43/84

IN THE PRIVY COUNCIL Nos. 17, 18 & 19 of 1984

O N   A P P E A L

FROM THE SUPREME COURT OF NEW SOUTH WALES
COMMON LAW DIVISION

B E T W E E N :

PHILLIP WILLIAM CARNEY — Appellant (Defendant)

- and -

JOHN EDWARD HERBERT — Respondent (Plaintiff)

10

AND BETWEEN :

PHILLIP WILLIAM CARNEY — Appellant (Defendant)

- and -

KARLO JEHNIC — Respondent (Plaintiff)

AND BETWEEN :

PHILLIP WILLIAM CARNEY — Appellant (Defendant)

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- and -

DARRELL BRUCE ARNETT — Respondent (Plaintiff)

CASE FOR THE APPELLANT

RECORD
*

1. These are appeals by the Appellant, Phillip William Carney, from the judgments and orders of the Supreme Court of New South Wales, Common Law Division (Rogers J.) ordered on 6th April 1983 in three actions, the hearing of which was consolidated, — p.322 / A p.31 / J p.31

* References are to the Record in Herbert v. Carney (16157 of 1980 unless prefixed by A indicating the Record in Arnett v. Carney (16158 of 1980) or by J indicating the Record in Jehnic v. Carney (16159 of 1980)

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namely numbers 16157, 16158 and 16159 of 1980, brought against the Appellant respectively by John Edward Herbert, Darrell Bruce Arnett and Karlo Jehnic, the Respondents, hereinafter referred to as Mr. Herbert, Mr. Arnett and Mr. Jehnic.

2. By the said orders it was ordered, so far as relevant hereto, that:

(a) 16157 of 1980

p.322

The Appellant pay Mr. Herbert the sum of A$94,271.08 and his costs other than the costs of the application for summary judgment heard by Master Allen on 15th and 16th September 1981 and of the appeal from the decision of Master Allen heard before Begg J. on 24th May 1982. 10

(b) 16158 of 1980

A p.31

The Appellant pay Mr. Arnett the sum of A$89,749.36 and his costs other than as at (a) above.

(c) 16159 of 1980 20

J p.31

The Appellant pay Mr. Jehnic the sum of A$148,942.83 and his costs other than as at (a) above. The said sums are those claimed against the Appellant with interest as awarded by the Court.

p.323
A p.32
J p.32
p.327
A p.35
J p.35

3. These appeals are brought by the Orders of the Supreme Court of New South Wales granting conditional leave ordered on 6th May 1983, and granting final leave ordered on 19th August 1983.

The Entities involved 30

4. Apart from the Appellant and the Respondents this action is particularly concerned with three companies:

(a) Airfoil Registers Pty. Limited - "Airfoil", in which the shareholding prior to 24th March 1980 was:

Appellant	93 shares
Mr. Herbert	5
Mr. Arnett	5
Mr. Jehnic	8
	111 shares

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The directors of Airfoil up to 24th March 1980 were the Respondents and the Appellant.

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(b) Newbridge Industries Pty. Limited - "Newbridge", a subsidiary of Airfoil within the meaning of the Companies Act 1961, and the registered holder of certain land at 131-133 Newbridge Road. The directors of Newbridge up to 24th March 1980 were the Respondents and the Appellant.

(c) Ilerain Pty. Limited - "Ilerain", a company
10 controlled by the Appellant and his wife.

The Issues

5. Section 67 of the Companies Act 1961 as amended and as in force in March 1980 provided, so far as relevant, as follows:

> 67. (1) Except as is otherwise expressly provided by this Act no company shall, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, give any financial assistance for the
> 20 purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or, where the company is a subsidiary, in its holding company or in any way purchase, deal in or lend money on its own shares.
>
> (2) ....
>
> (3) If there is any contravention of this section, the company and every officer of the company who is in default shall be guilty of an
> 30 offence against this Act. Penalty: Imprisonment for three months or one thousand dollars.

6. On 24th March 1980 a transaction was effected between the Respondents and the Appellant whereby the Respondents agreed to sell to Ilerain their shares in Airfoil:

(a) on terms that Newbridge secured the purchase price by a mortgage over its land;

(b) with the intention that the purchase price
40 should be paid by means of cheques drawn on Airfoil's bank account;

(c) at prices tied with the release by Airfoil of the indebtedness of Mr. Herbert and Mr. Jehnic to Airfoil on their loan account with Airfoil.

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7. The main issues arising on the Appeals are: whether the Respondents' claims against Ilerain, and hence against the Appellant as guarantor of Ilerain, for the unpaid instalments of the purchase price, are unenforceable by reason of breaches of section 67 of the Companies Act 1961 arising from (a) and/or (b) and/or (c) in paragraph 6 above.

The Facts

8. In early March 1980 the Appellant and the Respondents decided that the Appellant should purchase the Respondents' shares in Airfoil. 10

9. At a meeting between the parties on 17th March 1980:

p.270 (a) the prices to be paid to each of the Respondents for their shares were agreed;

p.271, 295/6, 300/1 (b) it was agreed that the amount of Mr. Herbert's and Mr. Jehnic's loan accounts owed to Airfoil should be deducted from those prices, and Mr. Herbert and Mr. Jehnic should thereby be released by Airfoil; 20

p.271, 290; p.385 -393 (c) each of the Respondents received from the Appellant three cheques for the purchase price calculated as at (a) and (b) above in three instalments, which cheques were drawn on the account of Airfoil with the Commercial Bank of Australia Limited, Padstow branch, and dated 24th March, 31st July and 15th August 1980 respectively.

In summary:

Mr. Herbert 30

Price as (a)	Loan Account	Price as (b)	Airfoil Cheques	
$114,800	$5,000	$109,800	24.3.80	$ 41,000
			31.7.80	$ 23,000
			15.8.80	$ 45,800
				$109,800

Mr. Arnett

Price as (a)	Loan Account	Price as (b)	Airfoil Cheques	
$106,500	Nil	$106,500	24.3.80	$ 41,000
			31.7.80	$ 28,000
			15.8.80	$ 37,500
				$106,500

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Mr. Jehnic

Price as (a)	Loan Account	Price as (b)	Airfoil Cheques	
$183,700	$7,000	$176,700	24.3.80	$ 68,000
			31.7.80	$ 37,000
			15.8.80	$ 71,700
				$176,700

		RECORD
	10. On 18th March 1980 Mr. Arnett on behalf of himself, Mr. Herbert and Mr. Jehnic informed the Appellant that they required security for the purchase price and it was agreed that Newbridge should provide a mortgage over its land in Newbridge Road. On the same day or soon thereafter, the Appellant informed the Respondents that the purchaser of their shares would be Ilerain.	p.273 p.277 p.273/5
10	11. On 21st March 1980 the Respondents delivered to the Appellant for him to study three draft sale agreements and three draft mortgages drawn up by their solicitor.	p.274/5
	12. On 24th March 1980 a meeting was held attended by the parties, by Mr. Carney's accountant, Mr. Morton, and by the Respondents' Solicitor, Mr. Simpson, who brought to the meeting a draft guarantee. At this meeting:	p.276
	(a) Mr. Carney agreed to execute the guarantee;	p.276
20	(b) the three sale agreements were executed providing for the payment by Ilerain of the prices as provided for by the cheques referred to in paragraph 9 above;	p.332 A p.38 J p.38
	(c) the three mortgages were executed whereby Newbridge acknowledged receipt of sums of like amounts as due to the several Respondents and agreed to pay the three instalments in each case;	p.374 A p.40 J p.41
	(d) the guarantee was executed in favour of the Respondents by the Appellant;	p.335
30	(e) three forms of share transfer were executed by the Respondents in favour of the Appellant.	p.276
	13. On 25th or 26th March 1980 caveats were lodged at the office of the Registrar General on behalf of the several Respondents in respect of the interest purportedly created by the mortgages entered into by Newbridge.	p.280 p.377 A p.43 J p.44
40	14. The Airfoil cheques dated 24th March 1980 were subsequently presented by the Respondents and were honoured. The cheques dated 31st July 1980 were presented for payment, but were dishonoured, the account of Airfoil having been closed.	p.276,8 p.295 p.302 p.276
	15. On a date prior to 30th June 1980 the Appellant and Ilerain sold all their shares in Airfoil.	p.222

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16. The steps in the three actions have been as follows:

RECORD	Date	Step
p.1, A p.1, J p.1	16.10.80	Statements of Claim
p.4,Ap.4, Jp.4	23.2.81	Defences
p.14,Ap. 14 Jp.14	7.5.81	Notices of motion for summary judgment
p.15-105	15.10.81	Hearing of motions for summary judgment before Master Allen.
p.106	23.10.81	Judgment of Master Allen in favour of Plaintiffs.
p.127	24.5.82	Hearing of appeals against judgment of Master Allen, appeals allowed.
p.131,A18, J18.	4.11.82	Amended Defences.
p.144-303	28.3.83	Trial before Mr. Justice Rogers
p.304	31.3.83	Judgment of Mr. Justice Rogers

The Contentions of the Appellant

A. The mortgage

17. Although aspects of the transaction were effected by means of separate documents, there was an agreement governing the whole transaction which stood behind those documents and which was made between the Respondents and the Appellant on 24th March 1980 when the Appellant agreed to execute the guarantee (or made prior thereto and amended by his agreement to do so) that the shares should be sold on terms which included a term that Newbridge should provide a mortgage as security and a term that the purchase prices should be reduced by the amount of the loan accounts and that the loan accounts should be released.

18. Although Rogers J. did not expressly make a finding that there was an agreement as contended in the previous paragraph, he set out the Appellant's contention in his judgment at pages 305 and 306 and by entering straight into a discussion of severance in connection with the mortgages on page 314 indicated that he accepted it. He was right to do so.

19. It was accepted on behalf of the Respondents and by Rogers J., and it is correct, that the

granting of the mortgage by Newbridge, a subsidiary of Airfoil, to further the sale of shares in Airfoil was giving financial assistance for the purpose of or in connection with the sale, and was in breach of section 67, with the effect that the term as to the mortgage was illegal and unenforceable. Rogers J.'s acceptance is again shown by his entering straight into a discussion of severance in his judgment on page 314.

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20. The sole issue in connection with the mortgage is thus one of severance. If the term that there should be a mortgage by Newbridge cannot be severed from the overall agreement between the parties, no part of that agreement can be relied upon by the Respondents.

21. The grant of the mortgage involved the Respondents and the Appellant as directors of Newbridge in a criminal offence. The term agreed between them that a mortgage should be provided by Newbridge was an agreement to commit a crime.

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22. Where a contract includes a term involving a criminal offence, the term will rarely if ever be severed : see inter alia :

Bennett v. Bennett [1952] 1 KB 249 at 253,4

D.J.E. Constructions Pty Ltd v. Maddocks [1982] 1 N.S.W.L.R. 5 at 11

Severance sometimes be permitted where the term is peripheral to the contract :

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Kearney v. Whitehaven Colliery Co [1893] 1 Q.B. 700

The case of Thomas Brown & Sons Ltd. v. Fazal Deen (1962) 108 C.L.R. 391 is to be explained on the basis that the High Court of Australia were prepared to treat the contract as giving rise to three separate bailments, of the safe, of the jewels, and of the illegally retained gold.

23. In contrast with contracts and terms which are :

(a) in unreasonable restraint of trade

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(b) uncertain

(c) ousters of the jurisdiction of the court

the principle which lies behind the unenforceability

RECORD

of contracts and terms involving crime or which are contra bonos mores is that of ex turpi causa non oritur actio. Tests of severability derived from cases involving any of the three former grounds of unenforceability are likely to be inappropriate in a case involving criminal illegality. For in the former cases the court has a stronger interest in upholding the contract where appropriate. Thus the test of severability proposed in McFarlane v Daniel (1938) 38 S.R. N.S.W. (a case where an employee was met with the defence that his contract contained a covenant in restraint of trade) is inappropriate in the present case. Where a term involving crime or contra bonos mores is not peripheral to the transaction it will not be severed : 10

Miller v. Karlinski (1945) 62 TLR 85

Napier v. National Business Agency [1951] 2 All E.R. 264

24. In the present case the main provisions of the agreement were : 20

a) that the shares should be bought and sold;

b) that the prices should be adjusted for the two loan accounts, and the loan accounts released;

c) that the payment of the price should be secured by the mortgage;

d) that the payment of the price should be secured by the guarantee.

In view of the nature and the status of the term as to the mortgage it was not severable. 30

25. The issue of severence was dealt with by Rogers J. in his judgment at page 319. He held that "For aught I know the personal guarantee may by itself have satisfied the cravings for security ...." But there was no evidence at all to that effect, but to the contrary. The evidence was that the Respondents required security meaning security by way of property and not merely by way of guarantee : see the evidence of Mr. Arnett at page 273. Further the Respondents did not drop the illegal mortgage when the guarantee was accepted by the Appellant. The evidence therefore was simply that the Respondents required both, and Appellant agreed to both. 40

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26. Should the question of severance to be decided on a basis other than that contended for above, the Appellant contends :

(a) on the true construction of the agreement the intention of the parties was that the sale of the shares was to be conditional on the efficacy of the term as to the mortgage;

10 (b) the term as to the mortgage formed an indivisible whole with the other terms, and could not be removed without altering the nature of the contract;

(c) if the term as to the mortgage was removed the contract was altered in kind in that it ceased to be a contract secured on land.

For these reasons the mortgage term should not in any event be considered severable.

B. The Airfoil Cheques

20 27. The Appellant contended before Rogers J. that it was a term of the overall agreement as well as the intention of the parties that the Airfoil cheques should be used to effect payment of the purchase price. The finding of Rogers J. that there was no such term is accepted. It is however contended that there is overwhelming evidence that it was the parties' intention so to use the Airfoil cheques to effect payment: the Appellant refers to the drawing of the cheques, their receipt
30 and retention by the Respondents, and their presentation by the Respondents, and also to the evidence of the witnesses, for example, that of Mr. Arnett on page 281, third and fourth questions and answers. Rogers J. declined in his judgment at pages 313, 314 to infer that the parties had this intention. In the Respondents' contention this finding is contrary to the evidence and is not supportable.

28. The financing by Airfoil of the purchase by
40 means of payment by Airfoil through its cheques was a clear breach of section 67. The intention of the Respondents that the agreement for sale should be so performed in this illegal manner and its part performance in that manner, has the result that they cannot enforce its provisions : see, for example, J.M. Allan (Merchandising) Ltd v. Cloke [1963] 2 Q.B. 340. As the agreement was partly so performed, no locus poenitentiae is available to them : see Alexander v. Rayson [1936]

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1 K.B. 169 at 190.

C. The Loan Accounts

29. The facts relating to the loan accounts were not pleaded, and Rogers J. refused an application to amend made on the first day of the trial. However the facts relating to the loan accounts were put in evidence : see the evidence of the Respondents at pages 271, 295/6 and 300/1.

30. The Appellant contends that the relevant facts were before the Court and that they showed clearly the illegal object of the contract. It was therefore the duty of the court to take note of the illegality and act accordingly : see North Western Salt Co. Ltd v. Electrolylic Alkali Company Ltd. [1914] A.C. 461, Elder v. Auerbach [1950] 1 K.B. 359 at 371.

31. Rogers J. considered the question in his judgment at pages 307 and 308. He said "I was of the view that any prima facie arrangement for the payment by a company of a loan account which is otherwise payable to a person does not infringe s.67 when payment is made on the occasion of a sale of shares. I came to this conclusion comforted by what fell from Mahoney J.A. in Burton v. Palmer (1980) 2 N.S.W.L.R. 878 at 887." Mahoney J.A. indeed there decided that such a payment by a company did not infringe section 67. But the facts evidenced in the present case were that the loan accounts were owed by Mr. Herbert and Mr. Jehnic to Airfoil, and not by Airfoil to them. Roger J. therefore proceeded under a misconception. Had he not done so, he would no doubt have referred himself to E.H. Dey Pty. Ltd. v. Dey [1966] V.R. 464 which was distinguished in Burton v. Palmer (above). It was held in Dey that the release of a loan account in connection with a sale of shares was in breach of section 67. The Appellant adopts the decision in Dey.

32. If it is suggested that the term as to the loan accounts is severable, the Appellant will rely upon his submissions, mutatis mutandis, made in relation to severance and the mortgage.

D. Mortgage, Airfoil Cheques and Loan Accounts

33. The Appellant contends that the three instances of illegality are not only to be considered separately but are also to be considered together in their cumulative effect on the agreement. It was permeated with illegality and should not be enforceable.

34. The Appellant respectfully submits that the judgments of the Supreme Court of New South Wales were wrong and ought to be reversed and that these Appeals should be allowed with costs here and below, for the following:

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R E A S O N S

BECAUSE the agreement for sale of the shares was unenforceable by reason of illegalities contrary to section 67 of the Companies Act 1961 in connection with the Newbridge mortgage and the loan accounts contained in the terms of the larger agreement of which it was part, and because it was the intention of the parties which was performed in part, that the sale agreement should be performed in an illegal manner, contrary to section 67 of the Companies Act 1961, by means of payment by Airfoil.

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BECAUSE the decision of Rogers J. was wrong in law, in that he held that the term as to the Newbridge mortgage was severable, and was wrong in fact and law in connection with the parties' intentions as to payment and in connection with the loan accounts.

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RAYMOND JACK Q.C.

KEITH REWELL

IN THE PRIVY COUNCIL

O N A P P E A L

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- and -	
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CASE FOR THE APPELLANT

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