompassed this objective standard by denying assumptions of proper authority where the outsiders “knew or ought to have known” that the assumption was not valid. “Ought to have known” required an inquiry where necessary.

Section 128(4) however has significantly diminished the objective standards imposed on the outsider by only removing their right of assumption if they “know or suspect” that the assumption is false. The explanatory memorandum that accompanied this amendment to the law actually stated that the amendment was to enhance the objectivity of the section, but it has had the opposite effect. The decision in *Northside Developments Pty Ltd v Registrar-General*, (which preceded the introduction of S128(4)), would be considered under different standards if heard today. It would not matter if the conduct of the Barclay's Bank officer was unreasonable by not making inquiry – it would come down to whether they *knew* or *suspected* the other party was acting in breach of their authority. This unfortunately creates a situation where poor performance or ignorance can be an advantage to the outsider – not a sound legal standard. The courts have determined that the onus of proof of whether the outsider *knew* or *suspected*, rests with the company.

### *Knew the assumption was incorrect*

It would require more conclusive evidence for the company to prove that the outsider actually *knew* (rather than merely *suspected*) the company officer was breaching authority. This would be a question of fact. It is not necessary that the actual knowledge be held by the outsider directly. In *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd*, the court was prepared to impute the knowledge of the outsider's solicitors as representing the actual knowledge of the lender (the outsider).

### *Suspected the assumption was incorrect*

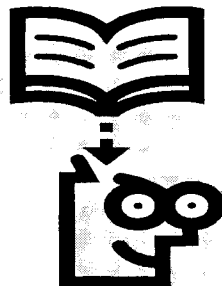
It may be possible to present less conclusive evidence to show that a person *suspected* a lack of authority. A court may be more persuaded by circumstantial evidence in determining the state of mind of the outsider than would be the case with actual knowledge as discussed above. However, if the outsider denies suspicion existed at the time the transaction was entered into, (and only they can really know what was in their own mind), then the court would have to find that the person was perjuring themselves if they were to accept the circumstantial evidence instead of the denial. A serious finding, not often reached without compelling evidence.



## Further Reading

- ❖ Lipton, P. and Herzberg, A, *Understanding Company Law*, 11<sup>th</sup> edition, Thompson Law Book Company, pages 261-290 and 107-140.
- ❖ Hanrahan, P., Ramsay, I., and Stapledon, G., *Commercial Application of Company Law*, 3<sup>rd</sup> edition, CCH, pages 119-137; 203-226; and 440-450.

## WHAT YOU SHOULD KNOW



...BEFORE....

## PROCEEDING TO THE NEXT CHAPTER

### Chapter 4.1

- ▶ How a company is managed;
- ▶ The division of power between members and directors;
- ▶ The executive role of the directors;
- ▶ The power of members to remove directors or alter the constitution;
- ▶ The different types of directors;
- ▶ The role of company secretary.

### Chapter 4.2

- ▶ The organic theory of companies;
- ▶ How a company contracts through its agents;
- ▶ The different types of authority;
- ▶ The indoor management rule;
- ▶ The statutory provisions covering these principles.

### **CRITICAL**

### **YOU MUST UNDERSTAND:**

1. THE DIFFERENT ROLES OF THE DIRECTORS AND MEMBERS;
2. RIGHTS OF OUTSIDERS AGAINST A COMPANY IN CONTRACT.

notes

June 2002 - Q1

Company directors have been described as having a fiduciary duty of "Good faith" to act in the best interest of the company". Describe the nature of this duty including references to cases and C.A. where possible.

June 2001 Q1 (d)

The three directors of Target Ltd hold a director meeting. By a majority of 3 to nil, they decide upon the following 2 courses of action.

(1) Target Ltd will issue shares to Friendly Pty Ltd. Greedy Ltd has announced it will attempt to takeover. Target Ltd and the directors of Target Ltd consider this is a bad development for both the company and its members.

Have the directors acted correctly in making to share issue. Refer to cases and C.A. where possible.

R125198A Case: Harlowe's Nominee Pty Ltd v Woodside