43/84

IN THE PRIVY COUNCIL

No. 17 of 1984

ON APPEAL FROM THE SUPREME COURT OF NEW SOUTH WALES

COMMON LAW DIVISION, COMMERCIAL LIST

MATTER NO. 16157 of 1980

CASE FOR THE RESPONDENTS

BETWEEN	PHILLIP WILLIAM CARNEY	Appellant (Defendant)
AND	JOHN EDWARD HERBERT	Respondent (Plaintiff)
AND BETWEEN	PHILLIP WILLIAM CARNEY	Appellant (Defendant)
AND	KARLO JEHNIC	Respondent (Plaintiff)
AND BETWEEN	PHILLIP WILLIAM CARNEY	Appellant (Defendant)
AND	DARRELL BRUCE ARNETT	Respondent (Plaintiff)

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COMMON LAW DIVISION

BETWEEN	PHILLIP WILLIAM CARNEY	**Appellant** (Defendant)
AND	JOHN EDWARD HERBERT	**Respondent** (Plaintiff)
AND BETWEEN	PHILLIP WILLIAM CARNEY	**Appellant** (Defendant)
AND	KARLO JEHNIC	**Respondent** (Plaintiff)
AND BETWEEN	PHILLIP WILLIAM CARNEY	**Appellant** (Defendant)
AND	DARRELL BRUCE ARNETT	**Respondent** (Plaintiff)

CASE FOR RESPONDENTS

RECORD

A. Material Facts

1. By written agreements bearing date 21 March 1980, each of the respondents agreed to sell to Ilerain Pty. Limited ("Ilerain"), a company controlled by the appellant, all their shares in Airfoil Registers Pty. Limited ("Airfoil").
2. In each case:
   a) the purchase price was to be paid by a down payment at the time of making the agreement, with the balance to be paid by two further instalments;
   b) payment of the further instalments was to be secured by: (10)
      i) a guarantee by the appellant to the respondent and
      ii) a mortgage by way of guarantee by Newbridge Industries Pty. Limited ("Newbridge"), a subsidiary of Airfoil, to the respondent over certain land;
   c) the purchase price was tendered by three cheques, one dated 24 March 1980 and the others post dated, drawn by Airfoil upon its banker in favour of the respondent;
   d) the cheque representing the down payment was met on presentation but the cheques for the further instalments were not; (20)
   e) a transfer to Ilerain of the respondent's shares in Airfoil was handed to the appellant and was duly registered so that Ilerain became the legal owner of those shares.
3. The respondents sued the appellant upon his guarantees. The appellant, although through Ilerain he had had the full benefit of the agreements, claimed that each agreement was illegal and void, and therefore unenforceable, and that therefore he could not be compelled to meet the liabilities of Ilerain thereunder.

References to Record

(30) Unless otherwise indicated references are to the Record in Herbert v Carney (16157 of 1980) and as far as practicable, have been reproduced in the right hand margin.

B. The Parties' Contentions

4. In each case, the allegation of illegality was founded upon Section 67 of the then Companies Act 1961 as amended (New South Wales). So far as material, that Section provided:

   "....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 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......

   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 offence under this Act."

5. The matters said to give rise to a contravention of Section 67 were:

   a) The fact that security by way of mortgage was provided by Newbridge, a subsidiary of Airfoil;

   b) The fact that the purchase price was tendered by cheques drawn by Airfoil on its own bank account and

   c) An allegation that each of the respondents was, as part of the overall transaction, to be permitted to purchase from Airfoil at an undervalue a motor car used by him in the course of his employment by Airfoil.

6. Additionally, in the cases of the respondents Herbert and Jehnic, it was sought to allege that, as part of the overall transaction, Airfoil would forgive amounts then owed to it by each of them on their loan accounts.

7. The allegation referred to in 5(c), although pleaded, was not pressed and there was no evidence in support of it: 306.

   Leave was sought to amend the defences to the claims of the respondents Herbert and Jehnic, to make the allegation referred to in 6; this leave was refused: 306 - 307.

   Although there was some evidence as to the loan accounts, Rogers J held that it did not disclose any illegality of which he was obliged to take notice: 307 - 308.

8. The respondents contended that:
   a) None of the matters said to give rise to illegality formed part of the transactions between them, Ilerain, and the appellant;
   b) In particular, the agreements for sale between them and Ilerain did not require, or stipulate as a mode of performance, that:
      i) payment should be made by cheques drawn by Airfoil or
      ii) security should be given by Newbridge.
   c) There was no sale of motor cars at an undervalue.
   d) The tender of payment by cheques drawn by Airfoil did not, at the time the sale agreements were made, necessarily involve any illegality.
   e) Insofar as the tender of payment of cheques drawn by Airfoil represented an illegal mode of performance, this was accidental and not integral.
   f) Although the giving of security by Newbridge represented a breach of Section 67, this could be severed from the agreements to sell the shares and from the appellant's guarantees of performance by Ilerain of its obligations thereunder.
   g) There was nothing in the facts as known relating to the loan accounts which compelled a conclusion of illegality.

C. <u>Reasons of Trial Judge</u>

9. Rogers J held that:
   a) there was no contractual obligation, or common intention, to make payment by cheques drawn by Airfoil;
   b) tender of payment by cheques drawn by Airfoil was not necessarily illegal; and
   c) he was not obliged, and should lean against, imputing or assuming that there was illegality. 313 - 314.
   d) The illegal mortgages from Newbridge to the respondents could be severed, leaving the sale agreements and the appellant's guarantees of performance by Ilerain of its obligations thereunder, enforceable. 320.

10. The respondents submit that, insofar as his Honour's holdings

depended upon findings of fact, not only were those findings of fact open to him, they were the only findings to which he could properly come. Further, the respondents submit that insofar as his Honour's holdings depend upon conclusions of law, they were correct.

D. Respondents' Submissions

11. It will be seen, both from what has been written and what follows, that the respondents are at issue with the appellant over the way in which the appellant's case puts the facts and the relevant principles; however, the respondents will not in all instances make express reference to their differences.

12. Evidence was given, in the appellant's case, by himself and one Morton. One Van der Sluis was called, in support of the ground of illegality summarised in 5(c) above, but was by consent withdrawn (233). In the respondent's cases, each of the respondents gave evidence.

13. Rogers J, who had the substantial benefit of observing the witnesses in the witness box as they gave their evidence, preferred the evidence of the respondents. He stated:

   "I do not accept either the defendant or Mr. Morton as witnesses of truth." (310)

   His Honour's reasons for these findings on credit are to be found at 310 - 311

14. The respondents submit that this Honour's findings on credit ought to be accepted by their Lordships. The respondents do not propose to weary their Lordships by lengthy citations from the evidence but do submit that there was ample, indeed overwhelming, material in the evidence to support his Honour's conclusion.

15. The appellant's case, as to the ground of illegality summarised in 5(b) above, was that the respondents required, and it was an integral and essential part of the transactions between the respondents and the appellant, that payment be made by cheques drawn by Airfoil. In each case, the agreement for sale provided by clause 1 that:

   "1. The Purchaser" (the appellant) "shall pay to the Vendor" (the respective respondents) "the sum of ...

233.

310

310 - 311

such amount to be made by cash or bank cheque as follows...."

(332 - agreement with Herbert). In each case, of course, the total consideration and the instalments thereof were stated. 332

16. The appellant's case in this respect flew in the face of the written agreement. Accordingly, it was necessary for the appellant to show either that there should be implied into the agreements a term that payment should be made by cheques drawn by Airfoil, or that the parties had the intention that this should be so. In truth, it was the appellant's task to go behind an agreement lawful on its fact, and prove an underlying unlawful agreement.

17. There was not, in the respondents' submission, any evidence upon which the latter finding could be made. The evidence (as Rogers J found) showed that all the cheques were drawn at one time, on 17 March 1980 (Arnett at 271 and 281). It was after the cheques were drawn, that the respondents retained their solicitor and he prepared the draft agreements (Arnett at 273 - 274; Danny Kenneth Simpson at 285). The respondents submit that, in each case, it was the agreement which spelt out the obligations of Ilerain in relation to payment; the fact that the parties chose to accept the cheques drawn by Airfoil did not alter the contractual obligation, whatever might be the position in relation to waiver or estoppel. 271 & 281 273 - 274 285.

18. As to the head of illegality referred to in 5(a), the respondents accept that each of the mortgages was illegal and void. However, they submit that, in the context of the overall transaction, the mortgages may be severed, leaving the balance of the transaction lawful and enforceable.

19. The sale agreements did not stipulate that security (by way of mortgage or at all) be given. The appellant's evidence was that the respondents, through Arnett, stipulated for security by way of mortgage (157). The respondents denied this. It is true that security was required (Arnett at 273) although this was after the initial agreement had been struck and the cheques had been drawn and handed over. It is also true that the security offered was security over the land of Newbridge (ibid). However, there is no suggestion that unless security from Newbridge by way of mortgage were given, the transaction would not proceed. 157. 273.

20. It was after the conversation referred to in the preceding paragraph, that the solicitor, Simpson, produced the draft guarantees from the appellant to the respondents.

21. Rogers J dealt with this aspect of the matter as follows: 319

"Here it is true that the plaintiff required some security. It is perfectly true, as counsel for the defendant pointed out, that they deferred cashing their cheques for the first instalment until after execution of the documents on Monday 24 March because they regarded it as part of the obligation that documents should be signed. However, the fact that the personal guarantee unexpectedly turned up on Monday for execution by the defendant highlights the truth of the claim made on the plaintiffs' behalf that they wanted some security and that as it happened that security became a second mortgage over the factory. For aught I know the personal guarantee may by itself have satisfied the craving for security ...

"Once again I take the view that I should not be astute to discover illegality."

22. The respondents submit that this view of the facts was the correct one and that it should not be disturbed.

23. In those circumstances, the respondents submit that his Honour was correct to hold that, in each case, the illegal mortgage could be severed from the overall transaction. They submit that the approach taken by his Honour is justified by at least three cases which, each on their own and together, define the law of Australia in this regard. The cases are:

<u>Thomas Brown and Sons v Fazal Deen and anor</u> (1962) 108 CLR 391 (<u>"Fazal Deen"</u>).

<u>Niemann v Smedley</u> (1972) VR 769 (<u>"Niemann"</u>).

<u>D.J.E. Constructions Pty. Limited v Maddocks and ors</u> (1982) 1 NSWLR 5 (<u>"Maddocks"</u>).

24. In <u>Fazal Deen</u>, there was a bailment, by the respondent Fazal Deen to the appellant, of gold, gems and a safe. The bailment of the gold was, by virtue of the National Security (Exchange Control) Regulations, illegal. In 1959, the respondent Fazal Deen demanded the return of the articles bailed to the appellant but they were not returned. He thereafter commenced proceedings for the return of the chattels or their value and damages for detention, in the

alternative damages for breach of contract and conversion. The High Court held that the performance of the agreement for bailment of the gold was illegal but that the terms of the bailment relating to the gold were severable from those relating to the gems and the safe. The respondent Fazal Deen could not succeed in relation to the gold, because he was obliged to rely upon the illegal contract to make out his claim. However, as that part of the agreement could be severed, he could and did succeed in relation to the gems and the safe. The reasons for this are set out at pages 410 - 411 and 412 of the report. At 410 - 411 Their Honours said:

> "So far as the gold was concerned, the performance of that agreement would, and in fact it did, contravene the regulations but it does not follow that the bailment of the gems and of the safe was tainted by illegality. If the terms of the bailment relating to the gold were severable from those relating to the gems and the safe the bailment of the latter chattels would be lawful. The test of severability was stated by Jordan CJ in McFarlane v Daniell 'If the elimination of the invalid promises changes the extent only but not the kind of contract, the valid promises are severable: Putsman v Taylor'. Applying that test, it is clear that the plaintiff's rights of action in respect of the gems and the safe would not be answered by a defence of illegality based upon a breach of the National Security (Exchange Control) Regulations since the contractual obligation upon the company as to the return of the plaintiff's property on demand applied to every part of the property deposited whether demanded together with the rest of it or separately. In the case of the gold, however, the plaintiff could not succeed if he was obliged to rely upon the illegal transaction to establish his case."

At page 412 Their Honours said:

> "Apart therefore from the contract of bailment, failure by the company to redeliver the gold, the gems and the safe following the plaintiff's demand for them in 1959 would not have given rise to a new cause of action so as to defeat the Statute." (The Statute of Limitations.) "But the cases

cited above show that the general rule is subject to an exception which is correctly stated in Halsbury's Law of England 2nd Ed. Vol.33 par. 78 in these terms: 'Where a bailee for safe custody has converted the goods, the bailor may demand their return and sue in detinue upon the bailee's breach of duty to deliver, although the remedy in trover be barred by Statute.' This is the course which the plaintiff followed in the present case and it was a course which he was obliged to follow to avoid being met by a defence of the

10 Statute of Limitations. It meant, however, that he was obliged to prove the contract of bailment and, to support his claim in detinue, to rely upon the failure of the company to comply with the obligations imposed by (sic) it to redeliver the goods upon the demand which he made in 1959. It follows from what has been said that the plaintiff's claim to recover the value of the gold cannot be supported (A.R.P.L. Palaniappa Chettiar v P.L.A.R. Arunaalam Chettiar) and to this extent the appeal must succeed."

The respondents submit that it is clear from the passages cited

20 that the High Court in Fazal Deen expressly decided the case upon the basis that there was but one contract, or bailment, covering three different classes of chattels. The passages cited below from Niemann and from Maddocks also, it is submitted, show this. The explanation of Fazal Deen for which the appellant contends in paragraph 22 of his Case is inconsistent with the reasons given in these cases and cannot be supported.

25. In Niemann, the appellants, the liquidators of a company, sought to recover from former employees of the company amounts said to be owing by them in respect of their subscription for shares in the

30 company. The shares had been issued upon terms that the company would finance the purchase over a term of years. There were three issues before the Full Court:

a) Was the liquidator entitled to recover premium as well as capital?
b) Were the respondents liable as contributories? and
c) Did the breach of Section 56 of the then Companies Act (the equivalent of Section 67 in the present cases) strike down the whole agreement or merely the term by which the company was to finance the transactions?

Implicit in this last question was a further question namely, if only the term as to finance was struck down, was it severable from the rest of the agreement?

The first and second questions do not concern us. The Full Court dealt with the third question (and the further question implicit in it) at pages 778 et seq. of the report. Their Honours said:

"There is perhaps room for debate as to whether the promise of the company was, on the one hand, a term of the agreement constituted by the application for shares and notification of the allotment thereof, or on the other hand, the subject matter of a separate agreement. We think the preferable view is that it was a term of the agreement for the acquisition of the shares. It is clear we think that the contravention of Section 56 did make that term illegal and void. But there is nothing in the language of the Section which suggests that the illegality of such a term infects the agreement as a whole and renders it illegal and void. The Section does not prohibit a purchase of or a subscription for shares one of the terms of which provides for financial assistance being given by the company in connection with that transaction. It prohibits a company 'giving financial assistance for the 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' - a transaction which is otherwise a perfectly lawful one. The question accordingly, in our opinion, is whether the illegal term is severable from the remainder of the agreement constituted by the application for shares and notice of the allotment thereof. The principles relating to severability were discussed at some length in particular relation to a clause void for uncertainty in the judgment of this court in Brew v Whitlock ... an illegal term, as distinct from one merely void, may raise different considerations for if it is of a kind involving a serious element of moral turpitude or is obviously inimical to the the interest of the community so as to offend almost any concept of public policy it will so infect the rest of the contract that the court will refuse to give any recognition

at all to the contract, eg. a promise to commit a burglary or defraud the revenue or one contra bonos mores. But such class of cases apart, where the illegality has no such taint the other terms will stand if the illegal portion can be severed ..

"It was said by Kitto J in Brooks v Burns Philp Trustee Co. Limited ....'questions of severability are often difficult, and tests that have been formulated as useful in particular classes of cases are not always satisfactory for cases of other kinds.' In McFarlane v Daniell .. - a restraint of trade - Jordan CJ said at page 345: 'When, however, the promises made by one of the parties are some of them illegal or void, and some of them valid, the questions arise whether the valid are severable from the invalid, and if so whether they are enforceable. When valid promises supported by legal consideration are associated with, but separate in form from, invalid promises the test of whether they are severable is whether they are in substance so connected with the others as to form an indivisible whole which cannot be taken to pieces without altering its nature: Horwood v Millar's Timber and Trading Co. Limited ....if the elimination of the invalid promises changes the extent only but not the kind of the contract, the valid promises are severable: Putsman v Taylor ...If the substantial promises were all illegal or void, merely ancillary promises would be inseverable.' The test cited by the learned Chief Justice as enunciated in Putsman v Taylor was applied by the High Court in Thomas Brown & Sons Limited v Fazal Deen .. which was a case of a contract illegal in part by statute. It was there held that a contract of bailment of gold, gems and a safe was not wholly illegal because the bailment of gold was contrary to Commonwealth Exchange Control regulations but was lawful and severable as to the gems and safe, the bailment of which did not infringe the regulations.,....

"In the present case the offending term is, as a matter of language, verbally separate from the remainder of the agreement and it is capable of removal by a blue pencil without affecting the meaning of the part remaining. The material

matter, we think, is whether elimination of that term would basically alter the true nature of the contract or involve the formation of a new and different contract. In our opinion, it would not do so. The whole purport and substance of the agreement was the subscription for shares. It was one in which, as Nelson J found, the applicants applied for and were allotted fully paid five shilling shares at a premium of five shillings. The promise of the company to finance 'the purchase' over a period was not the whole or the main consideration to support the promise of the applicants to pay for those shares, but was subsidiary to the main purpose of the contract - a contract to acquire fully paid shares in the company.

"In our opinion, accordingly, the term by which the company agreed to finance the transaction was severable from the rest of the agreement which remains valid."

26. In Maddocks, one Logan agreed to take shares from the appellant company. The subscription was financed by a cheque drawn by his then fiancee. To enable her cheque to be met, one Ensor drew a cheque on the company's account which he gave to Logan and which was deposited to the credit of Logan's fiancee's account, thereby enabling the fiancee's cheque in favour of the company to be met. The case concerned a dispute between Logan and the respondent Maddocks, as to the entitlement to the shares, and a claim by Maddocks to have the company's share register rectified so as to show him as the owner of the shares in question. It was contended that even if there were a contract or agreement between Maddocks and the company which was capable of supporting a claim for rectification, any such contract was void for illegality because of the method adopted to finance the transaction. Samuels JA (with whom Glass JA expressed agreement - page 13 of the report) dealt with the question of severability at page 21 of the report. After citing the warning given by Kitto J in Brooks v Burns Philp Trustee Co. Limited (1969) 121 CLR 432 at 438 to which the Full Court of the Supreme Court of Victoria referred in Niemann - vide supra - his Honour said:

"It is arguable that a contractual term cannot be severed if it involves the doing of an act which is contra bonos mores,

> or illegal at common law ... or by statute... and the company's loan to Mr. Logan amounted to a criminal offence under Section 67(3) punishable by imprisonment. It appears, however, that this limitation cannot stand with the decision of the High Court in Thomas Brown & Sons Limited v Fazal Deen ... where one term of a contract was severed from the rest, although its performance necessarily contravened a provision of the National Security (Exchange Control) Regulations and was thus subject to any penalty prescribed by the Regulations, or constituted an indictable misdemeanour at common law ...
>
> "The conditions for severance have been variously expressed. Bearing in mind Kitto J's admonition in Brooks, it is necessary to identify the class of case here in suit. Mr. Maddocks claimed to be entitled to have his name entered in the register of members, and that right (if otherwise well founded and enforceable) depends upon the validity of the allotment made. So the question is whether the allotment depends wholly or substantially upon an illegal consideration, that is, upon the company's loan to Mr. Logan. If it does then it is void...
>
> "In my opinion, the allotment was dependent upon the loan and the illegality of the loan infected the whole of the contract .... I conclude therefore that the loan by the company was indeed the consideration for the allotments; it was the prop which sustained the transaction and cannot be removed without destroying the whole contract. I do not see, therefore, how the term providing for the loan can be severed from the rest and the result is that the whole contract is illegal and void."

His Honour commented that this case was distinguishable from Niemann and that the reasoning of the Full Court in Niemann "does notcompel the like result in the present case".

Street CJ (with whom Glass JA also expressed agreement - see page 13 of the report) dealt with the question of severance at pages 10 - 12 of the report. At page 10 his Honour stated:

"Whilst the doctrine of severence can be applied in proceedings brought in the context of a contract illegal and void by reason of an infringement of a statutory provision (Thomas Brown & Sons Limited v Fazal Deen) I know of no case where it has been applied in a claim for the actual enforcement of such a contract. The principles relating to severability were developed in connection with contractual clauses void for uncertainty and for restraint of trade, and not in cases involving contracts illegal and void."

10

With the greatest of respect, his Honour's comments here are difficult to follow, as, apart from any other reason, Fazal Deen was just such a case, namely a claim for the actual enforcement of a contract illegal and void by reason of an infringement of a statutory provision.

His Honour continued to express disagreement with the judgment of the Full Court in Niemman. He then, at pages 11 - 12 said:-

"With the greatest of respect I do not consider that the doctrine of severability is available to save an integral term of an agreement such as the method of paying for shares that are being agreed to be issued in contravention of a section such as is presently under consideration . The distinction to be observed in the operation of the doctrine of severability as between contracts that are merely void and those that are illegal and void is adequately noted in Halsbury 4th ed, vol. 9, pars 386 and 429 at pp 260,261 and 297.

20

"In the light of the longstanding distinctions between a clause which is purely void and a clause which is illegal and void, I have some difficulty in accepting the correctness of applying the doctrine of severability in a situation that existed in Niemman v Smedley... in the rare case such as Thomas Brown & Sons Limited v Fazal Deen in which that doctrine has been applied in a context arising out of a contract void and illegal, the substantial separation between the good and the bad parts is plain to demonstration. I hesitate to regard the facts in Niemman v Smedley as falling within this limited category."

30

27. The respondents submit that Rogers J was correct in holding that the doctrine of severability was capable of application, notwithstanding that a part of the transaction was not merely void, but illegal and void. The respondents submit that his Honour's conclusion on this point is amply justified by the authorities referred to above. The respondents further submit that his Honour applied correctly the test of severability. In the present case, it was security which was important; there was no stipulation as to the precise form of such security. It is clear

10 that the respondents would not have proceeded with the transaction without security; it cannot be said, on the evidence, that they would not have proceeded without the mortgages from Newbridge. The substantial consideration for the respondents' promises to sell their shares was the promises of Ilerain to pay for them. These promises were supported by the appellant's promises of guarantee. If one applies the test enunciated by Samuels JA in Maddocks, it cannot be said that the (in this case) sale of shares depended wholly or substantially upon an illegal consideration namely the mortgages from Newbridge.

20 28. The authorities cited above make it clear that the test of severability laid down by Jordan CJ (in whose reasons Davidson and Owen JJ concurred) in McFarlane v Daniell (1938) 38SR (NSW) 337 at 345 is the correct test to apply. In this respect, the appellant's contention at para 23 of his Case is incorrect; it is clear, the respondents submit, that the test laid down in McFarlane v Daniell applies whether the question of severability arises in cohesion with illegality, or in connection with (for example) restraint of trade or ouster of jurisdiction. See also Brooks v Burns Philp Trustee Co. Ltd. and Anor (1969) 121 CLR 432

30 especially per Kitto J at 438. In McFarlane v Daniell, Jordan CJ said at 346:

> "If, according to the terms of the contract, a party cannot be called upon to pay money except upon the performance by the other party of the whole consideration, then if any part of the consideration is illegal the money cannot be recovered: Hopkins v Prescott (1937) AC 653 at 664."

The respondents submit that this statement of principle is correct and exactly governs the present case. On the true construction of the agreements for sale of shares, Ilerain could call upon the

plaintiffs to transfer their shares, and the plaintiffs could call upon Ilerain to pay, without either party proffering any illegal consideration. In the present transactions, what is prohibited is the security given by Newbridge. Obviously, it would not have been open to the respondents to call upon Newbridge under its guarantee. That, however, in the respondents' submission, is the beginning and the end of the illegality, and the only matter which is prohibited.

29. The respondents therefore submit that his Honour's conclusion on this aspect was correct, and ought not to be disturbed. In this respect, the respondents are comforted by what fell from Cross J (as he then was) in South Western Mineral Water Co. Limited v Ashmore 1967 1 W LR 1110 at 1120. In that case, the plaintiff granted to the defendant an option for the purchase of the plaintiff's total shareholding in a subsidiary. The option agreement provided for the purchase price to be secured by a debenture over the assets of the subsidiary. That debenture was not executed because it was found to infringe Section 54 of the Companies Act 1948. At page 1120 of the report Cross J dealt with the effect of the illegality as follows:

> "I cannot take the view and do not take the view that the fact that the granting of this debenture would be a criminal offence by Solent made the whole of this agreement absolutely null and void so that the courts will not allow anybody to rely on any of its provisions. No case that had been cited to me suggests that I am obliged to arrive at so ridiculous a conclusion."

The respondents respectfully adopt this, as the only comment which can properly be made upon the principles which must be held to be correct if the appellant's submissions in the present cases succeed. The respondents' submission is supported by the decision of the Full Court of the Supreme Court of Queensland, given since the decision of Rogers J herein, in Firmin & Ors v Gray & Co. Pty. Ltd. (1984) 2ACLC338 - another case of illegality by reason of breach of Section 67 (this time of the Companies Act 1961-1975 (Qld)) in which it was held that the illegal term could be severed.

30. As to the head of illegality raised, in the cases of Jehnic and Herbert, relating to their loan accounts, the respondents rely upon

the reasons given by Rogers J, which appear at pages 306-308. The respondents submit that the evidence did not compel, as the only conclusion which could be drawn from it, that illegality was involved. The respondents further submit that, in the absence of evidence of this standard, the court is not obliged to go looking for illegality.

31. In each case, the price for the shares was calculated without reference to the loan accounts. The only importance of the loan accounts is that, in the cases of the sales by Herbert and
10 Jehnic, the vendors were prepared to treat part of the purchase price as having been discharged by the release of the amounts of their respective indebtedness to Airfoil. In truth (and the appellant's case at paragraph 9 recognises this) the loan accounts were taken into account by way of adjustment to the agreed purchase price and not otherwise. (Appellant at 159 - 160, 164 and 195; Arnett at 269 - 271.)

32. Two things follow from this:
    a) the true agreement was, at least in the case of Herbert and Jehnic, for the payment of a higher sum, with the obligation
20 to pay satisfied, as to the amount of the loan accounts, by their release and
    b) the written agreement for sale was, in the case of Herbert and Jehnic, inaccurate in that it stated the adjusted figure and not the agreed purchase price, as being the purchase price for the shares.

33. If the agreements, in the cases of Herbert and Jehnic, were rectified so as to show the true purchase price, then there would, once again, be merely an accidental mode of performance of an agreement not in itself unlawful; in this case (and it is
30 submitted that it reflects the true case between the parties) the position would be no different to what the respondents have submitted the position is in relation to the tender of payment by cheques drawn by Airfoil.

34. The evidence also suggests (Arnett at 271) that there may have been debts owing by Airfoil to Herbert and Jehnic. It is the respondents' further submission that the incomplete and unsatisfactory state of the evidence on this issue - an issue on which the appellant bore the onus of proof - justified the attitude

taken, and conclusion reached, by Rogers J. In any event, it is essential to look at what is struck down. Section 67 does not prohibit a purchase of shares one of the terms of which provides for financial assistance being given by the company, whose shares are being purchased, in connection with that transaction; it strikes down the provision of assistance by the company (see Niemann at 778, cited in paragraph 25 above). Applying this to the loan account, at the most, what would be struck down is the extinguishment of the loan accounts.
10 But for the reasons set out below, the respondents submit that not even this follows.

35. The respondents submit that, as indeed is obvious, the sale agreements (in the cases of Herbert and Jehnic) include no term requiring the debts owed by the vendors to Airfoil to be extinguished in part satisfaction of the purchase price payable by Ilerain. The clear purpose of the sale agreements was that the vendors, the respondents, were not to retain any further interest in Airfoil and that the appellant was (through his own shareholding and through the shareholding of his nominee Ilerain)
20 to be the sole owner of Airfoil. In those circumstances it was appropriate that the obligation of the respondents to Airfoil and of the appellant to the respondents be discharged entirely at and in the course of the settlements of the sales of the shares. In the execution of this purpose, and in the results, a portion of the purchase price payable by the appellant (through Ilerain) to the respondents Herbert and Jehnic was applied to discharge their loan accounts. This could have been achieved:

a) by payment of the full price by Ilerain to Herbert and Jehnic, and by a contemporaneous exchange of cheques drawn
30 by Herbert and Jehnic in favour of Airfoil to discharge their indebtedness, or
b) by Herbert and Jehnic accepting a lesser price for their shares and by the appellant discharging their liability to Airfoil.

In neither of these circumstances could it be said that, at least in the circumstances of these cases, any illegality was involved. If, in the execution of this purpose, an illegal mode was employed this was casual and adventitious.

36. If, notwithstanding these submissions, it is said that as a result of the extinguishment of the loan accounts of Herbert and Jehnic effecting a part payment of the purchase price to them, there has been some illegality, it is submitted that the true view of the transactions is that there was an assignment of their loan account debts to the appellant so as to render him liable to Airfoil. It is important to note that, at the time of settlement, the appellant's loan account with Airfoil was in credit (in the appellant's favour) by at least $64,000 (exhibit A43; pp 211 - 222 especially 218). As against this, the loan accounts of the respondents Herbert and Jehnic were in debit in the sums of respectively $5,000 and $7,000 (295 and 300). It follows that, at the time of settlement, Airfoil was indebted to the appellant in a sum well in excess of the sum of the indebtedness of Herbert and Jehnic to Airfoil. The transfer of their debit loan accounts to the loan account of the appellant would have left the appellant's loan account in credit in his favour. In these circumstances, an assignment, or setting off, of this nature did not, and could not, amount to a contravention of Section 67. There was never any provision of "financial assistance" by Airfoil in respect of the loan accounts. The appellant called up his loan account to the extent of the indebtedness of the amount required to discharge the indebtedness of Herbert and Jehnic. This was a step which the appellant was fully entitled to take. The remarks of Mahoney JA in Burton v Palmer (1980) 2 NSWLR 878 at 887 are in point, as are the remarks of Hutley JA in the same case at 880. In that case, Samuels JA at 882 agreed with what Mahoney JA said. The respondents further submit that this analysis of the transaction is justified by the decision in Spink (Bournemouth) Limited v Spink (1936) Ch 544 especially at 548, 549.

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37. The appellant may seek to rely upon the decision of the High Court in North & Ors v Marra Developments Limited (1981) 148 CLR 42. However, the respondents submit that in that case, as Mason JA stated at 60, "the original agreement .....was one which from its inception contemplated the possibility of a breach of" (the relevant statutory provision) "as a means of executing the scheme which the parties agreed should be carried

into execution. As events fell out what was a contemplated possibility became an actuality ... The appellants fail, not because the agreement upon which they sue is avoided by Section 70, but because the performance on which they rely involved illegal conduct."

By contrast, the sale agreements on which the respondents rely in no way contemplate the possibility of illegal performance. In fact, they expressly provide otherwise viz. by requiring payment to be made "by cash or bank cheque" (332). 332

10 The respondents submit that it is quite unacceptable to argue that whilst the sale agreements stipulate a mode of performance which is unarguably lawful, nonetheless they (and the appellant's guarantees of the purchaser's performance) may be avoided because of an alleged illegal mode of performance inconsistent with their terms. The significance of illegal performance of a contract as a ground for declaring it unenforceable is, the respondents submit, authoritatively explained by the decision of the High Court in Langley v Foster 4 CLR 167. That case involved an agreement for the lease of certain conditionally 20 purchased and conditionally leased Crown Lands, with the right in the lessee to cut and remove timber, and to construct a tramway across the lands for the removal of timber. The cutting and removal of timber could not lawfully be done without certain licences permits or authorities. It was argued for the lessee that the agreements were (at least as they related to the conditionally leased land) unlawful or invalid. The High Court held that the agreements did not necessarily import any illegal action. It was capable of being construed as an agreement to give, so far as possible, the contemplated rights to the 30 appellant. In the absence of any intention on the part of the parties to break the law, the agreement should be so construed.

O'Connor J at pp 192 -193 dealt with the question of the relevance of illegal performance as follows:

"Now, the law with regard to the enforcement of illegal contracts is very plain and has been illustrated over and over again ... It is this: if a contract can be carried out

> in one way only, and that way necessitates the doing of something prohibited by law, the Courts would not enforce it; but if the contract may be carried out in a legal manner, and also in an illegal manner, before a party can object to the enforcement of the contract by the Court, he must satisfy the Court that it was the intention of the parties to carry it out in an illegal manner."

The remarks of Barton J on the same topic at 184 - 186 are to the same effect.

10 See too Norton v Angus 38 CLR 523 where an agreement, which might be performed in a lawful or an unlawful manner, was upheld by reason of the possibility of lawful performance and specific performance was ordered accordingly.

The respondents submit that having regard to these principles, the circumstances relating to the extinguishment of the loan accounts of Herbert and Jehnic ought not to be regarded as vitiating the sale agreements for illegality, unless that is the only construction which can be applied; clearly, for the reasons suggested in paragraphs 30 - 35 above, that is not the
20 case.

38. The respondents accordingly submit that the judgments of the Supreme Court of New South Wales are correct and ought to be upheld and that the appeals ought to be dismissed with costs, for the following reasons (among others):

a) The decision of the High Court in Thomas Brown & Sons Limited v Fazal Deen & Anor (1962) 108 CLR 391 is correct, and governs the present case, as to the question of severability.

b) The decisions of the High Court in Langley v Foster 4 CLR and Norton v Angus 38 CLR 523 are correct, and govern the
30 present case as to the question of illegal intention.

c) The illegal mortgage may be severed, leaving the balance of the transactions enforceable.

d) The circumstances relating to the tender of payment by the company's cheques, and the discharge of the loan accounts owed to the company, do not disclose any evidence of unlawful or wicked intention sufficient to vitiate the transaction;

in the alternative, any agreement as to the discharge of the loan accounts may be severed leaving the balance of the transactions enforceable.

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21st August, 1984