

OF 1940 No 4

IN THE HIGH COURT OF AUSTRALIA.

In re Lancocks Nurseries
Ltd

McPhar

v.

Mutton

REASONS FOR JUDGMENT.

Judgment delivered at Adelaide
on 27th September 1940

M c P H A I L v. M I T T O N

Order :

Appeal dismissed with costs.

RE LASSCOCK'S NURSERIES LIMITED.

McPHAIL v. MITTON.

JUDGMENT.

RICH A.C.J.

RE LASSCOCK'S NURSERIES LIMITED

McPHAIL v. MITTON.

JUDGMENT.

RICH A.C.J.

The transaction under review in this case is complicated and we found it necessary to reserve our judgment not because the argument left us in any real doubt as to the correctness of the judgment of Napier J. but because an examination of the materials laid before the Court appeared desirable before disposing of the case. I have now had an opportunity of going through the evidence and exhibits and I have re-read the learned Judge's reasons. I have also had the advantage of reading the judgments prepared by Starke J. and Dixon J. with which I agree. It is unnecessary for me to say more than ^{that} I am confirmed in the conclusions (1) that both payments to Lyons and Leader Ltd were made at the instance of the appellant as director of Lasscock's Nurseries Ltd. not for the purpose of promoting the interest or advantage of the latter company but with the object of providing the former company with a profit or advantage and (2) that both payments were voluntary and were not made in discharge of any obligations of Lasscock's Nurseries Ltd. and were not based on any

2.

interest of that company nor reasonably calculated to benefit it and were therefore not incidental to any power in the memorandum of Association and were ultra vires of the directors and the company. Either of these grounds would be enough to support the order of Napier J. In my opinion the appellant McPhail is clearly liable as for a misfeasance and the order under appeal was rightly made. The appeal should be dismissed with costs.

LESSCOCK'S NURSERIES LIMITED (IN LIQUIDATION); McPHAIL V MITTON.

JUDGMENT.

STARKE J.

Appeal from a judgment of the Supreme Court of South Australia made upon a misfeasance summons issued pursuant to the Companies Act 1934-1935 Sec.291.

The judgment declared that the appellant McPhail as a director of Lesscock's Nurseries Ltd. was guilty of misfeasance and breach of trust in directing and permitting the sum of £2770-14-7 belonging to the Company to be paid to S.H. and P.F. Leader in discharge of a memorandum of mortgage which the Company was under no liability to pay or discharge. The judgment also declared that the appellant McPhail was guilty of misfeasance and breach of trust in directing or permitting payment of the sum of £50 to Lyons and Leader Ltd. for services in connection with the formation of Lesscock's Nurseries Ltd. which the Company was not liable to pay. Appropriate orders were made for the payment of these sums to the liquidator of Lesscock's Nurseries Ltd.

About 1922 one Lesscock purchased a nursery garden from one Mellor and in 1925 gave a third mortgage to S.H. and P.F. Leader to secure the sum of £1991-11-11 with interest at the rate of 7% per annum. The mortgage was transferred in 1932 to the National Bank by way of security for advances. Lyons and Leader Ltd. was incorporated in 1937. It took over the business of Lyons and Leader and exercised what was called an option granted to it by S.H. and P.F. Leader over the mortgage held by them over Lesscock's nursery garden. In 1937, Lesscock's Nurseries Ltd. was incorporated. It took over the nursery business carried on by Lesscock and his wife. And it acquired an irrevocable option to purchase the freehold and leasehold land and the buildings and fixtures thereon being the land used by Lesscock and his wife in the business of Lesscock's Nurseries. In 1937, the Company was in need of financial assistance. An agreement

of March 1937 recites that it had requested Lyons and Leader Ltd. to make advances in cash not exceeding £4000 which that Company had consented to do upon delivery of a debenture to secure such advances. The debenture was in the usual form and created a charge, by way of floating security, over its undertaking and all its property and assets whatsoever and wheresoever both present and future including therein the uncalled capital of the Lasscock's Nurseries Ltd. for the time being.

The appellant McPhail was instrumental in the formation of Lasscock's Nurseries Ltd. and Lyons and Leader Ltd. He was a director of Lasscock's Nurseries Ltd. and the Managing Director of Lyons and Leader Ltd. He also held a considerable number of shares in Lyons and Leader Ltd.; about, I think, a third of the share capital.

In March of 1937 the sum of £100 was paid by Lyons and Leader Ltd. to the National Bank of Australasia Ltd., which released the third mortgage transferred to it by way of security. It was reassigned to S.H. and P.F. Leader and discharged. In March of 1937 Lyons and Leader Ltd. also paid to Lasscock's Nurseries Ltd. the sum of £3270-14-7, which in turn paid to S.H. and P.F. Leader £2770-14-7 "in full settlement of the (third) mortgage and interest accrued". Whereupon S.H. and P.F. Leader paid to Lyons and Leader Ltd. the sum of £2670-0-0, which represents, I suppose, assets or credits of S.H. and P.F. Leader taken over from them by Lyons and Leader Ltd.

The point of the misfeasance summons is that the appellant McPhail as a director of Lasscock's Nurseries Ltd. paid or authorised the payment out of the funds of Lasscock's Nurseries Ltd. of £2770-14-7 to S.H. and P.F. Leader in respect of a debt that was not incurred or owing by Lasscock's Nurseries Ltd. to them and for the discharge of the nursery garden, over which Lasscock's Nurseries Ltd. had but an irrevocable option of purchase, from a third mortgage of little value. The object

of these curious transactions appears to have been to finance the nursery garden business and enable Lyons and Leader Ltd. to supervise its conduct, to recoup itself the moneys which had been advanced to Lasscock by S.H. and P.F. Leader or which it advanced to Lasscock's Nurseries Ltd., and, if necessary, to exercise the powers contained in the debenture for that purpose. The accounts show that Lasscock's Nurseries Ltd. repaid from time to time to Lyons and Leader Ltd. various sums of money in respect of the advances made by it. About October 1937 a receiver was appointed under the debenture and he realised assets belonging to Lasscock's Nurseries Ltd. and made payments to Lyons and Leader Ltd. on account of its advances. Substantially, I gather, the whole of the advances made by Lyons and Leader Ltd. to Lasscock's Nurseries Ltd. were thus liquidated. See Transcript pp.187 & 353. McPhail, the appellant, who as already mentioned was a director of both companies, derived a considerable personal benefit from these repayments as a shareholder in Lyons and Leader Ltd. It is impossible in these circumstances to acquit McPhail of misfeasance as a director of Lasscock's Nurseries Ltd. in authorising or permitting the application of its funds in payment of the moneys owing by Lasscock to S.H. and P.F. Leader and in connection with the discharge of the third mortgage given to them. Lasscock's Nurseries Ltd. was under no obligation to pay this sum and the suggestion that the payment was made to relieve the nursery garden of the charge created by the third mortgage is beyond reason. The charge, as I have said, was of little value: the National Bank of Australasia Ltd. was content to transfer it in consideration of £100. The truth is that the payment was not made in the interest of Lasscock's Nurseries Ltd. but in the interest of Lyons and Leader Ltd., in which Company McPhail himself was largely interested.

The payment of £50 to Lyons and Leader Ltd. for services in connection with the formation of Lasscock's Nurseries Ltd.

can be disposed of more shortly. Lasscock and his wife had, by an agreement in writing dated 3rd. March 1927, undertaken to pay this sum to Lyons and Leader Ltd. Lasscock's Nurseries Ltd. was under no obligation to pay it: re Hereford Engineering Company 2 Ch.D. 621; re Rotherham Alum and Chemical Company 25 Ch.D. 103. Both the Articles of Association of the Company and Clause 20 of the 2nd. Schedule to the Companies Act 1934-5 confer authority upon the Company to pay promotion expenses but even this authority does not warrant a payment which is not owing by the Company, and to a Company (Lyons and Leader Ltd.) in which the director authorising or permitting the payment was personally interested. By accepting office as a director, McPhail was bound to exercise the duties of his office with fidelity and in the interest of Lasscock's Nurseries Ltd. But he, it is clear, failed so to act, and consequently was guilty of misfeasance,

The appeal should be dismissed.

re LASSCOCK'S NURSERIES LIMITED

M c P H A I L v. M I T T O N

JUDGMENT

DIXON J.

M c P H A I L v . M I T T O N

The course of Lassock's Nurseries Ltd. was a brief one. Its incorporation took place on 4th. March 1937 and its voluntary winding up commenced on 22nd. November of the same year. The idea of forming the company was conceived by the appellant and he became one of its directors. The ostensible purpose of the company was to take over the business of a nurseryman named Lassock. At the time, Lassock was in embarrassed circumstances. He owned the land upon which he conducted his nursery, but the land was encumbered with three, if not four, mortgages,

and his unsecured debts were not inconsiderable. The third mortgage was valueless. It was a mortgage given to two brothers named Leader to secure a principal sum of £1,291-11-1. With interest, the mortgage moneys owing at that time thereunder amounted to £2,770-14-7 and more. The brothers Leader had carried on a land agency business and they had lodged Lass^cock's third mortgage, among other securities, with their bank to support their overdraft. In the beginning of 1937 a reorganisation of their business took place with the result that one of them joined with the appellant McPhail and a third man to form a company called Lyons and Leader

Limited to carry on business as a land agent. McPhail took up a substantial part of the issued capital. The incorporation of the company took place on 25th. February 1937. McPhail's attention was invited to Lasscock's affairs. He learned of the embarrassed state of his business and of course he came aware of the existence of the mortgage debt to the brothers Leader. At his instance Lyons and Leader Ltd. was given an option to acquire this mortgage from the two Leaders for £100 and an arrangement was negotiated by McPhail with their bank to release the security on payment of the same amount.

The agreements for the acquisition of the nursery business by Lasscock's Nurseries Ltd. were of an unusual kind. For a consideration, to be satisfied in shares, the new company acquired the plant, stock in trade and goodwill of the business but not the land upon which it was carried on and upon which the trees and shrubs were growing. As to the land, the company took only an illusory option to purchase at a price to be arranged. It was claimed that this course had the merit of avoiding stamp duty, but it is difficult to believe that the mortgage debts with which the land was encumbered did not form the real reason. Then the usual undertaking to discharge the debts of the business and to indemnify the vendor does not

appear in the agreement, though it is true that included
among the things ^{acquired} ~~applied~~ by the company there are "debts ~~in~~
due ~~and~~ to and by the vendor." Immediately on the
incorporation of Lasscock's Nurseries Ltd., that company
granted a debenture to Lyons and Leader Ltd. as a floating
security over its assets for advances to be made. Then an
exchange of cheques took place. Lyons and Leader Ltd gave
a cheque for £3,270-14-7 drawn in favour of Lasscock's
Nurseries Ltd: Lasscock's Nurseries Ltd. gave a cheque in
favour of the brothers Leader for £2,770-14-7 : the brothers
Leader gave a cheque in favour of Lyons and Leader Ltd for £
£2,670. The last cheque was paid into the account of

Lyons and Leader Ltd. and so supported the withdrawal of the £3,270-14-7 except as to £600. Of the £600 the brothers Leader retained £100 which was doubtless applied in paying their bank £100 to release the mortgage. The remaining £500 was at the apparent disposal of Lasscock's Nurseries Ltd., but various cheques were drawn at once against it: to reimburse McPhail for a small advance to Lasscock; to repay another temporary advance by Lyons and Leader Ltd., and to pay the first mortgagee some interest under an arrangement by which the first mortgagee agreed to hold its hand for twelve months. Another sum paid there-out to Lyons and Leader Ltd was £50 in discharge of an obligation undertaken by Lasscock in one of

the preliminary agreements to pay that company £50 "for services in connection with the formation of the Company." After all these payments but little of the advance remained for Lasscock's Nurseries Ltd.

The sum of £2,770 was carried to the profit and loss account of Lyons and Leader Ltd. and was reflected in distributions made among the members of that company, including, of course, McPhail.

It clearly was a profit and an intended profit of that company, that is provided that the advance of £3,270-14-7 made to Lasscock's Nurseries Ltd. was repaid. The repayment of that sum was secured by the debenture, and the

security was not found ineffectual. A strict supervision of the Nursery business was maintained by McPhail and by the beginning of October 1937 the amount owing on the debenture had been brought down to £1,971-17-7. On 4th October 1937 a receiver and manager was appointed under the debenture and he, by the sale of stock, a large quantity of which had assumed a chattel form by being placed in pots, and of plant belonging to the business, managed to obtain the whole of that sum for Lyons and Leader Ltd., notwithstanding that the first mortgagee, on learning of the proceedings, adopted measures to enter into possession of the land. A large part of Lasscock's unsecured creditors were left unpaid and he

has been made bankrupt.

Upon these facts the Liquidator issued a misfeasance summons seeking an order that McPhail pay into the funds of the company the amounts of £2,770-14-7 and of £50 representing the payments to Lyons and Leader Ltd. The Liquidator contended, not only that these payments were made without consideration and in discharge of liabilities which the Company had neither incurred nor taken over, but also that the very purpose with which they were made was to advance the interest, not of Lasscock's Nurseries Ltd., but of Lyons and Leader Ltd. and, through that company, of

McPhail himself.

Napier J., who made a thorough investigation of the detailed circumstances of the entire transaction from its inception to its close, upheld this contention, and made an order declaring that McPhail had been guilty of misfeasance in directing and permitting these sums to be paid away and applied in the manner stated, and ordering him, subject to certain conditions, to pay the amounts to the liquidator. McPhail now appeals to this Court from the order.

His case is that his object in forming Lasscock's Nurseries Ltd. was to place Lasscock's business on a sound, or at all events a sounder, footing and so to make it possible for Lyons and Leader Ltd. to make advances which would enable

the carrying on of the business which, as he hoped, would then prove successful; that, as the holder of an option over the land, ~~whatsoever~~ which, whether enforce^eable or not, Lasscock might be relied upon to honour, the Company had a real business interest in the land subject to the mortgage, and not only for that reason but also because the trees, plants and shrubs forming the Company's stock in trade grew upon it, the Company acted properly and within its ~~powers~~ in clearing off the third mortgage and so avoiding the loss of the plants and shrubs which the Company would suffer if the third mortgagees entered into possession of the land.

, In my opinion the ~~XXXXX~~ case so made by the

appellant fails both in fact and in law.

A reading of the materials contained in the appeal book has convinced me that the true explanation of the form into which ~~me~~ McPhail threw the transaction is that he believed that a debenture over the assets of the company would form a good security for at least £3,270 and that, whether the business did or did not prosper, he could rely upon recovering an advance of that amount, provided a valid and indefeasible floating charge could be obtained. In this view the events proved him right. But adopting it, he saw in it an opportunity of converting the valueless third mortgage of the brothers Leader into a valuable asset of Lyons and Leader Ltd. The basis of the advance of £3,270-14-7 was the application of

£2,770-14-7 of that amount in paying off the otherwise valueless mortgage which Lyons and Leader Ltd. acquired for £100 so as to be able to obtain the mortgage moneys in that way.

If Lasscock's Nurseries Ltd. had incurred a liability to the first and second mortgagees by taking a transfer of the land or incurring a contractual liability to Lasscock to indemnify him against the first and second mortgages, then there would have been a grave risk in the company's paying off the third mortgage. But by entering into no contractual obligation in respect of the land and by remaining a stranger to it, the company, though avoiding that risk, left itself without any interest which would justify it in paying off the

the third mortgage. To suggest that the power of the third mortgagees to enter and take possession of the growing trees, shrubs and plants forming part of the stock in trade ~~of~~ gave the company a sufficient interest to justify the payment, disregards the fact that for years the brothers Leader had taken no steps under the mortgage, had treated it as valueless and knew full well that any action on their part would only result in the immediate intervention of the first and second mortgagees. I think therefore that it was a voluntary payment unsupported by any real interest of the company and beyond the powers of the company. But in any case it could not operate to the advantage of the company and McPhail

knew that it could not do so and caused the ~~payment to~~ be made not in order to promote the interests of the company but in order to advance those of Lyons and Leader Ltd.

The small sum of £250 stands in a somewhat different position. Under sec. 35 of the Companies Act 1934 certain powers set out in the second schedule are to be implied in a memorandum of association and these include a power to remunerate any person or company for services rendered in or about the formation or promotion of the company. But, notwithstanding this power, I think that the payment of the sum was in the circumstances a misfeasance, because it was made in discharge of an obligation undertaken or imposed

upon Lasscock and was authorized ~~xxxxxxx~~ not in the interests of the Company or because it was thought a charge fairly and properly incidental to its establishment, but simply in the interests of Lyons and Leader Ltd. in order to increase the amount credited to it against or out of its cheque for £3,270-14-7 and because Lasscock could not find the money.

In the case of each sum McPhail, by authorizing and directing the payment, made himself liable for misfeasance as a director.

In my opinion the judgment of Napier J. is right and the appeal should be dismissed with costs.

JUDGMENTMcTIERNAN J.

I agree that the appeal should be dismissed and have nothing to add.