

Recent Case Law and legislative update in business Law

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TOPICS TO BE COVERED

- [I] *Electronic Transactions Act* and a consideration of what can constitute a signature
- [II] Sale of land and E signatures including a consideration of *Stellard's* case Qld SC [2016].
- [III] E signatures and guarantees
- [IV] Limiting / exemption clauses in an E commerce context
- [V] Franchising: take away lessons from a comparison of *Shah v Hagemrad* [2018] FCA 91 and *Kallin Pty Ltd* [2018] NSWSC 124.
- [VI] Director's duties: a shift from *generally speaking, no obligation* on a director to ensure a corporation performs its duties to third parties; to the *stepping stones* theory under which ASIC can seek the imposition of penalties on directors under whose watch corporations do not fulfil their duties to third parties: is this a pointer to revisiting *Spies* HC?

[I] ELECTRONIC SIGNATURES

1. *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 held that a signature on a contract means a person is, except in the case of deceit or fraud, is bound by what is in it, even if the person has not read it. A signature is thus a powerful thing in commerce—perhaps the cornerstone of commerce, with the handshake being a distant cousin: *Barry v City West Water Limited* [2002] FCA 1214 (mediation—was a matter settled or not?)

see e.g. paras [47] –[49]).

2. Certain types of contracts e.g. those involving interests in land, are required to be in writing and signed by the person to be charged or their agent e.g. s 54A *Conveyancing Act 1919* (NSW); with similar provisions in other states. s 23 *Conveyancing Act* (NSW) is also relevant. In Qld, guarantees also have to be in writing, and signed: see s 56 and 59 of the Qld *Property Law Act 1974*.

Thus, this topic is very important for creditors who wish to obtain the benefit of charging clauses in respect of land, allowing them e.g. to lodge caveats.

3. The *Electronic Transactions Act 1999* (Cth) provides that a transaction under a Commonwealth law will not be invalid simply because it was conducted through electronic communication, and validates the use of electronic signatures.

Each state and territory has its own broadly similar *Electronic Transactions Act*.

An electronic signature is any method of electronically indicating that a person has 'signed' an electronic or online document. A signature on paper, scanned into computer file and inserted into a document, would be an electronic signature. However, a *digital signature* is a type of electronic signature that can be verified using a process that validates and connects the signature to a specific person—there are various technologies commercially available, based on public key infrastructure (i.e. encryption and de-cription).

4. The policy underpinning of the legislation is 'functional equivalence', that is, no discrimination will be made between paper based transactions and electronic transactions, and that a contract that is formed automatically is not invalid, void or unenforceable because there was no human review or intervention, e.g. s 14C of the *NSW Electronic Transactions Act 2000*.

5. “Writing” is defined in the interpretation Acts of the various States e.g. NSW *Interpretation Act* s 21 defines writing to include any mode of representing or reproducing words in a visible form; see further eg Qld, the *Acts Interpretation Act* 1954.

**[II] Sale of land and E signatures including a consideration of *Stellard’s* case Qld SC [2016].
*Contract for the sale of land: can it be made via email?***

6. *Stellard Pty Ltd & Anor v North Queensland Fuel Pty Ltd* [2015] QSC 119 suggested Yes. The defendant advertised the Koah Roadhouse (i.e. the business plus freehold) for sale, & the parties’ respective agents negotiated via email.

The defendant’s agent sent the plaintiff a proposed form of contract via email, setting out the price of \$1.6 m but said it was to be “subject to contract”. The Plaintiff’s agent emailed back, accepting subject to due diligence and also subject to contract. The agent (the son of the director, Drew) intentionally signed off “Drew” by *typing it* (i.e. not a conventional signature).

7. The Defendant found it could get a better price elsewhere, and sought to resile from the arrangement, on 4 grounds:

(a) the alleged offer was not an unconditional offer capable of unqualified acceptance because it was expressed “subject to contract”, (b) the acceptance of the offer was not an unqualified acceptance and (c) the parties did not reach agreement on all material terms and (d) the parties did not manifest an intention to be bound until a written contract in the form of the REIQ standard commercial contract was signed.

“[2] The plaintiffs claim that a contract for the sale of the roadhouse to them was constituted by an email exchange between them and NQF. NQF says that there was no intention to be legally bound by that exchange and, in any event, there is no sufficient

written memorandum or note to satisfy s 59 of the *Property Law Act 1974* (“PLA”).”

8. It was held the contract fell into the first category of *Masters v Cameron* [1954] HCA 72; 91 CLR 353, 360-362 viz the parties reached finality in the terms of their bargain and intended to be immediately bound, but proposed to have the terms restated in a fuller form.

The email was held to meet the requirement for writing signed by a seller in s 59 of the *Property Law Act*. Martin J held that the requirement in s 14(1)(b) was met because the person signing could be *identified* and their *intention* could be established by evidence of various conversations before the email was sent coupled with an admission on the pleadings that the person who sent the email was duly authorised so to do.

HH said as follows at para [68]:

“.....In circumstances where parties have engaged in negotiation by email and, in particular, where an offer is made by email, then it is open to the court to infer that consent has been given by conduct of the other party.”

(citing *Golden Ocean Group Ltd v Salgaocar Mining Industries PVT Ltd* [2011] EWHC 56; [2011] 1 WLR 2575 and, on appeal, [2012] 1 WLR 3674.)

9. The essential point is that it was held that section 14 of the *Electronic Transactions (Queensland) Act 2001* (Qld) could be *supplemented with extrinsic evidence*. Given the trail of emails, the acceptance email contained a ‘signature’, and so there was an enforceable contract for land as it was a ‘*memorandum or writing ...signed*’ by the registered owner or its agent.¹

¹ For those who wish to be reminded more fully of the 3 categories in *Masters v Cameron*, I recommend *John Hillam v JPSF Pty Ltd* [2017] NSWSC 1510; and a brief look backwards to *Australian Broadcasting Corporation v XIVth Commonwealth Games Ltd* (1988) 18 NSWLR 540 at 548.

10. The issue of authority, which had loomed so large in *Stellard Pty Ltd & Anor v North Queensland Fuel Pty Ltd*, arose again, in *John Hillam v JPSF Pty Ltd* [2017] NSWSC 1510. One matter for consideration was whether the typed name of the owner's agent, Ms Mao, could constitute a signature within the meaning of s 9 *ETA*. Even if it could so amount (a matter HH left open), nevertheless, that would not assist the plaintiff, because the ".....email is simply not "recognizable as a note or memorandum of a concluded agreement....": para [276].

Corporations

11. Pursuant to s 127 *Corporations Act 2001* (Cth), a corporation can sign by any method, whilst to s 129 makes certain presumptions of authority. The *Electronic Transactions Act 1999* (Cth) is, however, excluded: Sec 7A(2) of the *Electronic Transactions Act 1999* (Cth) and s. 4 and item 30 of schedule 1 of the *Electronic Transactions Regulation 2000* (Cth). While item 30 refers to the 'Corporations Law', that is taken to include the *Corporations Act 2001* (Cth) under s. 10(b) of the *Acts Interpretation Act 1901* (Cth).

Thus, if a document is electronically signed by the corporation, then the company has to specifically authorize this; alternatively there must be ostensible authority.

E-SIGNATURES AND GUARANTEES

12. NSW Court of Appeal decision of *Williams Group v Crocker* [2016] NSWCA 265 addressed (or perhaps, re-dressed!) the application of a directors' e-signature to an all moneys guarantee.

The Williams Group Australia Pty Ltd supplied building material. One of its customers was IDH Modular, which had set up an electronic signing system for the directors to use, called "Hellofax". Hellofax permitted each user to upload a copy of their signature which could be applied to documents electronically.

This system was set up in circumstances where Mr Crocker, one of the directors, lived in Brisbane whereas the company premises were in Murwillimbah.

Mr Crocker's e-signature was applied to a trade credit application (including a director's guarantee, and purportedly witnessed by the customer's administration manager) in favour of Williams Group. The documents were then returned to Williams Group.

The company defaulted, and Williams Group sought to enforce the guarantees.

Mr Crocker successfully repudiated liability on the guarantee on the bases that:

- a. the e-signature on the "Hellofax" system was appended by an unknown person at the company;
- b. he did not place the electronic signature on the guarantee, nor
- c. did he authorise anyone else to do so, nor
- d. was there any "ostensible authority".

13. Ostensible authority is where a principal represents by words or conduct that an agent has the authority to enter, on behalf of the principal, into contracts within a certain compass. E.g. and speaking from memory, a quaint example in the common law was that in days gone by, a wife was presumed to be able to bind her husband's credit in shopping for household necessities.

There was significant evidence about passwords and who had access to the computer system and what documents were able to be viewed by Mr Crocker; whether Mr Crocker had given authority to anyone to use his signature.

A further issue in the case was whether Mr Crocker had acted with sufficient knowledge of the guarantee so as to *ratify* it; but he prevailed in this regard, as well.

14. *Take away lessons from the case:*

From the perspective of the "applier" of the e-signature: there ought be in place a

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system to ensure the authority has been afforded to the application of the e-signature.

From the perspective of a party such as Williams Group: have a system for checking that the ephemeral but significant e-signature, is what it purports to be. Maybe even pick up the phone and speak to a real, living person to verify this, however heretical that seems in a digital world!

Further, parties in the position of Williams would do well to draw from the lessons of *Commercial Bank of Australia Pty Ltd v Amadio* (1983) 151 CLR 447. The response to that case by financial institutions was to require that a guarantor provided a statement of independent legal advice.

If the amounts of money involved are significant enough, then there is no substitute for dealing face to face or at least, via the 'phone with the relevant person - though a little out of vogue.

EXCLUSION AND LIMITATION OF LIABILITY CLAUSES & UNFAIR TERMS

15. *Take away propositions:*

- a. A properly drawn limitation / exclusion of liability clause will operate according to its tenor –as a matter of contract law;
- b. By and large, exclusion and limitation of liability clauses can be trumped by the *ACL*, with certain exceptions tucked away in the *ACL*, e.g. for carriers and warehouse operators;
- c. The dividing line between direct and indirect/consequential loss is hazy, and subject to the shifting sands of judicial exposition;
- d. Limitation and exclusion of liability clauses will only stand a chance of being binding if brought to the attention of the party to be bound *before* or (latest) *at the time* of contract (but for the exception identified below). They will not be binding if e.g. handed to a customer in a glossy booklet after, say, an account is

opened at a bank (because that is when legal relations arise between banker and customer) and as the customer leaves the branch;

- e. Such a clause may, even if held to be validly incorporated in a contract, be susceptible to being struck down under the unfair contract terms provisions in the ACL.

16. (a) to (c) could occupy a seminar on their own, and time does not permit their consideration here. As such, I will only consider, in this seminar (d) and (e) above, and open for general debate amongst attendees how these principles might apply in an environment of E commerce. The types of matters I wish to raise for debate include:

How can one guard against a contract becoming unwittingly binding in an age where emails between multiple parties, abound?

The pros and cons in an E environment of

- *incorporating general terms by reference e.g. hyperlinking or some similar technology e.g. DropBox or the even more foppish "document vault";*
- *incorporating exempting clauses by reference e.g. hyperlinking etc.;*
- *seeking to incorporate exempting clauses by having them (probably buried) within the usual mind numbingly long terms that pop up when effecting an E agreement.*

17. *In National Australia Bank v Dionys as trustee for the Angel Family Trust* [2016] NSWCA 242, I appeared at trial for Ms Dionys. After a multi-day hard fought trial, the learned trial judge, HH Judge Peter Maiden SC of the District Court, upheld my argument that the Bank had transferred, without authority, about \$0.5m of Ms Diony's money out her account.

18. One of the NAB's arguments was that there was a limitation of liability clause, contained in a booklet handed to Ms Dionys at about the time the account was opened, and as she was leaving the Bank. I never conceded that those terms formed part of the agreement.

19. In the event, HH ordered the money to be re-paid to Ms Dionys. The Bank appealed. A significant issue on the appeal was whether the booklet incorporating the Bank's wide ranging limitation and exclusion of liability provisions, had become incorporated into the contract with Ms Dionys; and as part of that, whether the NAB had taken steps reasonably necessary to such terms to Ms Dionys's attention.

20. Extracts from paras [77] follow:

".....the question of whether a limitation clause is included in a contract and the question of when and by what means the contract was made are closely related..... As I have pointed out, NAB bears the onus of proving that cl 5.18 of the NAB Conditions was incorporated into the agreement between NAB and Ms Dionys.In my opinion, NAB has not established on the balance of probabilities that Mr Ahmad gave Ms Dionys the Booklet containing the NAB Conditions **before** she signed the Authority Card.....

Once Ms Dionys signed the Authority Card and the agreement with NAB was finalised, it was not open to NAB unilaterally to introduce new terms and conditions into the agreement, whether by handing her the Booklet or otherwise.

..... Clause 5.18 is an unusual condition for this purpose because, as I have pointed out, it significantly limits NAB's liability under common law principles and correspondingly curtails Ms Dionys' right_.....

21. If a bank wishes a customer to be bound by unusual or onerous terms in a document, there is no obvious reason why it should not ensure that the document is signed. The customer's signature ordinarily gives contractual effect to the document that it otherwise may not have. In the absence of such a signature, the bank runs the risk that the terms contained in the document will not form part of the contractual arrangements between it and the customer....."

22. In 2016, the Australian Consumer Law (ACL) was amended to extend protection to small businesses in respect of *unfair terms and conditions in standard form contracts*. A term will be 'unfair' if that term:

- would cause a significant imbalance in the rights and obligations of the parties under the contract;
- is not reasonably necessary to protect the legitimate interests of the party advantaged by the term; and
- would cause detriment (financial or otherwise) to a party if it were applied or relied on.

Clauses that might engage these provisions include limitation of liability/ exclusion of liability / entire agreement clauses ; and automatic renewal clauses.

23. In *Meyerowitz-Katz v American Airlines Group Inc trading as American Airlines* [2017] NSWLC 17, the aggrieved consumer (a solicitor) successfully submitted that a limitation of liability clause was unfair within the meaning of the *Competition and Consumer Act 2010* (Cth) Sch 2 (Australian Consumer Law) ss 23-25. Excerpts of the judgment are as follows:

“[61] The International General Rules document is unduly long, complex and poorly formatted. It took the Court more than two hours to read the 98 page document. It is unrealistic to suggest that a customer would read the document prior to purchasing a ticket. It contains substantial information which would be irrelevant to a consumer in the position of Mr Meyerowitz-Katz although the relevance of various terms is only discernible by reading the entire document. The document is in upper case type format throughout which makes it difficult to read. The table of contents is so broad and general that it provides little assistance in guiding the reader to any particular provision. The document fails to use formatted headings to identify the commencement of new sections or to provide numbering to identify different subsections within Rules. Rule numbering does not follow sequentially. Within each chapter of the document the rule numbering recommences at 70. The language used is inconsistent. It refers to the consumer variously as “you”, “him” and

“the passenger”. It is littered with abbreviations, legalistic phrases and industry jargon.

[62] Mr Meyerowitz-Katz fairly describes the impugned term as “buried” within the International General Rules. *In my view only the most obsessive and time gifted consumer would be capable of digging deep enough to uncover the provision.*

[63] Even if a consumer managed to read through the International General Rules and uncover Rule 72 that consumer would be presented with a provision that is poorly drafted and unclear in meaning. The first sentence, as it appears in the document bears repeating:

“FAILURE TO OCCUPY SPACE IF THE PASSENGER FAILS TO OCCUPY SPACE WHICH HAS BEEN RESERVED FOR HIM ON A FLIGHT OF ANY CARRIER AND SUCH CARRIER FAILS TO RECEIVE NOTICE OF THE CANCELLATION OF SUCH RESERVATION PRIOR TO THE DEPARTURE OF SUCH FLIGHT, OR IF ANY CARRIER CANCELS THE RESERVATION OF ANY PASSENGER IN ACCORDANCE WITH PARAGRAPHS OF THIS RULE, SUCH CARRIER WILL CANCEL ALL RESERVATIONS HELD BY SUCH PASSENGER ON THE FLIGHTS OF ANY CARRIER FOR CONTINUING OR RETURN SPACE, PROVIDED SUCH CARRIER ORIGINALLY RESERVED THE SPACE.”

[64] The sentence is a breathtaking 88 words long. The sentence commences with what appears to be a subheading *“Failure to Occupy Space”* which is not separated from what follows. The use of phrases *“occupying space”* and *“continuing or return space”* are not terms of common usage or understanding. *Most consumers would no doubt consider that they are reserving a seat on a plane flight rather than reserving some area of space within the universe.* Instead of making it clear that American Airlines will cancel subsequent flights on an itinerary the provision uses the term *“carrier”*. The Rule extends to *“any carrier”* creating the impression that the provision is a general industry rule rather than a term applicable between American Airlines and its customers.

.....

[66] The assessment of transparency is a comparative process involving degrees of clarity

ranging from crystal clear to mud. In the present case, American Airlines has presented the term in a form that falls squarely into the muddy end of the range.”

24. Some recent cases where similar questions have arisen include:

- (i) *Pacific Resources International Pty Ltd v UTI (Aust) Pty Ltd; Brackley Industries Pty Ltd v UTI (Aust) Pty Ltd* [2012] NSWSC 1274: warehouse destroyed by fire - cause of fire - duties and liabilities of bailee - whether duty discharged-- *whether standard terms and conditions incorporated into contract* - whether standard terms and conditions *exclude liability*;
- (ii) *Crane Distribution Limited v Minnicelli* [2013] NSWSC 1611: Formation - Signed document - Incorporation of terms in another document - Objective test of intention - Construction of contract;
- (iii) *Clark v Electrical Home-Aids Pty Ltd* [2017] NSWCATAP 63: relief in relation to unfair terms Australian Consumer Law (NSW) s 23 and 24 : purchase of a Miele vacuum cleaner. After payment, consumer handed a receipt that recorded
“1. Warranty

(Warranty excludes malfunction caused by misuse, abuse, negligence, accident, normal wear & tear or alteration by any person, filters, replaceable bags & drive belts)”

Limitation of liability, Lord Denning and the Age of Automation: all that is old, is new again

25. *Thornton v Shoe Lane Parking Ltd* [1970] EWCA Civ 2

The free lance trumpeter, Mr Thornton, whose playing was “of the highest quality”, parked his car in Shoe Lane Parking on the way to a gig at the BBC. To get in, he was greeted by an automated red light, which turned green and allowed him to progress to a ticketing machine. He paid his money, and was given a ticket. In small print, there was reference to terms and conditions, which were displayed elsewhere and contained a wide exclusionary clause, including *abrogating statutory rights to compensation for injury*.

Mr Thornton was injured, and sued. Shoe Lane invoked the “ticket cases”, which relied on the fiction that once handed a ticket, the customer could refuse and ask for his/her money

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back. Lord Denning's riposte was as follows:

".....That theory was of course, a fiction. No customer in a thousand ever read the conditions. If he had stopped to do so, he would have missed the boat or the train.

26. None of those cases has any application to a ticket which is issued by ***an automatic machine***. The customer pays his money and gets a ticket. He cannot refuse it. He cannot get his money back. *He may protest to the machine, even swear at it. But it will remain unmoved.* He is committed beyond recall. He was committed at the very moment he put his money into the machine. The contract was concluded at that time. It can be translated into offer and acceptance in this way: the offer is made when the proprietor of the machine holds it out as being ready to receive the money. The acceptance takes place when the customer puts his money in the slot. The terms of the offer are contained in the notice placed on or near the machine stating what is offered for the money. *Thus customer is bound by those terms as long as they are sufficiently brought to his notice before-hand, but not otherwise....."*

27. Lord Denning then rhetorically asked the reader to assume that an automatic machine is a booking clerk in disguise, so that the old ticket cases still apply. In that event, said his Lordship, having regard to the nature of the exempting clause, it was so wide and so destructive of rights that in "...order to give sufficient notice, it would need to be printed in **red ink** with **a red hand** pointing towards it – or something equally startling....."

As an aside, counsel for the defendant was Mr A. Machin.

Exempting clauses and course of conduct

28. Bear in mind that an exempting clause may become incorporated by reference via *a post-contract* course of conduct: para [55] of *Allen Fabrications Limited v ASD Limited (t/as ASD Metal Services)* [2012] EWHC 2213 (TCC).

FRANCHISES, FAKE SALES AND NON-RELIANCE CLAUSES

29. *Take away lessons of the cases below:*

(i) If acting for the purchaser: significant representations on which the purchaser of a business relies in deciding to purchase, ought be reduced to writing. It would be good practice for solicitors acting for purchasers to have a standard form of questions to provide clients, asking *inter alia*

“In your discussions with brokers & officers of the vendor, was anything said to you for example about cash flow, or fit out, or anything else, that was significant to your decision to purchase ? ”

In the marketing material provided, including any financial statements such as profit and loss statements, or summaries of those documents, was there anything really significant to you that made you decide to go ahead with the sale?

(ii) If acting for the vendor: non reliance clauses / entire agreement clauses *may well not* provide protection against proceedings for misleading or deceptive conduct. It would be good practice to convey this to clients as part of standard documentation.

Case studies

30. The sale of a Subway franchise was the subject of consideration in *Shah v Hagemrad* [2018] FCA 91. The central issue was whether the defendants fraudulently represented the sales of the Haymarket branch of Sunway as being 30% higher than they in truth, were, in order to achieve a higher sale price.

31. Clause 2 of the Agreement contained the usual entire agreement / non-reliance provision. This one took the following form:

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“a) The Buyer enters and completes this Agreement solely as a result of its own due diligence, investigations, inquiries and advice.

(b) This Agreement records the entire agreement between the parties as to its subject matter.

(c) Any prior or collateral agreement related to the subject matter of this Agreement is rescinded by this Agreement. The parties release each other from all claims in respect of any prior or collateral agreement.

(d) Any representation not expressly warranted in this Agreement is withdrawn. The parties do not rely upon any representation that is not expressly warranted in this Agreement. The parties release each other from all claims in respect of any representation that is not expressly warranted in this Agreement.

(e) The Buyer will not bring any claim unless it is based solely on and limited to the express provisions of this Agreement.”

32. “[2] The applicants’ claim is based on s 18 of the Australian Consumer Law (“ACL”) rather than the tort of deceit but there is no doubt that the statutory cause of action relied upon, at least as the case was developed at the trial, is founded on the proposition that Mr Hagemrad and Mr Allouche deliberately and dishonestly created fake sales that were included in sales records upon which they knew prospective purchasers would rely.”

33. The vendor’s broker provided the usual types of marketing material, extolling the wonderful position near to Central/ Sydney Uni/ Paddy’s Market etc., fit out and the like.

34. Various types of reports were provided, including the “Combo” report, which was an purchaser’s bible as to financial health, and reported on cash flow and also allowed royalties to be calculated, and the like.

35. In these types of cases, the defendants / respondents seek to explain discrepancies between:

- (i) cash flow as represented in pre- sales marketing material;
- (ii) objective reality, like banking records, obtained only after the sale has closed, and via e.g. discovery.

36. By pointing to aspects of the plaintiff's conduct of the business to suggest sales fell by reason of their (mis) management. In this case, this took the form of suggestions that the absence of out -door seating for some months, and work on the Light Rail project in Haymarket, and re-routing of busses away from the franchise, dragged down sales.

37. There was also an allegation by the respondent that his business partner had been stealing from the business, thus leading to a situation where cash flow was in fact as high as represented, although it might not been recorded opaquely (to say the least) in the financial records.

38. At paras [94] –[100], the Court rejected the vendor's attempts to explain discrepancies in the financial records, finding that true explanation for the cash flow problems experienced by the Haymarket franchise was *the poor trading performance of the business*.
 I am satisfied that this is more likely than not the result of *fake sales*"

“[105] –[106] With regard to “exclusion” or “no reliance” clauses, French CJ observed in *Campbell v Back Office Investments Pty Ltd* [2009] HCA 25; (2009) 238 CLR 304 at [31]:

Where the impugned conduct comprises allegedly misleading pre-contractual representations, a contractual disclaimer of reliance will ordinarily be considered in relation to the question of causation. For if a person expressly declares in a contractual document that he or she did not rely upon pre-contractual representations, that declaration may, according to the circumstances, be evidence of non-reliance and of the want of a causal link between the impugned conduct and the loss or damage flowing from entry into the

contract. In many cases, such a provision will not be taken to evidence a break in the causal link between misleading or deceptive conduct and loss. The person making the declaration may nevertheless be found to have been actuated by the misrepresentations into entering the contract. The question is not one of law, but of fact.

39. In the present case I am satisfied that Mr Shah relied on the Combo Reports notwithstanding what appeared in the disclaimer accompanying the Intro Pack and that he signed a contract (which he understood himself to be bound by) containing the extensive “no reliance” and related provisions found in cl 2.”

40. Compare and contrast the facts and outcome in *Kallin Pty Ltd v ACN 107 851 847 Pty Ltd* [2018] NSWSC 124. The question was whether the defendant – Good Booze t/as Shorty’s Liquor Rhodes – misrepresented sales to the purchaser. In particular, whether significant sales of Shorty’s were made wholesale to another of Shorty’s branches (thus inflating sales levels).

41. The purchaser had harboured concerns about this aspect prior to the purchase; had inspected records, sought comfort from the vendor in this respect. The contract for sale of the business had a variant of the usual non –reliance clause. It was headed “**Records**” and provided as follows:

“The Purchaser acknowledges having had full and sufficient opportunity of inspecting the books of the Vendor relating to the Business and of examining the Business for itself and no warranty as to the Business (other than those in this Agreement), or the takings or outgoings of the Business is given by the Vendor except that the entries in the books are true and correct. The Vendor is not responsible or liable for any representations, specifications and promises of any kind or description other than those expressly made in this Agreement.

There were the usual contested conversations, set out at length in the judgment; and vigorous cross examination and also questions by the judge.

42. The learned judge noted that the plaintiff had put in an offer of 600K to purchase, much lower than the asking price, supposedly in an effort to bring dealings to a close, then continued as follows:

“[53] He was then given the opportunity to buy at not much more, in the knowledge that Coles had made an offer. This was a chance for a bargain which he was not going to let pass.The factors which drove his conduct were the opportunity to get the business instead of Coles and the opportunity to expand the number of Chambers Cellars stores by acquiring a business in that area.”

43. In other words, the court found as a fact there had been no reliance on any representations; and moreover, that the sales by Shorty’s to its CBD stores, was inconsequential in the overall scheme of things, and would have made no impact on the plaintiff’s decision making had it so known at the time.

DIRECTOR’S DUTIES

44. Take away lesson: there is a discernible drift in the law towards expanding the zone of liability of directors; from a situation where it is immensely difficult for a non ASIC applicant to sue a directors for negligently failing to ensure the company meets its obligations; to a situation where ,at the least, ASIC can pursue directors for civil penalties for such conduct. This is called the stepping stones theory of liability.

Consideration and analysis

45. Some of the main duties include to act in the interest of the company as a whole; fiduciary duties (e.g. avoid conflicts of interest); a duty of care, skill and diligence and a duty not to improperly use position or information. The following sections of the *Corporations Act 2001 (Cth)* are pertinent:

Sec 180 -duty of care and diligence. This was centre stage in the *Centro case* of 2011 (*ASIC v Healey*) where directors were held to have breached this provision by approving

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consolidated financial statements which failed to disclose short-term liabilities north of \$1.5 billion. The directors sought refuge in the complex accounting standards of what was considered a “current liability”, but unfortunately for the directors, the deficiencies in the financial statements were facial.

It is thus not so easy for directors to seek refuge behind the audit committee, auditor or management.

Sec 183 - not to improperly use information (see e.g. *ASIC v Vizard* 2005-director of Telstra used confidential information as the basis on which to buy shares).

Section 184 renders it a criminal offence for a director to act recklessly or to be intentionally dishonest in breaching a director’s duty.

Section 588G: Directors have a duty to ensure that a company does not trade if it is insolvent. A company will be insolvent if it cannot pay its bills as and when they fall due (or if a reasonable person would suspect that this is the case). A breach of this provision can result in the director becoming personally liable for debts accrued while the company was insolvent.

Sections 191 through to 195 of the Act establish a duty to disclose material personal interests.

Sections 285 through to 318 of the Act impose financial reporting obligations. These provisions relate to a director’s duty to exercise powers with care and due diligence.

46. *Whites Hill (SA) Pty Ltd v All Commodities Pty Ltd (No 2)* [2107] SADC 9, HH Judge Slattery.

“The High Court has on a number of occasions discussed whether a director is required to have the interest of creditors in mind when making decisions as a director of a corporation. The general rule is now very well settled and may be stated as follows:

1. In general, directors do not attract any liability for a company's breaches of its contract.
2. Directors do not owe a duty to a company's creditors: *Spies v R*.
3. Director's duties under the *Corporations Act* and at general law are owed to the company.

47. In the High Court Decision in *Spies v R* at [93], the plurality said the following on the topic of whether the Court should find that such a duty, simpliciter, is recognised:

... to give some unsecured creditors remedies in an insolvency which are denied to other creditors would undermine the basic principle of pari passu participation by creditors."

48. The plurality held as follows:

[94] In *Re New World Alliance Pty Ltd; Sycotex Pty Ltd v Baseler*, Gummow J pointed out:

It is clear that the duty to take into account the interests of creditors is merely a restriction on the right of shareholders to ratify breaches of the duty owed to the company. The restriction is similar to that found in cases involving fraud on the minority. Where a company is insolvent or nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the shareholders. This restriction does not, in the absence of any conferral of such a right by statute, confer upon creditors any general law right against former directors of the company to recover losses suffered by those creditors ... *the result is that there is a duty of imperfect obligation owed to creditors, one which the creditors cannot enforce save to the extent that the company acts on its own motion or through a liquidator.*

[95] In so far as remarks in *Grove v Flavel* suggest that the directors owe an independent duty to, and enforceable by, the creditors by reason of their position as directors, they are contrary to principle and later authority and do not correctly state the law."

49. In *Tsaprazis v Goldcrest Properties Pty Ltd* [2000] NSWSC 206, the issue arose whether a director of a lessor company had a duty to ensure it did not breach covenants in the lease, and thus to avoid the lessee suffering economic loss. The lessor company (owner of premises) wished to develop a building, from which the tenants ran a restaurant. The tenants had spent considerable amounts fitting out the restaurant.

50. The Court stated the general principle at para 11 as follows:

“[11]In general, only the company is liable under such a contract, not its shareholders or directors, unless they guarantee the company's performance. Directors may become indirectly liable to other contracting parties through breach of their director's duties to the company, or through breach of the Corporations Law relating to such matters as insolvent trading. Consistently with this general approach, directors are not liable for the tort of inducing breach of contract, where, in exercising their functions as directors, they have caused the company to breach its contract.....”

[12] This is not a claim for inducing breach of contract, but has some similarity to it. The relevant elements of the tort of inducing breach of contract would be that the defendant knows of the contract, and with intent to cause a breach procures the party to breach the contract. Here, the alleged elements are that the defendant knows of the contract, knows of circumstances which mean that the plaintiff would be severely damaged by a breach of contract, and contributes to the creation of those circumstances; and then, having the power to ensure that the party did not breach the contract, fails to do so.

[13] In my opinion, the Court should be very hesitant to find a duty of care in this situation. The position of directors in relation to contracts by companies is one where there are very extensive general law rules and statutory provisions as to the responsibilities and liabilities of directors.....

[14]this does not exclude liability of directors in recognised areas of tort, such as trespass, fraud and conversion, for actions done by them on behalf of the company; but

does tend against the existence of a liability based purely on the failure of a director to cause the company to comply with its contract.....

[17] It is possible that a director of a company who takes some positive action, knowing that it will bring about a situation where a person who has a contract with the company will suffer substantially greater loss if the company breaks its contract, could come under a duty to exercise reasonable care to ensure that the company fulfils its contract. The important elements here, I believe, would be the positive action, substantially increasing the vulnerability of the other party, taken in actual knowledge of this effect.....”

Duty to act non - negligently to ensure a corporation complies with its legal obligations: “stepping – stones” theory gains traction

51 .ASIC can pursue *Corporations Act 2001 (Cth)* breaches using *civil penalty proceedings* in relation to breach of director’s duties (particularly the duty to exercise care and diligence) and continuous disclosure violations. Civil penalty proceedings are brought by ASIC and require a lower burden of proof than a criminal prosecution. If a declaration of contravention is made by a court, the consequences can be:

- pecuniary penalties (up to \$200,000 per breach for individuals and \$1million for corporations)
- banning orders from managing corporations for individuals
- compensation orders.

52. As at late 2016, and according to research by King and Wood Mallesons (“K & W M”) and viewed online May 2018 in the two decades that the enforcement option has been available to ASIC there have been 26 decided cases involving alleged breaches of the duty of care and diligence. As at 2012, after the *James Hardie* litigation, which arose from a misleading announcement issued by directors to the ASX upon the re-structure of the group, it became apparent that directors had the following obligations:

- (i) Read all of the board papers, even if it voluminous;
- (ii) Ask questions if clarification is called for;
- (iii) Seek more information if they form the view that such is required in order to arrive at a reasonable decision; and
- (iv) Take reasonable steps to ensure the minutes are materially correct.

53. As Greg Golding , partner of K & W M noted in his November 2016 article, a “particularly potent argument that ASIC has pressed in recent years is that *it is a breach of the duty of care and diligence if a director fails to prevent a company from contravening its legal obligations. This theory is described as the “stepping stones” theory of director liability.*

It is only possible to impose liability on this basis if the director has been negligent in guarding against the company breaching the law.

I have culled and edited summaries of the following cases from various sources, which I hereby acknowledge: *K & W M* online publication of November 2016 (ibid); Clyde & Co online publication of September 2016.

ASIC v Cassimatis (No. 8) [2016] FCA 1023

54. The directors breached their duties of care and diligence owed under section 180(1) by allowing Storm to contravene its financial advice obligations to its clients. This way so even though the directors were the only shareholders of Storm and had approved the conduct as shareholders – the Court considered that the statutory director’s duties perform a public role and cannot be contracted out of.

55. The Court noted that the application of the test involves a consideration of all circumstances including the foreseeable risk of harm to the interests of the company, the

magnitude of that harm, the potential benefits accruing from the director's conduct and the burden to the company of any action to alleviate the foreseeable harm.

56. The Court found that Storm had breached the *Corporations Act* by providing financial services according to the model to the category of vulnerable clients identified by ASIC and the directors had breached their duties of care and diligence because:

A reasonable director of a company in Storm's circumstances and with Mr and Mrs Cassimatis' responsibilities would have been aware of a strong likelihood of a contravention of the Corporations Act if he or she exercised his or her powers to cause or permit the Storm model to be applied to clients who were in a class pleaded by ASIC, particularly investors who were retired or near retirement with few assets and limited income.

57. The Court found that the breaches by Storm were not merely reasonably foreseeable but that a reasonable director in the position of Mr and Mrs Cassimatis would have regarded them as likely. The Court found that the course of conduct by the directors was a single contravention by each of Mr and Mrs Cassimatis and not multiple contraventions consistent with the number of investors who constituted the class of vulnerable investors. ASIC conceded that there had been only one contravention by each of the directors.

58. The Court also found that, while it considered Mr and Mrs Cassimatis acted honestly and "*genuinely held the view that capital loss could never occur with index fund investment in the Storm model*", their conduct would not be excused under s1317S of the *Corporations Act* because of their significant roles and responsibilities and the seriousness of the contraventions by Storm.

59. Penalties were the subject of *Australian Securities and Investments Commission v Cassimatis (No 9)* [2018] FCA 385 (Dowsett J).

ASIC v Padbury Resources

60. Padbury made misleading statements to the market in breach of continuous disclosure concerning the availability of funding to build the proposed Oakajee port infrastructure in WA. The directors breached their duties in permitting that to occur.

3 year banning orders were made, \$25,000 pecuniary penalty imposed , and the directors were ordered to pay ASIC costs \$200,000.

See also the following cases: ASIC v MFS & ASIC v Astra Resources

BUSINESS NAMES: *The retirement of trading names*

After 31 October 2018, the ABN Lookup will cease displaying trading names and will only list & display registered business names. This is in an effort to streamline and make more accurate the process involved in searching for business names, nationally.

As such, those in business in Australia should ensure they have their business name registered with ASIC.

Naturally, the registration of a business name does not equate to trademark protection—that is under the *TMA*.

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