BANK OF NEW ZEALAND v FIBERI PTY LTD*

INTRODUCTION

As an artificial legal entity, a company must act through natural persons, such as its officers and the agents which it employs. One hazard of acting through agents is the possibility that the agent might act outside the authority which was actually conferred upon him or her by the company. A dispute might then arise between the company and the outsider dealing with the company as to whether an affected transaction is binding on the company.

Sections 164(3)(b), (c) and (e) of the Corporations Law[1] help to protect the position of outsiders by allowing them to make certain assumptions about the authority of purported agents of a company. Namely, the outsider may assume that:

- a person who appears from a return lodged with the Australian Securities Commission to be a director, principal executive officer or secretary has been duly appointed and has the customary authority of such persons in companies of that kind;
- a person held out by the company to be its officer or agent has been duly appointed and has the customary authority of such officers or agents; and
- a document has been duly sealed if it bears what appears to be an impression of the company seal and the sealing is attested to by two persons who can be assumed to be directors, or a director and a secretary, by virtue of paragraph (b) or (c).

Section 164(4) then imposes two restrictions on an outsider's entitlement to make the assumptions provided for in sub-s (3). An outsider cannot assume that a matter is correct if 'he [sic] has actual knowledge that the matter ... is not correct' (sub-s (4)(a)), or 'his connection or relationship with the company is such that he ought to know that the matter ... is not correct' (sub-s (4)(b)). The interpretation of s 164(4)(b) has been a matter of some controversy.

In the recent case of *Bank of New Zealand v Fiberi Pty Ltd*, s 164(4)(b) was interpreted so as to place upon outsiders a more onerous duty to inquire into the true authority of an agent than was imposed in prior cases. This represents a shifting of the risk of incurring loss from the actions of unauthorised agents towards the outsider. This case note considers whether such a shift is appropriate and concludes that an allocation of risk more favourable to outsiders is warranted.

* (1994) 12 ACLC 48. New South Wales Court of Appeal, 13 July 1993, Kirby P, Priestley and Clarke JJA (*'Fiberi'*).

[1] These provisions are based on s 68A of the previous Companies (New South Wales) Code 1984. Some of the cases and articles in this essay concern s 68A of the Code, but references to 's 68A' have been substituted with 's 164'.

THE FACTS

The defendant, Fiberi Pty Ltd ('Fiberi'), was a shelf company acquired for the purpose of purchasing and holding the title to a property at Palm Beach. Mr Bruce Doyle, the controller of a group of companies known as the Doyle group, was a director of Fiberi, and Ms Gretchen Arnhold was a director and secretary. Mr Doyle and Ms Arnhold subsequently married. [2] The property formed the principal family residence.

In 1989, as the Doyle group experienced financial duties, the Bank of New Zealand ('BNZ') procured guarantees from Fiberi to secure the indebtedness of two companies belonging to the Doyle group. The guarantees were in turn secured by a mortgage of the Palm Beach property. Both guarantees were made under the common seal of Fiberi and were signed by Mr Doyle as director and his son as secretary, although the latter had not been appointed to that office. Ms Arnhold was not aware of these transactions.

When the guarantees were not satisfied, BNZ brought proceedings for recovery of possession of the Palm Beach property. The main issue at trial concerned the validity of the two guarantees given by Fiberi. If the guarantees were not binding on Fiberi, no moneys became due under the mortgage and hence BNZ would not be entitled to possession. BNZ submitted that the guarantees were valid due to the operation of ss 164(3)(c) and (e). The trial judge, Allen J, found for the defendant on the basis that Fiberi did not hold out Mr Doyle's son to be a director or secretary.[3] The appeal by BNZ was dismissed in the Court of Appeal decision which forms the subject of this case note. The High Court refused an application for special leave to appeal.[4]

THE JUDGMENTS

The judges of the Court of Appeal reached the same result as the trial judge, finding that BNZ was precluded from assuming that Mr Doyle and his son had the authority to enter binding guarantees on behalf of Fiberi because BNZ's connection or relationship with Fiberi was such that it ought to have known that the assumption was incorrect. However, Kirby P and Priestley JA (Clarke JA agreeing) differed in their interpretation of the test set out by s 164(4)(b).

Kirby P held that the test in s 164(4)(b) is similar to the test which operated at common law as set out by the High Court in *Northside Developments Pty Ltd v Registrar-General and Others*.[5] At common law, outsiders cannot assume that an agent has authority 'if the circumstances are such as to put that party on inquiry as to whether the authority exists'.[6] Kirby P's approach does not place any great emphasis on the opening words 'connection or relationship'. The

2 For the sake of clarity, Mrs Doyle will be referred to as Ms Arnhold.
3 *Bank of New Zealand v Fiberi Pty Ltd* (1992) 8 ACSR 790 (Allen J).
4 *Bank of New Zealand v Fiberi Pty Ltd* (1994) 12 ACLC 232.
5 (1990) 170 CLR 146 ('*Northside*').
6 Ibid 180 (Brennan J).

nature of the relationship between an outsider and a company is merely a factor to be weighed in determining if, in all the circumstances, the outsider was put on inquiry. An outsider may be put on inquiry in the course of an isolated transaction with a company; it is unnecessary that there be a pre-existing or ongoing relationship between outsider and company.[7]

Kirby P emphasised the following factors in finding that BNZ was put on inquiry:

- the transactions were for purposes unrelated to Fiberi's business and it gained no apparent benefit from them;
- Mr Doyle was a director of Fiberi, and the need for inquiry is greater where an outsider is dealing with a director rather than a managing director;
- Fiberi clearly had not purchased a commercial property for apparent commercial use — it was simply holding land used for residential purposes;
- simple inquiries would have revealed that Mr Doyle's son was neither a director nor secretary of Fiberi; and
- BNZ, through its employee, Mr Johnson, received information containing discrepancies concerning the ownership of the Palm Beach property. Yet, in the words of the trial judge, '[i]t sufficed, in Mr Johnson's simplistic approach, that Bruce Doyle, on his understanding, had complete practical control of Fiberi in the sense that whatever he wanted the company to do it would do.'[8]

Priestley JA (Clarke JA agreeing) treated the opening words of s 164(4)(b) in similar fashion, in that 'the approach should not be first to characterise the connection or relationship ... and then to ask whether a person having that connection or relationship ought to know a particular matter'.[9] Instead, the relationship between outsider and company forms part of the 'factual matrix' in which the test of knowledge falls to be applied. The approaches of Kirby P and Priestley JA diverge in that Priestley JA frames the test in terms of whether the outsider 'ought to know', rather than 'was put on inquiry', that the agent's authority was lacking.

Priestley JA seems to take up the doctrine of 'strict' constructive notice developed in equity in the context of property law, according to which an outsider is fixed with notice of all matters which he or she, acting reasonably, would have known. An objective standard of reasonable conduct is set. In contrast, the 'put on inquiry' test first considers the facts subjectively known by the outsider, then determines if, in light of those facts, a reasonable person would have been put on inquiry. Some lack of innocence on the outsider's part is required; mere negligence is not sufficient. The test set out by Priestley JA is less favourable for an outsider although the two tests would often produce similar results. Priestley JA concluded that the facts as summarised by Kirby P show that a reasonable

[7] *Fiberi* (1994) 12 ACLC 48, 53.
[8] *Bank of New Zealand v Fiberi Pty Ltd* (1992) 8 ACSR 790, 805.
[9] *Fiberi* (1994) 12 ACLC 48, 59-60.

bank official in Mr Johnson's 'factual matrix' ought to have known that the guarantees were signed without authority.[10]

The approaches taken by Kirby P and Priestley JA in *Fiberi* differ from the view predominant in case law and academic writings.[11] According to this view, s 164(4)(b) constitutes a significant departure from the test of knowledge at common law, reflecting a legislative desire to increase protection of the position of outsiders. The phrase 'connection or relationship' is given independent meaning and serves almost as a pre-condition: focusing on the nature of an outsider's connection or relationship with the company, the court determines if it is such as ought to have produced the relevant state of knowledge. In *Lyford v Media Portfolio Ltd*,[12] Nicholson J held that the outsider must have a legal or non-arm's length connection such as being a director, shareholder or employee of the company. In the later case of *Story v Advance Bank Australia Ltd*,[13] the court applied the test more flexibly. The court refused to categorise the connections which might be relevant and entertained the possibility that the connection can arise out of the supposedly unauthorised dealing itself.[14]

The difference between this approach and the two taken in *Fiberi* is illustrated by the case of Mrs Story.[15] Mrs Story, like Ms Arnhold, was a director of a small company whose major asset was the family home. The other director, her husband, mortgaged the home to a bank without her consent by forging her signature. The company's interest in the dealing, although ambiguous, was not explored further by the bank. The appeal court found that it was a difficult question whether the bank was put on inquiry under the common law test but, in the instant dealing, under the test in s 164(4)(b), the bank's connection or relationship with the company (as lender), was not such that it ought to have known that the mortgage was not authorised.[16]

ANALYSIS

It seems that the general purpose of the package of amendments including s 164 was to improve the position of outsiders in their dealings with companies.

[10] Ibid.

[11] *Lyford and Another v Media Portfolio Ltd and Others* (1989) 7 ACLC 271; *Brick and Pipe Industries Ltd v Occidental Life Nominees Pty Ltd and Others* [1992] 2 VR 279; *Story v Advance Bank Australia Ltd* (1993) 11 ACLC 629. See, eg, Harold Ford & R Austin, *Ford's Principles of Company Law* (6th ed, 1992) 118-9; Roman Tomasic, Jim Jackson and Rob Woellner, *Corporations Law: Principles, Policy and Process* (2nd ed, 1992) 293.

[12] (1989) 7 ACLC 271, 281.

[13] (1993) 11 ACLC 629 ('*Story*').

[14] Ibid 639.

[15] *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* (1992) 10 ACLC 703, appealed in *Story v Advance Bank Australia Ltd* (1993) 11 ACLC 629.

[16] *Story* (1993) 11 ACLC 629, 638-9. At first instance, Studdert J had found that the bank was put on inquiry but, as the protection to outsiders was broader under s 164(4)(b), the bank was nevertheless entitled to make the relevant assumptions: *Advance Bank Australia Ltd v Fleetwood Star Pty Ltd* (1992) 10 ACLC 703, 712-4.

The doctrines of *ultra vires*[17] and constructive notice[18] were abolished, which removed two significant pitfalls for outsiders. According to Kirby P, s 164 demonstrates 'a general legislative intention to allocate the risk of loss from fraud and the like in the ordinary case, in dealings with a company, upon the company itself'.[19]

While he supported the increase in business convenience which would result in upholding transactions between the agents of companies and outsiders generally, Kirby P was strongly influenced by the reasoning of the High Court majority in *Northside* in favour of putting outsiders on inquiry should the circumstances justify it. If outsiders were freed from any burden of establishing the actual authority of company agents, the result 'would be to furnish a charter for dealings between fraudulent officers and supine financiers'.[20] The imposition of a burden on outsiders to help expose dishonest and fraudulent agents promotes a worthwhile goal — to 'enhance the integrity of commercial transactions and commercial morality'.[21]

After evaluating the general policy considerations affecting the dealings of outsiders and companies, the High Court in *Northside* found that the balance between the competing interests was best struck by the 'put on inquiry' test. Kirby P agreed with the High Court, saying 'it would take language more direct and clear than [s 164] to exclude the operation of such basic common law principles'.[22]

On the other hand, there are strong moral and economic arguments indicating that companies should assume a large share of the risk of loss arising from the actions of unauthorised agents.[23] It is the company which requires and benefits from the services of the agent,[24] and it is the company which puts the agent 'into circulation'. As the primary beneficiary from the employment of agents, the company should likewise assume a greater part of the moral responsibility for the agent's actions.

In addition, the company has a greater ability to select and test agents for their trustworthiness, and to oversee their activities. Since agents are part of the company's organisation, it can use internal checks and disciplinary measures to supervise the agent. A feature in many of the cases concerning unauthorised

17 Corporations Law s 162. According to the doctrine of *ultra vires*, a company had no legal capacity to act outside the objects set out in its articles. No apparent authority could exist in relation to the *ultra vires* acts of agents.

18 Corporations Law s 165. Outsiders were fixed with constructive notice of a company's public documents. Thus they were presumed to know of any restrictions on authority contained therein.

19 *Fiberi* (1994) 12 ACLC 48, 52.

20 *Northside* (1990) 170 CLR 146, 189 (Brennan J).

21 Ibid 165 (Mason CJ).

22 *Fiberi* (1994) 12 ACLC 48, 54.

23 Some of the following arguments are more fully discussed in: Yedidia Stern, 'Corporate Liability for Unauthorized Contracts — Unification of the Rules of Corporate Representation' (1987) 9 *University of Pennsylvania Journal of International Business Law* 649, 652-5; Richard Stone, 'Usual and Ostensible Authority — One Concept or Two?' (1993) *Journal of Business Law* 325, 326-7.

24 '[T]he feeling that one who derives a benefit from an act should also bear the risk of loss from the same act is probably a deep-rooted one which has played its part in the formulation of modern law': Patrick Atiyah, *Vicarious Liability in the Law of Torts* (1967) 18, cited in Stern, above n 23, 655.

agents is the striking deficiency of controls in the company, rather than the existence of particularly ingenious agents who have managed to evade all possible safeguards. Often, the company has been content to allow the so-called unauthorised agent to act as the *de facto* controlling force until adverse consequences arise. If the losses resulting from the actions of unauthorised agents were made to fall on companies, it should discourage companies from operating in such a lax fashion. This would be in keeping with other developments in company law requiring a higher standard of care and diligence from directors.[25]

It should be noted that s 164(3)(b) and (c) do not permit an outsider to assume that an agent has any more than the customary authority of such agents.[26] This remains a significant protection for the company from the particularly excessive actions of agents.

In economic terms, it is much more efficient for a company to assume responsibility for agents. The outsider might only deal with an agent on a handful of occasions, and the cost of ascertaining the agent's credentials would be relatively high. Indeed, the time and expense involved in such inquiries would remove much of the very purpose of using agents. In contrast, an agent represents a company over a series of transactions and it would be worthwhile for the company to set up a system of checks and controls.

When the 'put on inquiry' test was formulated in the 19th century the number of companies in existence and their use of agents was limited. It might have been realistic to require outsiders to be on the alert for unauthorised agents. In the modern commercial world the use of agents is extensive. There are 'innumerable business transactions with corporations' which are 'fundamental to our economy and form of society'.[27] In such an environment, 'the incidence of breach of warranty, error, or fraud by servants is so small relative to the volume of business that inquiry or any other delay or cost-creating factor is uneconomical.'[28]

Finally, a feature of most of the cases dealing with the unauthorised acts of agents is that they involve outsiders who are major financial institutions. They tend to be in a position of superior bargaining power. As banks in the process of granting a loan or a mortgage, these outsiders have an accepted right to make inquiries of their clients and possess considerable resources for making such inquiries. The development of a strict test which imposes an onerous burden of inquiry on banks might be justified — but to impose such a test generally would overlook the fact that many transactions involve outsiders who deal with companies from an equal or inferior bargaining position. For example, a small

[25] See, eg, *AWA Ltd v Daniels t/a Deloitte Haskins & Sells and Others* (1992) 10 ACLC 933; *Commonwealth Bank of Australia v Friedrich and Others* (1991) 5 ACSR 115.

[26] In the light of *ANZ Executors and Trustee Co Ltd v Qintex Australia Ltd* (1990) 2 ACSR 676, it appears that actions which are not for 'corporate purposes' would be beyond the customary authority of any agent.

[27] *Fiberi* (1994) 12 ACLC 48, 52 (Kirby P).

[28] J Hetherington, 'Trends in Enterprise Liability: Law and the Unauthorized Agent' (1966) 19 *Stanford Law Review* 76, 127. See also *Registrar-General v Northside Developments Pty Ltd* (1989) 7 ACLC 52, 59 (Kirby P).

company supplying goods to many large companies should not be expected to untangle the convoluted web of authority in each company.

The drafters of s 164(4)(b) have opted for an entirely new form of words rather than incorporating the language of the 'put on inquiry' test repeatedly employed in case law. It is submitted that, in recognition of the increasingly strong arguments for shifting the risk of loss from the activities of unauthorised agents onto their principals, the legislature intended to formulate a test which was more favourable to outsiders than the common law test.

At first glance, then, the approach taken in cases such as *Story* seems to be appropriate. An interpretation of s 164(4)(b) which requires that an outsider have a particular type of connection or relationship with the company as a pre-condition to any imputation of knowledge would certainly achieve the legislature's policy aim of favouring outsiders. The protection of outsiders, though, would be achieved in an arbitrary fashion. Such an interpretation narrows the focus of the court's inquiry to the nature of the relationship between outsider and company to the exclusion of other factors. It tends to lead to results like the one in the case of Mrs Story, where outsiders are not required to make further inquiries by virtue of the nature of their relationship with a company, despite strong indications that an agent might lack authority.

A preferable approach would be to take the 'connection or relationship' between an outsider and a company as referring to the entire 'factual matrix' of the relations between the two, as advocated by Priestley JA in *Fiberi*. This is because a wide range of factors are relevant in determining whether an outsider ought to know that an agent lacks authority — for example, the rank of the agent, the subject matter of the dealing, the degree of benefit accruing to the company, and the difficulty of further inquiry.

However, the interpretation of s 164(4)(b) should not continue to follow the path taken by Priestley JA in imposing an equitable test of constructive notice. In drafting s 164, the legislature expressed a concern to protect '*bona fide*' or 'innocent' outsiders in dealings with companies.[29] This implies that, in order to lack innocence and be disqualified from making the assumptions, an outsider would have to possess some knowledge of suspicious facts. Section 164 does not appear to extend so far as to disqualify outsiders who are merely negligent. The courts tend to be reluctant to import any part of the equitable doctrine of constructive notice into the commercial world.[30] Priestley JA's approach sets out a test that is more onerous for outsiders than the common law position and, as discussed above, this is not warranted by policy considerations.

It is preferable to construe s 164(4)(b) as stipulating that an outsider ought to know an agent lacks authority if, in light of the entire factual matrix, he or she possesses sufficient subjective awareness of suspicious circumstances to warrant the imputation of that knowledge. This test is phrased almost identically to the

[29] Explanatory Memorandum to the Companies and Securities Legislation (Miscellaneous Amendments) Bill 1983 (Cth), paras 386 and 404 respectively.

[30] *Manchester Trust v Furness* [1895] 2 QB 539.

'put on inquiry' test at common law. However, in applying the statutory test of knowledge, judges should give effect to the policy advantages of protecting the position of outsiders by requiring outsiders to inquire further into the existence or extent of an agent's authority only in the face of extremely suspicious circumstances.

It is not submitted that the result reached in *Fiberi* was incorrect as the circumstances pointing to a lack of authority were extremely strong.[31] The facts in *Fiberi* were not conducive to highlighting the disadvantages flowing from placing a burden of inquiry onto outsiders. The judgments in *Fiberi* thus interpreted s 164(4)(b) so as to remove the overly restrictive focus on the words 'connection or relationship' prevalent in earlier cases, without adding a caution that the test in s 164(4)(b) should be applied with great favour towards outsiders. In the absence of such a warning, a court which has before it the full range of factors pointing to a lack of authority in the purported agent, might too readily find, in hindsight, that the outsider ought to have known that the authority was lacking. Outsiders would then be encumbered with an undesirably onerous burden of inquiry.

CONCLUSION

To resolve the difficult question of who, as between two innocent parties, should bear the loss caused by the wrongdoing of a third party, resort must be had to fine distinctions in moral responsibility and the balance of economic convenience. In general, these factors tend to point towards legal rules which place a good proportion of the responsibility for the actions of agents on the companies who employ them.

This does not mean that outsiders should be free of any duty to police agents. In cases where the possible lack of authority in an agent is blatant and further inquiry is simple and inexpensive in terms of the resources of the particular outsider, outsiders should be encouraged to help advance the important goal of commercial morality. The balance between the interests of company and outsider is best struck by a test of knowledge which has regard to the full range of circumstances in determining whether an outsider ought to be imputed with knowledge of a lack of authority, but which is applied with great strictness so that outsiders are not readily fixed with an obligation to make further inquiry.

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[31] Indeed, in rejecting leave to appeal, Brennan J found that, on the facts of the case, the unlikelihood of a successful appeal precluded the case from being a suitable vehicle to consider the construction of s 164(4): *Fiberi* (1994) 12 ACLC 232, 236.

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