2/1925

THE HIGH COURT OF AUSTRALIA.

SYDNEY REGISTRY.

BEFORE:- .....Isaacs J.
Higgins J.
Rich J.
Starke J.

Barr v Trevitt.

ORDER OF COURT:-

Appeal dismissed with Costs.

JUDGMENT delivered in Sydney this 17th day of December 1925.

BARR v. TREVITT.

JUDGMENT. RICH J.

BARR v. TREVITT.

JUDGMENT. RICH J.

The proceedings in this case were taken under section 162 of the N.S.W. Companies Act, 1899, which provides a summary remedy against the persons named in the section where misfeasance results in damage. It was not suggested before us or as I understand in the Court below that set-off is available to the party attacked under this section. Mr. Browne admitted that there had been misfeasance on the part of his client but he contended that it had not resulted in loss to the funds and assets of the company. Any other matter is wholly irrelevant. As I am of opinion that the matter should be remitted for further hearing it would be inexpedient to discuss the facts of the case. It would appear that at the general meeting of the company held on the 30th. Aug. 1922 the whole matter was discussed and the following questions were asked by counsel for the appellant - "At that meeting was there anything "said about the payments to Mr. Barr?" (objected to). "What was said at "the meeting" - objected to - rejected. This evidence was I think wrong-

ly rejected. The issue being whether there had been repayment to the company of the amount for which the appellant had become liable so that no loss resulted to the company Cavendish Bentinck v. Fenn, 12 A.C. at p. 662 it is material to know what explanation was given to the shareholders of the transaction whereby what Maughan J.J. has described as mechanical entries (and all entries of figures are in one sense mechanical) became translated into a statement of the actual facts elucidating the true position of the company's affairs.

I agree that the omission to give notice of motion by way of cross appeal does not debar the Court from extending an appeal to some matter part of the subject of the original proceeding not covered by the notice of appeal. But the circumstances of this case do not, I consider, warrant the Court in extending the discretion conferred by the rule in question.

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BARR V TREVITT.

JUDGMENT. ... MR JUSTICE ISAACS.

JUDGMENT. ... ISAACS J.

At first it seemed to me that this case called for nothing more than the consideration of a comparatively short and simple question of law or mixed fact and law, as to whether upon circumstances not really in dispute, one side or other was technically in the right. But as the matter proceeded, and more particularly as the relevant events and transactions were presented and elaborated by the learned Counsel for the appellant, it became perfectly evident that the learned primary Judge rightly treated it as involving some very serious questions materially affecting Company law and administration in New South Wales. Especially do those questions concern the protection of trade creditors dealing with limited companies both at the hands of company directors, and at the hands of a Court of justice when its remedial powers under the Statute are invoked. I have no hesitation in saying that if misfeasances of directors in dealing with the funds of the companies in whose interests they are supposed to act, could be justified or their consequences evaded as easily as is contended for in this case, there would be very little protection left for outside creditors. The learned primary Judge, Mr Acting Justice Maughan, decided against the appellant. He dissected the facts and eventually concluded (1) that much of the documentary evidence was suspicious and untrustworthy (2) that verbal explanations were not to be believed

and (3) that there was an absence of proper evidence of agreement to exonerate the appellant. I have carefully examined the evidence and thoroughly agree with all the learned Judge said. ----------

The application before the learned primary Judge was made by Leslie Loftus Trevitt, the liquidator of King and Company Limited, for an order directing the appellant Joseph Percival Barr, who had been a director of the company, to repay with interest all sums of money paid to him out of the company's moneys in respect of a purchase of his 500 shares in the company by the two other directors, Harold Newton King and Gwendoline Morrison (since Mrs King) under an agreement dated 1 May 1922. As to £350 of those moneys the Court under sec 162 of the Companies Act 1899 held there was a misfeasance and ordered Barr to replace the money so taken from the company. This is an appeal from that decision, and in my opinion, once the facts are understood, it is and always was an utterly hopeless appeal. Much reliance was placed by learned Counsel for Barr on certain book entries, indeed the whole case for exculpation depends on book entries. For reasons I shall state I am clear that even if those entries stood unaffected by anything else, they would in fact and in law, fall short of the suggested effect. But Maughan J in his very careful review of the facts came to the conclusion in which I agree that what he called "the mechanical entering up of the debits "and credits" in the relevant folios of the Ledger, would not be

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sufficient to exonerate the appellant, or to supply the place of an agreement that would do so. His Honor clearly meant an agreement amounting in law to a payment. The proved circumstances of this case render it especially necessary in my opinion to require strict proof of exoneration. They are as follow:- King and Morrison, had been carrying on a knitting business in partnership, and in August 1921 a corporation called King & Company Limited was formed to take over the business, King receiving 800 and Morrison 700 £1 shares fully paid up in the new company. Barr signed the memorandum as a subscriber for one share, describing himself as "accountant". He then applied for, and was allotted 500 shares and paid £500 to the company. There were some signatory shares issued to other persons who by subscribing in the first instance made up the necessary statutory number for incorpora-tion. There were also issued a few other shares perhaps 200 partly paid for. But it is sufficient to say that in substance H.H.King, Miss Morrison and Barr controlled the affairs of the company, and were formally appointed and acted as directors. Passing over for the moment the intermediate events which are the direct subject of our consideration, it should be noted how the present question came to arise. On 19 December, 1923, the Company went into voluntary liqui-dation. The assets have been realised and have produced £444/6/6 with a possible but not very hopeful chance of obtaining £20 more. The liabilities at liquidation were £1195/8/1. So that even elimina-ting costs and expenses there is a ~~difficiency~~ deficiency of nearly

£750 as a result of about two years business existence.

Among the debtors to the company as appears in the private ledger are Mr King £134/-/7 and Mrs King £142/1/6 but nothing of these amounts is available. Another director, Mr F.L.King owes £10/1/6 but even that is not realisable. There were preferential creditors, the Crown £46/-/5. Kent £39/4/4 and J Morrison debenture holder £210/0/6 in all £295/13/3. If that be deducted from the £444/6/5 realised as ets and if costs and expenses are reckoned, there is not much left for the trade creditors whose claims amount to a little over £890. When the liquidator examined the books of the company he found that Barr, while a director, agreed to transfer his shares equally to King and Morrison and received the consideration money out of the com-pany's funds. This led to correspondence and to the present pro-ceedings to compel restoration of the funds so dealt with, King and Morrison (now Mrs King) have not been proceeded against in this way for apparently they have nothing. The liquidator therefore who even in point of law stands in a stronger position than the company itself (Flitcroft's Case, 21 Ch D.p.519) has in the circumstances a clear legal and moral right on behalf of the unpaid creditors to require strict proof of any exoneration relied on which would en-able the former director to retain, at the rate of twenty shillings in the £, the company's moneys so received in preference to the company's trade creditors who get a mere trifle.

The constitution of the company makes it altogether ultra vires of

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the company to purchase shares, or to lend money to purchase shares. Further, No.5 of the Company's Articles, says in the most explicit terms:- "The Directors shall not employ the funds of the Company or any part "thereof in the purchase of shares of the Company". The incapacity of a company to purchase its own shares is of course well known. Barr, with experience as a public accountant was necessarily fully conscious of that. Article 5 just quoted was a distinct prohibition against employ -ing the company's money for such a purpose. In the face of light, the three directors entered into the agreement of 1 May 1922 referred to in the notice of motion. The agreement itself is of an extraordinary nature and the way it was carried out was even more extraordinary. The whole scheme in plain English was to let Barr get back the £500 he had paid into the company together with a small sum he had earned by unskilled working at a knitting machine, and in addition to the £6 or £7 a week he was ordinarily getting nearly £200 more for the extra trouble he had been put to, and for the use of his money. The problem plainly was how to do this, without colliding with the law prohibiting a company purchasing its own shares, and without openly violating Article 5. Of course that was, and I now hold it to be impossible, but the way it was attempted was by means of the agreement of 1 May, and the devious methods resorted to for the purpose of carrying it out. The agreement was made only eight months after the incorporation of the company. In form, and in legal effect, King and Morrison, personally bought Barr's shares. If they intended the purchase to be in reality a purchase for the company they were consciously doing an illegal act, and by paying

paying £100 down by the company's cheque and further stimulating for the company's endorsement of the bills, which meant certainly payment by the company, they were flagrantly violating Article.5. If, as the letter of the appellant's solicitors dated 13 February 1924, asserts the intention was that King and Morrison were really purchasing personally and intended to have the benefits of the shares, then in view of Article 5 the matter was if anything still worse. Maughan J, as to this agreement, after hearing the evidence of the parties, says:- " the "reason given by the respondent for this development was that the busi "-ness was doing so well that King and Miss Morrison wanted to get it "back again, but I doubt very much whether this is the true explanation". His Honor therefore was not prepared to believe Barr. I think the doubt so expressed is amply justified. The real reason is not disclosed As a result however of this agreement Barr on 1 May, as the learned Judge found, received the 5 promissory notes, three of which have not been produced and two of which are in evidence. The notes as originally given were the notes of King and Morrison as principals, but endorsed by the company by King and Morrison as directors. As now produced the two are altered by being converted into a note by "King and Com- "-pany Limited", which makes nonsense of the notes as endorsed but as will appear presently this was done as part of a subsequent expedient to try and avoid personal responsibility. The sum of £100 was paid to Barr by the company's cheque, drawn by King and Morrison, and bearing date 19 May 1922.

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It was paid on 22 May out of the company's bank account. But though the appellant received the £100, and the company's endorsement for all the rest of the price, amounting in all to £711/13/4 for the shares, the ----------

transfer of the shares was not executed until 31 May, which was the day Barr was to retire from the company. The shares were expressed to be transferred 250 to King and 250 to Morrison, each transfer stating it was in consideration of 355/16/8. On 31 May 1922, at a directors meeting attended by the three directors, Barr tendered his resignation as director; the two transfers were submitted and were with the share certificates directed to be held by Messrs Sly and Russell pending the payment in full, that is until 4 January 1923, and Mrs S.King was appointed director till the end of the year. Then says the Minutes:- "there being no further business the meeting was adjourned". That appears at p.7 of the Minute Book. Up to that moment there had been no dividend declared and there had been no ----------

directors fees or other remuneration, which could in any way account for the difference between £500, the paid value of the shares and the sum of £711/13/4 the agreed consideration. How then can we account for the difference, viz, £211/13/4? Possibly, as Vaughan J, says, there may have been a few pounds due for salary. It is said that £18/7/- was thus due for work done. The balance is approximately accounted for ....?

after deducting a bonus of £30 by £50 for dividends, £50 for directors fees and £100 allowance as director for working overtime. The explanation in evidence by King was that the sum of £711/15/4 was calculated on this basis by way of anticipation. Mr Brown for Barr

made this the basis of his contention. In point of fact it depends largely if not altogether on the authenticity of a minute bearing date 31 May 1922 and purporting to record a directors' meeting on that day. Maughan J pointed out the extraordinary circumstances of that minute. There was an already stated a directors' meeting on that day, and the minutes have been referred to. The explicit statement is there made that there was no further business. Those minutes were never amended but were, at a subsequent meeting, on 11 July read and confirmed as they stand. That confirmatory meeting appears on p.8 of the Minute Book. Next on folio.9. there appear what purport to be Minutes of a Meeting of Directors of 31 May on which this possibly crucial pro-vision for the balance of the price might have depended. After stating the circumstances, Maughan J, says:- "It is extremely pecu-liar and also suspicious that a further minute of the meeting of "31 May appears without any explanation on folio 9 of the Minute Book" I join in the learned Judge's suspicion and distrust of that minute. More especially is that so in view of two circumstances. One is the provision of Article 84 that King as Managing Director shall for 5 years receive a salary of not less than £312 a year, and "shall devote the whole of his energy and skill and such time as "shall be necessary for the conduct promotion and advancement of the "business of the company during his employment as such Managing "Director". The other is that in King's evidence it appears that at that time each director was getting £6 or £7 a week.

I am not satisfied that that second minute, dated 31 March, truthfully represents anything done at a directors meeting on 31 May. If such a resolution was ever passed it must have been passed between 11 July and 30 August, 1922, when the shareholders' meeting was held. At that meeting as appears from the recorded minutes "Directors' fees and additional salary as passed by Directors "Meeting of 31 May was duly approved". The only members present at the shareholders' meeting were H.E. King, Miss Morrison and Mrs King. This meeting must have followed very closely the directors meeting of the same three persons on the same day, at which Mr King reported having paid Mr Barr £150 in respect of Directors' Fees &c. As to this, Maughan J, rightly observes:- "There is as a matter of "fact no trace of King ever having paid such a sum to the respon- "-dent except in the shape of the two cheques I have already men- "-tioned". The second cheque was one for £298/7/- on 1st June which if it included directors fees was inconsistent with the alleged minute of 31st March which stipulated for "the approval of the "shareholders in general Meeting". Those two cheques however con- -tained no such sum. The £100 cheque was the first payment for the shares. The second cheque was the amount of the first note £250 plus £30 and £18/7/- bonus and salary and in advance of the date fixed in the agreement. There is not the least trace of any state- -ment or arrangement by Barr to treat the cheques as payment of the £150 directors fees. The full £500 representing the nominal value

of the shares themselves had not yet been paid. The subsequent events including book entries disprove the statement. In any case it was never stated to or approved at the shareholders' meeting. The learned primary Judge manifestly did not believe the entry nor do I. Reverting to the shareholders' meeting the Balance Sheet was approved by the three persons named constituting the Shareholders' Meeting. The Balance Sheet is in typewriting, and there is appended a written statement including "Directors fees £450". That I suppose means £150 to each of the three Directors for the past year. Now what was done with regard to the Directors' fees &c? Not a penny was ever paid to King or Morrison. Barr got the amounts in the total £760/0/4 that he received up to 4 January 1923. But as to the rest, it remained so far as King and Morrison are concerned in cross entries of debit and credit. As to Barr himself, credits and debits are hopeless, because admittedly he received £500 of the company's money for the shares besides the extras, and he still retains all he received. He must therefore rely on the mutual relations of King and Morrison, with the company to prove if he can the restoration in law to the company's coffers of the moneys wrongfully taken from them by the tripartite arrangement and never restored in fact. As to the original nature of this act I adopt without quoting what Maughan J says. The substance is that the payments and receipts of the £100 and the £250 were misfeasance, and that the three directors concerned immediately became liable to make good the loss to the company.

They never did make good the loss. Mr Brown relied on certain bbok entries, ledger/ folios 104, Kings A/C, 106 Morrison's A/C and 115 Barr's A/C . In King's A/C it appears that on 31 May, he was debited with £50, that is one half the £100 first paid to Barr, be-cause King got one-half the shares. In the books this debit of £50 is euphoniously called "cash advance". That is to say the Managing Director in spite of Article 5 and contrary to the consti-tution of the company, applied the company's money to pay for xhxx shares in a way that was substantially a return of capital to another director, calling it for the present a cash advance to himself and intending to account for it by creating subsequently an indebtedness of the company to himself. The process is repeated on 1st June as to £149/3/6 which was one-half of £298/7/-. The way that cross indebtedness appears has been stated. King is debited also with two other sums £50 and £30 as "cash advances", the total debits being £293/6/- £283/6/8. As against that there is a solitary credit of £11/2/11, leaving a net debit of £272/3/1, which is taken into the balance sheet of August 1922 as a debt. It is obviously not treated at anytime as paid off, being carried on into the next financial year and followed by debits of one-half the other moneys paid to Barr. Morrison is dealt with in the same way at folio 106.

On 20 December 1922, at a meeting of Directors it appears from the Minutes that "after discussion it was resolved that the 500 "shares(fully paid up) originally held by Mr J.F.Barr till date of

"of his resignation from the directorship(31st May 1922) be taken over "by the company and be written off capital". It should be observed this was a few days before the last promissory note payable to Barr fell due, when the shares were to be transferred in the Share Register. On 2nd or 4th January 1923, that note £90/8/4 was paid. The half of that note £45/4/£(as were also one/ half of each of the other notes of similar amount) was debited to King and to Morrison respectively. But not as "cash advances" and the reason for that is shewn in the cash book from which the entries come, by words shewing that the amounts are to be charged as for King & Co Limited's shares. Then in conformity with the reso ution of 20 December - a fortnight before- we find in the Share register at folio 8 which is Barr's share folio and under date 2 January 1923, an entry showing that his 500 shares have been trans--ferred to "King & Co Ltd". Turning back then to the cash book en--tries of £90/8/4 paid respectively on 1 October, 1 November and 1 De--cember, it is seen that these several payments debited to King and Morrison in equal amounts are followed by the words "King & Co Ltd". The alteration of the two promissory notes for £90/8/4 due respectively 4 December 1922 and 4 January 1923 by inserting "King and Company Ltd" as the maker immediately above the names of King and Morrison, is ob--viously part of the same operation to effectuate the resolution of 20 December [illegible]. Of course this all results in a muddle,but not in affording a legal quittance to anybody for the original misfeasance. Then on 6 April 1923, a new departure takes place,probably to fit in as far as possible with what has just been narrated. For the first time an account is opened in the ledger for J.P.Barr. The company by this time is plainly moribund, and preparations are being made for burial as decent and as safe as is possible. First in the Journal folio 22, an entry is made debiting Barr with £248/7/- and crediting King and Morri--son with £124/3/6 each, a statement being added "for payments to Barr "charged to their accounts in error". That is carried into the Ledger accounts. But what does the £248/7/- represent? That is explained by the credit entries in Barr's account. It is dividend £50. Wages £18/7/- Bonus for Bank Guarantee £30. Overtime £100 and director's fees £50.

It will be at once noticed that it does not include a penny of the £500 for the shares themselves, and therefore as must be taken not a penny of the £100 and £250 first received by Barr and directed by the judgment under appeal to be replaced. Further the entries referred to are pro tanto ~~xx~~ part of a process which is an attempted undoing of the agreement. If Barr is to be debited as between him and the company, for that is the necessary meaning of his account in the company's ledger, with the £248/7/ previously debited to King and Morrison, it means the money was advanced to him by the company. And conversely if he is to be credited per contra by the company in account with itself with the various sums amounting to £248/7/- it disregards the intervention of King and Morrison altogether.

It is plain that the new Barr ledger-account, folio 115, is an attempted step in the variation of the agreement of 1 May 1922, by making the company the transferree and not King and Morrison of the shares from Barr and by making Barr the person dealing direct with the company in getting an anticipatory advance of £248/7/-.
Folio 115 is as useless as a source of exculpation for Barr as any other entry. So far as appears Barr was no party to the new set of entries. If he had been they would not avail him. Nor, so far as appears was he party to the divagations beginning 20 December, including the alteration of the promissory ----------

promissory notes now appearing to have been made by the corporation. Maughan J was perfectly justified in rejecting the mechanical book entries as sufficient justification and in demanding some distinct reliable evidence of exoneration. ----------

I repeat the appeal is utterly hopeless and hold it should be dismissed with costs.

As to the rest of the order, relieving Barr from the £361/13/4, there was no cross appeal or notice in lieu of it. Application was made by Mr Flannery at the bar to challenge this part of the order, but resisted by Mr Brown. Mr Flannery did not sustain the onus resting on an applicant so tardily seeking to appeal and the Court refused in its discretion to exercise its power to open the ~~quest~~ question.