26, 1963

In The Privy Council

No. 12 of 1963

ON APPEAL

FROM THE SUPREME COURT OF NEW SOUTH WALES
IN ITS EQUITABLE JURISDICTION
IN APPLICATION INSTITUTED BY SUMMONS IN
PROCEEDINGS TO WIND UP No. 245 of 1961

In the Matter of

INTERNATIONAL VENDING MACHINES PTY. LIMITED (in Liquidation)
And in the Matter of the Companies Act 1936 Section 308

Between

LOUIS STEEN and JOSEPH STEEN — Appellants (Respondents)

and

CHARLES ALLEN LAW the Liquidator of INTERNATIONAL VENDING MACHINES PTY. LIMITED - Respondent (Applicant)

CASE FOR THE RESPONDENTS

1. This is an appeal brought by leave of the Supreme Court of New South Wales in its Equitable Jurisdiction from a judgment of Jacobs J. sitting in Equity dated 20th December, 1961, under which his Honour made an order under Section 308 of the Companies Act, 1936 of the State of New South Wales that the appellants were jointly and severally liable to pay to International Vending Machines Pty. Limited (in liquidation) the sum of £150,000 together with interest from 25th June, 1959, to the date of payment at the rate of 5% per annum.

2. Section 308 of the Companies Act 1936 of the State of New South Wales is in the following terms:—

"308. (1) If in the course of winding up a company it appears that any person who has taken part in the formation or promotion of the company, or any past or present director, manager, or liquidator, or any officer of the company, has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court may, on the application of the liquidator, or of any creditor or contributory, examine into the conduct of the promoter, director, manager, liquidator, or officer, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance, or breach of trust as the court thinks just.

(2) This section shall extend to and in respect of the receipt of any money or property by any director of the company during the two years preceding the commencement of the winding up, whether by way of salary or otherwise, appearing to the court to be unfair or unjust to other members of the company.

(3) The provisions of this section shall have effect notwithstanding that the offence is one for which the offender may be criminally liable.

(4) Where an order for payment of money is made under this section, the order shall be deemed to be a final judgment.

Record. p.2, ll.15-18 p.10, ll.5-6

3. On the eighth day of May 1961 an order was made for the winding up of International Vending Machines Pty. Limited (hereinafter called "the Company") and the respondent was appointed the

Record. pp.1-2 liquidator thereof. On the Seventeenth day of May 1961, the respondent made an application pursuant to Section 308 of the said Act seeking to recover a sum of £200,000 from the appellants.

p.2, ll.2-6 4. The Company was formed on 12th June, 1958 and commenced trading on 1st July, 1958. At all material times up to 25th June 1959 p.255, ll.15-19 it had an issued capital of £102 consisting of 102 shares of £1 each which were fully paid up.

p.261, ll.20-25 5. The transaction which was challenged by the respondent and in respect of which it was sought to make the appellants liable was a loan made by the Company to A.M. Holdings Pty. Limited on the 25th June, 1959 of the sum of £200,000 intended to be and in fact used by A.M. Holdings Pty. Limited to purchase forthwith from the respondents and from Sydney Steen who was the son of Louis Steen and the brother of Joseph Steen the 102 issued shares of £1 each in the capital of the Company which were held by them.

6. The main facts and circumstances surrounding the making of pp.255-273 the loan are set out in the reasons for judgment of his Honour.

7. Section 148 of the Companies Act 1936 is in the following terms:—

"148. (1) Subject to the provisions of this section, it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase made or to be made by any person of any shares in the company:

Provided that nothing in this section shall be taken to prohibit—

(a) Where the lending of money is part of the ordinary business of a company, the lending by a company of money in the ordinary course of its business;

(b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase by trustees of fully-paid shares in the company to be held by or for the benefit of employees of the company, including any director holding a salaried employment or office in the company;

(c) the making by a company of loans to persons, other than directors, bona fide in the employment of the company with a view to enabling those persons to purchase fully-paid shares in the company to be held by themselves by way of beneficial ownership.

(2) The aggregate amount of any outstanding loans made under the authority of paragraphs (b) and (c) of the proviso to subsection one of this section shall be shown as a separate item in every balance-sheet of the company.

(3) If a company acts in contravention of this section the company and every officer of the company who is in default shall be guilty of an offence.
Penalty: "One hundred pounds."

8. Section 361 of the Companies Act 1936 is in the following terms:—

"361. (1) If in any proceedings for negligence, default, breach of duty, or breach of trust against a person to whom this section applies it appears to the court hearing the case that that person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court thinks fit.
(2) Where any person to whom this section applies has reason to apprehend that any claim will or might be made against him in respect of any negligence, default, breach of duty or breach of trust, he may apply to the court for relief, and the court on any such application shall have the same power to relieve him as under this section it would have had if it had been a court before which proceedings against that person for negligence, default, breach of duty or breach of trust had been brought.
(3) Where any case to which subsection one of this section applies is being tried by a judge with a jury, the judge, after hearing the evidence, may, if he is satisfied that the defendant ought in pursuance of that subsection to be relieved either in whole or in part from the liability sought to be enforced against him, withdraw the case in whole or in part from the jury and forthwith direct judgment to be entered for the defendant on such terms as to costs or otherwies as the judge may think proper.
(4) The persons to whom this section applies are the following:—
(a) directors of a company;
(b) managers of a company;
(c) officers of a company;
(d) persons employed by a company as auditors, whether they are or are not officers of the company.

9. At the hearing, the respondent argued that the appellants were liable to pay to the company the sum of £200,000 with interest from the date of the loan, for the following reasons—

Record.

p.261, 11.25-30 (a) That the loan of £200,000 constituted financial assistance given by the Company for the purpose of and in connection with the purchase by A.M. Holdings Pty. Limited of shares in the capital of the Company.

p.261, ll.30-34 (b) That the sum of £200,000 was advanced in contravention of the provisions of Section 148 of the Companies Act 1936.

p.261, ll.34-39 (c) That the appellants were well aware that the sum of £200,000 was to be used by A.M. Holdings Pty. Limited for the purpose of acquiring from them and from Sydney Steen the said shares and that the appellants as the only Directors of the Company and of A.M. Holdings Pty. Limited knowingly and actively procured the advance for this purpose.

p.261, ll.39-44 (d) That the sum of £200,000 was lent solely for the benefit of the appellants and the said Sydney Steen and was not lent for or as part of or in connection with any business of the Company or for any of its purposes and that such loan which was made without interest and without security, could not have been for the benefit of the Company.

(e) That A.M. Holdings Pty. Limited was incorporated on 29th May 1959 and when the loan to it of £200,000 was made it had an issued capital of £3,010 and assets of comparatively small value and that its purchase of the 102 issued shares in the capital of the Company meant that the Company as a creditor (if it could sue at all in the circumstances) would virtually have to look to its own assets as the source for repayment of the loan.

p.261, l.44-p.262, l.1 (f) That the loan was procured by the appellants in order to reduce the indebtedness of themselves and Sydney Steen to the Company and to establish themselves as substantial creditors of the company at the 30th June, 1959 and to provide themselves thereafter with moneys for their own purposes.

p.257, ll.38-42 (g) The evidence established that, as at the date of the loan, the appellants and Sydney Steen were indebted to the Company in the following sums:—

Louis Steen — £38,568/11/3.
Joseph Steen — £38,283/15/11.
Sydney Steen — £1,120.

p.260, ll.38-42 The evidence also established that a substantial part of the moneys obtained by the appellants and Sydney Steen for the sale of their shares was immediately paid to their credit with the Company with the result that immediately after the transaction was carried out and at the time of the Company's balancing date, 30th June, 1959, the Company was indebted to them in the following amounts:—

Record.
p.300
p.297
p.299

Louis Steen — £28,931/8/9.
Joseph Steen — £29,216/4/1.
Sydney Steen — £13,880.

pp.297-301

The evidence further established that thereafter within several months the appellants and the said Sydney Steen had withdrawn these credits and had again overdrawn their accounts with the Company.

p.258, ll.9-14

(h That the evidence established that in the month prior to the making of the loan a special sales campaign was conducted for the purpose of getting in moneys from the public for the sale of machines and in advance of delivery of the machines and that the purpose of this was to enable the Company to make the loan with the consequent benefit to the appellants.

p.258, ll.14-20

(i) That the evidence established that the sum of £200,000 was chosen as the figure for the purchase price prior to the discussions between the company's accountant, Mr. Purcell and the taxation consultant, Mr. Challoner, contrary to the evidence given by the appellants and Mr. Purcell.

p.265, l.47-
p.266, l.9

(j) That in the circumstances the appellants as directors of the company had duties similar to those of a trustee and since they knew the circumstances in which the loan was made and since the loan was—

(i) ultra vires
(ii) in breach of Section 148

they were liable to compensate the Company for the loss.

(k) That the appellants were liable to compensate the Company whether or not the transaction was illegal and whether or not the moneys paid by the Company to A.M. Holdings Pty. Limited were recoverable by the Company.

(l) That the appellants were liable to compensate the Company whether or not they knew that their actions constituted a breach of Section 148 of the Companies' Act.

(m) That a transaction entered into in breach of Section 148 is illegal and that moneys paid thereunder are irrecoverable and that the decision of the Supreme Court of New South Wales in **Dressy Frocks Pty. Limited v. Bock** (1951) 51 S.R. (N.S.W.) 390, which was followed by O'Bryan J. of the Supreme Court of Victoria in **Shearer Transport Pty. Limited v. McGrath** (1956) VLR 316, was correct in law notwithstanding the decisions in **Spink (Bournemouth) Limited v. Spink** (1936) Ch. 544 and **Victor Battery Co. v. Curry's** (1946) Ch. 242.

(n) That in obtaining advice from the taxation consultant Mr. Challoner, who advised that a loan to purchase the shares in the Company would be a breach of Section 148 Mr. Purcell was acting inter alia as agent for the appellants and that even if it be held that there was no evidence that the appellants knew

that the transaction was a breach of Section 148 of the Act they should by reason of his knowledge be held to have known it.

Record. p.271, ll.4-7

(o) That the appellants in agreeing to the loan as directors of the Company did not declare their respective interests in the loan and could not form a quorum and the making of the loan was ultra vires also on this ground.

(p) That in the circumstances the appellants could not properly have declared a dividend in view of the contingent liabilities of the company under guarantee to machine owners and in view of liabilities in respect of machines sold but not yet supplied and that therefore the appellants' submission that the making of the loan was an alternative to declaring a dividend was no answer to the respondent's claim.

p.271, l.17

(q) That in computing the loss which the company suffered, no allowance should be made for the fact that the sum of £50,000 was subscribed by the appellants and Sydney Steen for 50,000 shares of £1 each in the capital of A.M. Holdings Pty. Limited out of moneys received by them on the sale of their shares in the Company to A.M. Holdings Pty. Limited and in turn subscribed by A.M. Holdings Pty. Limited for shares in the capital of the Company.

(r) That the making of the loan was not justified in the circumstances by the need to avoid income tax liabilities because any tax liability could (as the appellants were at the time advised) have been avoided by the same means as were adopted, namely, by issuing shares of the nature discussed in **W. P. Keighery Pty. Limited v. Commissioner of Taxation** (1957) 100 C.L.R. 66 or **Federal Commissioner of Taxation v. Sydney William (Holdings) Limited** (1957) 100 C.L.R. 95, but without making any loan.

(s) That the interpretation sought to be put on the phrase "where the lending of money is part of the ordinary business of a company" in Section 148 (1)(i) of the said Act by the appellants upon the hearing is erroneous. It is submitted that Section 148 (1)(i) refers to the situation where the Company is a money lender or where money lending is one of the businesses of the Company, and does not refer to the situation where the Company in the course of its business (where that business is not money lending) does make a loan or loans.

(t) That in any event the loan in question was not in the ordinary course of business, this being a loan without interest and without security to a Company which at the date of the loan was not associated with the Company.

(u) That once it was established that under the general law the appellants were liable to the Company to compensate it for

the loss which it had suffered by reason of the transaction, the Court could not exercise any discretion under Section 308 to determine whether it would or would not compel the appellants or either of them to repay or restore the money which the Company had lost, especially having regard to the fact that the appellants retained the funds and refused to restore them to the Company.

(v) That if his Honour had a discretion under Section 308 his Honour should refuse to exercise it in favour of the appellants for the following reasons:—

(i) that the onus was on the appellants to adduce evidence to show that the discretion should be exercised in their favour and that they had failed to do so.

(ii) that prior to making the loan the appellants had not considered whether in the circumstances the loan could properly be made.

(iii) that they had obtained the benefit of the moneys which had been wrongly disbursed.

(w) That the appellants were not in the circumstances entitled to relief under Section 361 of the said Act. Furthermore, they had received the benefit of the moneys advanced and did not offer to restore these.

Record. p.262, ll.1-7

(x) That A.M. Holdings Pty. Limited was at all material times a Company brought into existence by the appellants for the purpose (inter alia) of acting and that it did act in relation to the loan so as to cloak the fact that the appellants were at the material times the true principals in the matter.

10. On 20th December, 1961 Jacobs J. delivered judgment and held that the appellants were jointly and severally liable to repay to the Company the money, the subject of the loan to the extent of the Company's loss which his Honour held to be £150,000, with interest thereon from 25th June, 1959 to date of payment at the rate of 5% per annum and that the appellants pay the respondent's costs of the application. In his reasons for judgment his Honour held (inter alia):—

p.272, l.44-p.273, l.2

p.264, ll.40-41

(a) That there was a breach of Section 148 of the Companies Act.

p.264, ll.17-31

(b) That the circumstances of the case did not fall within the proviso of paragraph (a) of sub-section (1) of that section for the following reasons:—

(i) that what is meant by the words "its business" in the said proviso is the ordinary business of the Company, and that in this case the ordinary business of the Company was the selling of vending machines.

(ii) that in the ordinary course of the company's business loans to merchandising companies would be made and therefore a loan of that kind would be made in the course of the company's business but that a loan without

interest and without security to a company which at that stage was not associated with the lending company was not in the ordinary course of its business.

(iii) that the loan could not be regarded as one made in the ordinary course in the ordinary business of the Company.

Record.
p.264, ll.32-39
p.265, ll.41-46
p.267, ll.1-9

(c) That a director of a company who procures the lending of money of the Company to another for the purpose of it being used for the purchase of shares in the Company commits an act of misfeasance even though he is unaware of the provisions of Section 148 of the Companies Act.

p.267, l.9
p.268, l.17

(d) That although in a Company the obtaining of competent though incorrect advice may be taken into account in excusing the director pursuant to Section 361 of the Companies Act, it does not affect the primary liability of the director who acts with knowledge of the circumstances, but in ignorance of the law.

p.268, ll.3-13

(e) That **Hirsche v. Sims** (1894) A.C. 654 is a clear and binding authority that good faith will not excuse a director who has acted ultra vires the Company.

p.265, ll.9-31

(f) That he was not prepared to accept the evidence of Mr. Purcell or of either of the appellants; that he was not impressed by any of these witnesses; that neither of the appellants showed frankness in answering questions in cross examination and that he was most unimpressed with some of the actions about which they were cross examined as to credit.

p.268, ll.26-35

(g) That the Court has a discretion under Section 308 whether or not to compel a director to repay or restore money or any part thereof.

p.268, ll.41-42

(h) That in the circumstances of the case assuming he had a discretion he would not exercise it in the appellants' favour for two main reasons, namely:—

p.268, l.43-
p.269, l.36

(i) that if directors ask that a discretion be exercised in their favour to displace a primary legal abligation they must justify by proof of their conduct in the matter. That in this case there was no evidence from the directors that they considered prior to the disbursement of the moneys whether they could be with safety disbursed either as dividends or as loans from the company to another company which had no substantial assets, particularly in the light of the fact that they had been advised to obtain legal advice on any possibility of liability of the Company in respect of guaranteed returns to investors and that the directors took no steps to set aside any fund to meet such a liability whether it is a legal liability or not and to disburse without security to a company which has no separate assets, a very large sum of money, a sum

which exceeded by some £50,000 the amount of profit which would have been distributable after company tax.

Record. p.269, l.37-p.270, l.5

(ii) that the appellants had obtained the benefit of the moneys which they disbursed.

p.270, ll.1-4 (i) That the making of the loan was illegal and no action would lie for the recovery of it, nor would tracing of the money in equity be permitted.

p.270, ll.35-42 (j) That an enquiry into the conduct of the appellants in the transaction upon the assumption that there had been no breach of Section 148 was a profitless enquiry because he could not separate in his mind in considering the transaction the primary fact that the Company lent £200,000 without security to another company whose only asset in effect would be the shares in the Company itself and that the case was a classic illustration of the mischief which Section 148 seeks to prevent.

p.270, ll.42-45 (k) That it was not to the point to say that the money might have been distributed as dividends and that he was not satisfied that they could have been so distributed.

p.271, ll.7-14 (l) That the fact that the directors had voted in respect of a matter in which they were interested could not give the liquidator the right to recover the money the subject of the vote at any rate unless it were established that the company was not solvent at the time.

p.271, ll.16-34 (m) That the extent of the loss in this case was £150,000 and that although £200,000 was the amount of the loan for the purpose of purchases by A.M. Holdings Pty. Limited of shares in the Company nevertheless the transactions accompanying that loan must be regarded and upon doing so it is found that £50,000 of their money came back into the company by way of subscription for shares in the Company by A.M. (Holdings) Pty. Limited and that the £50,000 has remained in the Company for such benefit to creditors as might be obtained from it.

p.271, l.45-p.272, l.1 p.272, ll.1-14 (n)That in determining the loss there was no reason whatsoever why tax saving in respect of the year ending 30th June, 1960 should be taken into account and that with regard to tax savings for the year ended 30th June, 1959 there were other courses open which would have resulted in the Company being entitled to the status of a public company for tax purposes without any illegal loan being made. Thus the Company itself could have had its shareholding widened so that its shareholding was on the same basis as the shareholding in A.M. (Holdings) Pty. Limited and that it was not a sufficient answer to this to say that the directors were not aware of the other courses which were open.

p.272, ll.14-17 (o) That there was no such relationship between the illegal loan

and the possible saving of tax thereby that it could be said that the result of the illegal loan was a saving of tax.

Record. p.272, ll.19-43

(p) That the appellants were not entitled to any relief under Section 361 because the benefit from the transaction had to the extent of the loss gone to the guilty directors.

p.262, ll.8-12

(q) That the transactions entered into were real transactions and that A.M. (Holdings) Pty. Limited was not a Company brought into existence by the appellants for the purpose (inter alia) of acting nor did it act in relation to the loan so as to cloak the fact that the appellants were at the material times the true principals in the matter and the fact that the said A.M. (Holdings) Pty. Limited was acting not on its own behalf but on the behalf of the appellants.

11. The respondent relies upon the decision in his favour and the reasons for judgment except in so far as his Honour held that the respondent was not entitled to recover the sum of £50,000, part of the sum of £200,000 claimed by the respondent.

SUBMISSION

The respondent respectfully submits that the appeal should be dismissed with costs for the following amongst other

REASONS

(1) Because the decision appealed from is (except in relation to the sum of £50,000 hereinbefore referred to) right.

(2) Because of the reasons appearing from the respondent's submissions set forth in paragraph 9 of this Case.

NIGEL BOWEN

ROBERT ELLICOTT