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Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

Dear Mr Kluver

CAMAC Discussion Paper

Shareholder Claims Against Insolvent Companies: Implications of the Sons of Gwalia decision

I am pleased to make a submission in relation to the Discussion Paper and congratulate CAMAC on its effort to address such a complex issue as shareholder claims against insolvent companies.

The decision in Sons of Gwalia Ltd v Margaretic has brought about much conjecture and excitement in the commercial community. It raises a number of implications, both legal and commercial.

This submission is not intended to address each and every aspect raised by CAMAC in its Discussion Paper. Rather, it chooses to specifically focus on understanding the High Court’s reasoning and in doing so, presents an opinion on the decision as a question of law, and on arguments for legislative reform in light of commercial concerns.

In examining the issues raised in the Discussion Paper, this submission will have regard to the following question as its platform of debate,

Should shareholders who acquired shares as a result of misleading conduct by a company prior to its insolvency be able to participate in an insolvency proceeding as an unsecured creditor for any [debt] that may arise out of that misleading conduct?

In summary, the following conclusions are drawn:

(a) The issue presented for decision before the High Court is one of statutory interpretation. On this basis, the decision and reasoning of the majority is supported;

(b) The rule in Houldsworth’s case should, therefore, be abrogated by statute in the present matter; and

(c) The principles in Sons of Gwalia should stand, and the effect should not be reversed.

1 [2007] HCA 1 (“Sons of Gwalia”).
2 As examined by the High Court, and discussed in this paper, a caution is issued to the reader such that the word “debt” may be better substituted with the word “liability”.

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As examined by the High Court, and discussed in this paper, a caution is issued to the reader such that the word “debt” may be better substituted with the word “liability”.
I now turn to each of these conclusions.

The claim in context

The nature and basis of the claim

1. I acknowledge the widely held sentiment that a claim of this nature should not succeed such that it be granted equal standing to that of general creditors. Firstly, however, I am of the opinion that that sentiment should be set aside while a reasonable effort is made to distinguish the High Court’s reasoning in this instance.

2. **Basis of the claim**: The essential issue presented by each appeal concerns the operation of insolvency provisions in the *Corporations Act 2001* (Cth) (“the Act”). It is not necessary for the purposes of this paper to repeat the full facts of the case. Relevantly, the resolution of the difference between the parties depends on whether any debt owed by the company in liquidation to the claimant shareholder is one owed in that person’s “capacity as a member of the company”.

3. The starting point of this examination is a clear appreciation that Mr Margaretic claimed SOG (“the company”) was in contravention of s 52 of the *Trade Practices Act 1974* (Cth), s 1041H of the Act, and s 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth). The basis of his claim therefore was that he was a victim of misleading and deceptive conduct and entitled to compensation.

4. **Nature of the claim**: Any conclusions drawn on this issue depend on the meaning, operation, and interpretation of s 563A of the Act. To elucidate the point of distinction, s 563A requires a line to be drawn between a shareholder claiming in the capacity of a member, and a shareholder claiming otherwise than in such capacity.³ Gleeson CJ reasoned that it was therefore necessary to analyse the nature of the claim, and not sufficient to only describe its effect on other creditors.

5. I support His Honour’s reasons because it is the nature of the claim that discerns Mr Margaretic’s position and, when s 563A is interpreted in this context, is precisely the point to which the High Court is at pains to distinguish. The obligation Mr Margaretic seeks to enforce is rooted in the company’s contravention of the prohibition against engaging in misleading or deceptive conduct; a contravention of federal consumer protection provisions.

6. **Conclusion**: In so far as the claim is put forward in the tort of deceit, it is a claim that stands apart from any obligation created by the Act and owed to by the company to its members. Those claims are not claims “owed by the company to a person in the person’s capacity as a member of the company”.⁴

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³ Per Gleeson CJ at [28].
⁴ Per Hayne J at [206].
Consideration of past authority: framing and reframing the issue

7. The task of construing the relevant provisions of the Act requires attention to be given to past authority and the legislative history, and it is relevant to offer a summary at this point. At the risk of repeating reasons well set out in the various judgments, I wish to briefly establish a background so that the overall issue can be properly understood in context.

8. Framing the issue: It is perhaps best to begin with the principle set down in Houldsworth v City of Glasgow. The House of Lords laid down the principle that a person who subscribed for shares cannot recover damages from the company in an action in deceit for the misrepresentation which induced them to take the shares. Their remedy is to rescind the allotment and obtain restitution of their subscription money. The rule applies whether or not the company is in liquidation.

9. In other words, a member who has not rescinded the allotment cannot, while the company is a going concern, bring an action in damages against the company: In re Addlestone Linoleum Company. Nor can they be admitted to proof if the company is being wound up: Oakes v Turquand; Tennent v City of Glasgow Bank. Indeed, as these cases show, once the winding up has commenced the right to rescind, and therefore the right to claim damages, is forever lost: Webb Distributors (Aust) Pty Ltd v State of Victoria. It makes no difference that the liquidator has sufficient asset to pay creditors in full: In re Hull and County Bank.

10. As noted by Justice Jacobson, the authority which exposes the conundrum at the heart of the differing views is the decision at first instance and on appeal, In re Addlestone Linoleum Company. What Addlestone shows is that the claim was brought by the shareholders in their capacity as members because the terms of their contract bound them to pay the call which was applied toward payment of creditors. It was therefore, a statutory obligation to contribute assets to a fund to be applied to meet the debt of creditors and to adjust the rights of contributors or members. It was the price for which the shareholders purchased limited liability. As the matter pertained to statute, Kay J held that the claim was excluded by subsection 38(7) of the Companies Act 1862 (UK), which was in similar terms to paragraph 360(1)(k) of the Companies (Victoria) Code.

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5 (1880) 5 AC 317 ("Houldsworth").
6 Sons of Gwalia Limited (Subject to Deed of Company Arrangement) v Margaretic [2006] FCAFC 17 (Finkelstein J, 12).
7 (1887) 37 Ch D 191 (“Addlestone”). In this case, shares were issued at a discount of £2 10s. On liquidation, a call was made for the £2 10s and some of the shareholders sought to prove in winding up for damages in the amount “for breach of contract or otherwise” in respect of the shares.
8 (1867) LR 2 HL 325.
9 (1879) 4 AC 615.
11 (1880) 15 Ch D 507.
12 Sons of Gwalia Limited (Subject to Deed of Company Arrangement) v Margaretic [2006] FCAFC 17 at [117].
13 Ibid at [121].
11. *Addlestone* was distinguished by the House of Lords in *Soden v British and Commonwealth Holdings Plc*. In *Soden*, Lord Browne-Wilkinson observed [at 323] that s 74(2)(f) of the *Insolvency Act 1986* (UK), which is similar in terms to s 563A of the Act, requires a distinction to be drawn between on the one hand, sums due to a member in his or her character as a member by way of dividends, profits or otherwise, and, on the other hand, sums due to a member otherwise than in that character. Sums due in the character of a member must be sums falling due under the statutory contract. To that bundle of rights and liabilities, his Lordship said, must be added the rights and obligations imposed on members under the *Companies Act 1985* (UK).

12. The rationale for this distinction was to ensure that the rights of members as such do not compare with the rights of the general body of members. This is a key argument brought before the courts in *Sons of Gwalia* and represents the broader commercial concern. However, the principle in *Soden* is not that members come last, but that a member having a cause of action independent of the statutory contract is in no worse position than other creditors. This construction was said to be supported by the words “by way of dividends, profits or otherwise” which illustrate what constitutes sums due to a member in that character [at 323-324]. His Lordship observed, [at 325], that if there was a cause of action in *Addlestone* it must have been based on the statutory contract.

13. Moving to Australia, it has been held that the principle set down in *Houldsworth* will defeat actions in deceit by subscribing shareholders. The issue seems first to have arisen in *Re Dividend Fund Incorporate (in liq)* where the Houldsworth principle was applied to a claim against an unlimited liability company. To distinguish *Sons of Gwalia*, it is interesting to note in *Dividend Fund* that the trial judge found the rule established in *Houldsworth* applied only to unlimited liability companies, and the shareholders were not precluded from maintaining an action (against the company) for damages.

14. On appeal in *State of Victoria v Hodgson*, the trial judge’s decision was not favoured by Tadgell J who said, “…the principle of limited liability leads inevitably to the conclusion that a member…cannot prove in the winding up for damages designed to indemnify him for loss sustained in subscribing for share capital to the company” at [627]. Accordingly, shareholders were precluded from proving for damages in a winding-up. The case then went to the High Court as Webb’s case.

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15. See above n.12 at [128].
16. See also, *Sons of Gwalia*, affirmed in the reasons of Gleeson CJ at [19]; cf reasons of Kirby J at [118].
17. The concept of statutory contract was discussed by McHugh and Gummow JJ in *Bailey v New South Wales Medical Defence Union Ltd* (1995) 184 CLR 399 at 443-440. Lord Browne-Wilkinson concluded that an amount owing to a member in the character (capacity) of a member was an amount falling due under and by virtue of what he described as the statutory contract. To that his Lordship added, [at 325], “claims based upon having paid money to the company under the statutory contract which the member says that he is entitled to have refunded by way of compensation for misrepresentation or breach of contract”.
19. The principle is set out at paragraph 2.3.1 of the Discussion Paper.
20. *Sons of Gwalia Limited (Subject to Deed of Company Arrangement) v Margaretic* [2006] FCAFC 17 (Finkelstein J, 19).
21. [1992] 2 VR 613, 627 (“Hodgson”). The appeal was brought before the Appeal Division of the Supreme Court of Victoria.
15. In context of the operation of s 360 of the Companies (Victoria) Code (the provisions of the Code were based on s 38 of the Companies Act 1862 (UK) (the first modern companies statute) (“the 1862 UK Act”), Webb concerned whether the claims shareholders sought to make were admissible to proof in the winding up. The majority in Webb acknowledged [at 28] that the conclusion reached by Tadgell J in Hodgson was underpinned, in part, by the principle that in return for limited liability, share capital could not (except as permitted by statute) be returned to the shareholder but had to be applied only in the legitimate course of the company’s business. The Court held in Webb that the provisions of s 360 of the Code precluded the shareholders from rescinding the contracts under which they acquired their shares and precluded them from maintaining an action for damages in respect of that acquisition.

16. Reframing the issue: The claim for damages in Webb was brought against the building society as a consequence of a breach of contract between the member and the building society. The basis of the claim for damages in Sons of Gwalia was not breach of contract, but the company’s breach of federal consumer protection provisions. It is necessary to distinguish Sons of Gwalia because the issue must be reframed in light of the reliance placed on past authority by the first and second appellants.

17. The real point on appeal is whether Mr Margaretic’s claim was brought in his “capacity as a member” of SOG.

18. Conclusion: A study of past decisions may be helpful, by analogy, to a court applying the relevant statutory provisions to the case in hand. However, in the current matter, when considering the issue in its reframed form, what is involved, as Kirby J states [at 117], “is the unpacking of the meaning of s 563A of the Act and, in the end, nothing else.”

A statutory question

19. Construction and interpretation: I support the view of the Court that the issue presented for decision was a matter of statutory interpretation. The purpose of the applicable statutory provisions must be interpreted in the context of the claim and a wider consideration of the purpose of s 563A is necessary. Relevantly, it is the duty of the High Court to give effect to the provisions of that section.

As Kirby J said,

The ultimate duty of a court in a case of this kind is to give effect to the meaning of

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22 Trevor v Whitworth (1887) 12 AC 409. The case stood for the proposition that this principle was the dominant principle of the 1862 UK Act. For completeness, the second line of authority established that once a winding-up has commenced a shareholder cannot rescind his contract to subscribe for shares because otherwise the rights of innocent third parties (creditors and contributories) would be defeated: see Oakes v Turquand (1867) LR 2 HL 325, Stone v City and County Bank, Limited (1877) 3 CPD 282 and Tennent v City of Glasgow Bank (1879) 4 App Cas 615.

23 Per Hayne J at [189].
the law as expressed by the Parliament. That meaning is ascertained from the language of the enactment. But it is also ascertained by reference to the context in which the provision in question appears and by perceptions that may be derived from that context, the legislative history and the apparent policy of the Act [at 109].

20. Resort must be had to the fundamental tenets of construction which will better maintain coherence in the law and promote fairness.24 I agree, but, with respect, I do not believe the majority would have intentionally set out to interpret s 563A so as to produce an unfair or incoherent result at odds with Parliament’s intention. In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act shall be preferred to a construction that would not promote that purpose or object.25 Where a statutory problem is proffered for resolution, the High Court has insisted that analysis must commence and finish with the text of the legislation.26

21. While persuasive arguments can be mounted in support of alternative interpretations, I do not share Justice Callinan’s opinion, having regard to the legislative history of s 563A of the Act that, “the contextual indications are more than mere straws in a breeze sighing in SOG’s direction.”27 In this instance, I am firmly of the view that it is necessary to examine the words of s 563A in their context and, to give effect to their meaning the analysis must, as Kirby J notes, “…proceed, not only be reference to the words of the statutory provision but also by reference to the object and purpose of those words” [at 116].28

22. A wider legislative reading: Following a history of legislative amendments, s 563A of the Act now has a wider reading than its predecessors in the Companies Act 1961 (WA), that contained a number of provisions largely based on s 38 of the 1862 UK Act, and later the Corporations Law of Western Australia. Amended by the Corporate Law Reform Act 1992 (Cth) (“the 1992 Act”), s 38 of the Companies Act was disassembled and substantial alterations to the legislative provisions governing external administration of companies was made.29 It is the changes to the winding up provisions which are of significance to the present matter.

23. The 1992 Act severed the connection between the statutory identification of debts and claims admissible to proof in a winding up, and the classes of debts admissible to proof in bankruptcy.30 Relevantly, it repealed s 525 and s 553 of the Companies Act. However, the 1992 Act inserted two new provisions concerned with what it identified as “debt[s] owed by a company to a person in the person’s capacity as a member of the company.”

24 Per Callinan J at [227].
25 Acts Interpretation Act 1901 (Cth), s 15AA(1).
26 See, for example, Central Bayside General Practice Association Ltd v Commissioner of State Revenue (2006) 80 ALJR 1509 at 1528.
27 Per Callinan J at [242].
28 See also, Kingston v Kenrose Pty Ltd (1987) 11 NSWLR 404 at 423 per McHugh JA approved Bropho v Western Australia (1990) 171 CLR 1 at 20.
29 For example, it introduced administration and deed of company arrangement provisions of the kind to which SOG was later to resort.
30 Per Hayne J at [160]. Under the provisions of the Corporations Law as they stood before the 1992 Act, the claims now made by Mr Margaretic would not have been admissible to proof in the winding up in SOG.
They were s 553A and s 563A. These provisions are in the same terms in the Act as they were under the 1992 Act amendments. Provision was made by the 1992 Act for the condition on which a debt might be admitted to proof, for the priority to be afforded to the satisfaction of such debts, and it dealt with “payment of debt owed by a company.”

24. The Act followed the drafting set by the 1992 Act, not only in relation to the prescription of the debts and claims admissible to proof in winding up, but also in relation to the separate provisions made in respect of a debt to a person in that person’s capacity as a member of the company.

Debt or claim

25. Wording of the provision: The wording in s 563A, “in the person’s capacity as a member of the company” defines the particular kinds of obligations that are to be postponed. That is, it identifies the particular kinds of “debt owed by a company” to which particular consequences are attached. The words “by way of dividends, profits or otherwise” are more readily seen as examples of the kinds of obligation in question, rather than words limiting or defining the obligations.

26. However, to the extent that the Parliament has identified the kind of “debts” owed, the wording of s 563A suggests that what is involved in the postponement are sums constituting the ordinary revenue (and possibly the capital) of the company, and not claims of an extraordinary and exception kind for false and misleading conduct. As Kirby J remarks, if the phrase “or otherwise” is contrasted *ejusdem generis* with the immediately preceding words, unliquidated claims for damages for misleading and deceptive conduct do not fit comfortably with debts such as “dividends” and “profits” which normally inhere in the ordinary operation of the company as such.”

27. Distinguishing between a debt and a claim: Nevertheless, the focus for decision must be placed on the character of the “debt” allegedly owed to the respondent. As Gleeson CJ notes, [at 6], “The existence of a liability is the hypothesis upon which [s 563A] proceeds.” Standing alone, the phrase “or otherwise” would be broad enough to include a “debt” owed by a company pursuant to a claim for unliquidated damages for proof of misleading and deceptive conduct giving rise to remedies under the specified federal legislation.

28. Aside, it is important to also interpret (and apply) the wording of the Deed of Company Arrangement. Clause 1.1 defines “creditor” to mean “any person who has or asserts a claim”. The term “claim” is defined in language based upon the provisions of s 553(1) of

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31 Per Hayne J at [165].
32 Ibid at [167].
33 Ibid at [201].
34 Per Kirby J at [124-125].
35 Where general words follow particular words, then general words will then be contrasted as being limited to the same kind as the particular words. Parties may exclude the operation of the rule by using appropriate language.
36 Per Kirby J at [124].
the Act. It includes a “debt” and a “claim” against the company, present or future, certain or contingent of sounding only in damages.

29. It was common ground that Mr Margaretic’s claim fell within s 553 of the Act, which would be imported into the Deed\(^{37}\) and it follows that Mr Margaretic was a “creditor”. This is a poignant distinction to make because Mr Margaretic had a provable “claim” in damages as a member. It was not the case that a “debt” was “owed” by the company to him in his “capacity as a member”. Mr Margaretic’s claim was framed such that he never intended to seek recovery of any paid-up capital or to avoid any liability to make contribution to the company’s capital. In this sense, his membership of the company was not, as such, definitive of the capacity in which he made his claim.\(^{38}\)

30. The majority of the High Court held that s 563A of the Act did not therefore operate to postpone the debts owed to shareholders with claims against the company for misleading or deceptive conduct. Part of the Court’s reasoning as to why this claim was not caught by s 563A, as CAMAC notes, was that it was based on statutory protection provisions which are not restricted to members of a company.\(^{39}\) Thus, membership of the company was not essential to the claim.

31. **Conclusion:** The question before the court, as it was in Soden, is better asked as ‘is there a debt owed by a company to a person in the person’s capacity as a member of the company, whether by way of dividends, profits, or otherwise’?\(^{40}\) For the reasons given above, that question should be answered ‘no’.

**Abrogation of the Houldsworth principle**

32. It follows that the rule in Houldsworth has been abrogated for subscriber claims against a company in liquidation given s 563A exhibits a legislative intention to exclude the rule in a winding up.\(^{41}\) For the reasons set out above and below, I am of the view it is necessary that this be the case.

33. **Does the common law accord with the legislation?:** Any presumed general subordination of shareholder claims on the assets of an insolvent company to the claims of general creditors, must give way to the true meaning of the legislation that actually governs the case.\(^{42}\) In this instance, as Kirby says,

> If any general presumptions do not accord with the legislation, properly construed, it is the legislation that must prevail for it expresses the parliamentary command. Statutory interpretation is ultimately, always, a text-based activity [at 117].

\(^{38}\) Ibid at [106].
\(^{39}\) Discussion Paper, at para. 2.2.1
\(^{40}\) Per Hayne J at [192].
\(^{41}\) Discussion Paper, para. 2.3.2.
\(^{42}\) Per Kirby J at [117].
34. The arguments advanced in support of, or in opposition to, the admissibility of such claims to proof were based on what was said to be the common law rule in *Houldsworth’s* case, and whether that rule had received statutory recognition in the Companies (Victoria) Code. The arguments of the appellants are by no means meritless, but it is interesting to note, notwithstanding the recognition *Houldsworth* attracted, that the parties in *Webb*, as was the case in *Sons of Gwalia*, placed *Houldsworth*, not the applicable statutory provisions, at the forefront of their arguments.

35. As Hayne J remarks, [at 188], in reference to reliance on past authority, this “reveals the difficulties implicit in taking the state of judge-made law in the field as the starting point for consideration of issues” of the kind considered in *Webb* and indeed *Sons of Gwalia*. His Honour further states,

> Neither *Webb* nor *Houldsworth* established any common law “principle” that no shareholder, no matter how the shares were acquired, can have a claim of the kind now in issue against a company whose assets were to be administered as on a liquidation [at 190].

36. The asserted common law “principle” could not deny the operation of the relevant federal consumer protection and investor protection provisions. None of the considerations in *Webb* or *Houldsworth* is relevant to the present matter where there was no contract for subscription for the acquisition of shares made by the shareholder, Mr Margaretic, and the company, SOG.

37. The relevancy of the so-called *Houldsworth* principles was earlier brought to light by Justice Gummow. His Honour remarked,

> Neither the “principle” attributed to *Houldsworth*, nor *Houldsworth* itself, had anything to do with the presently relevant provisions of the Act and the Code. Section 360(1)(k) of the Code cannot have been enacted on the basis that *Houldsworth* represents an “entrenched rule of company law” which must be regarded as having been “expressly considered and approved” by the legislature. The origins of s360(1)(k) may be traced to the 1862 UK Act, which preceded *Houldsworth* [at 86].

38. Mr Margaretic’s claim is not a future or contingent claim or debt, but a certain claim framed under statute. The matter is, as has been discussed, a decision of statutory construction and cannot therefore be decided on principles of general law. Whether the claim against SOG is admissible to proof in the winding up of the company depends, and depends only, upon the relevant provisions of the 2001 Act. Because the statutory definition of claims admissible to proof on a winding up was changed in 1992, past authority decisions do not dictate the outcome in the present matter.

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43 Per Hayne J at [182].
44 Per Hayne J at [188]. See also the remark of Kirby J at [104].
45 Per Hayne J at [190].
46 I refer here to the temporal limits of s 553 of the Act.
47 Per Hayne J at [192].
39. Lastly, it remains necessary to consider reasons for either retaining or reversing the High Court’s decision.

Legislative reform

40. CAMAC has invited respondents to comment on whether the rule in *Houldsworth* should be abrogated.\(^{48}\) As the answer to that question is ‘yes’, the question that then arises is whether a change in the law should be supported\(^ {49}\) to restore what was regarded as a settled position in respect of shareholder claims against companies in liquidation post *Webb*.

Policy

41. *Policy objective:* In acknowledging the call for reform, it is important to carefully weigh up the appropriate balance between giving force to consumer protection provisions for shareholders and the practical implications for insolvency law.\(^ {50}\) If the Parliament concludes that the interpretation adopted by the Federal Court, now confirmed by the High Court, strikes the wrong balance, it can easily repair the defect by amending s 563A of the Act.\(^ {51}\)

42. *Policy concerns:* A key commercial concern that arises out of the decision is that the ability to bring such claims is inconsistent with the policy objectives of Part 5.3A of the Act, which operates as a successful mechanism for reorganising insolvent companies. This concern is recognised by Justice Kirby [at 109] who, in obiter, remarks that if one were to give effect to a presumed general policy of s 563A of the Act, it would not be surprising to conclude, consistent with the language and purpose of the Act, that it operated to postpone claims such as the respondent’s entitlement to recovery to those of general creditors.

43. On the one hand, for instance, extending the range of claims by shareholders is likely to be at the expense of ordinary creditors, and legislation that confers rights of damages upon shareholders necessarily increases the number of potential creditors in a winding-up.\(^ {52}\) Two points are worth noting here. Firstly, the notion such claims as per the present case would be at the “expense” of ordinary creditors and, secondly, the decision of the High Court, if not reversed, will open the flood gates to the number of potential creditors in a winding up. The key concern underpinning these arguments is the risk that, by allowing such shareholder claims, the pool of funds (albeit capital) available to firstly satisfy debt obligations owed by the company to ordinary creditors would be diluted.

44. As was argued in *Hodgson*, it may be contended that the decision in *Sons of Gwalia*, in allowing shareholders to prove such claims in competition with conventional unsecured creditors, is inconsistent with the notion of limited liability. It also raises the notion of

\(^{48}\) Discussion Paper, para. 2.5.
\(^{49}\) See Discussion Paper, Ch 7.
\(^{50}\) Discussion Paper, para. 2.2.2; cf Gleeson CJ at [18].
\(^{51}\) Per Kirby J at [133].
\(^{52}\) Per Gleeson CJ at [18].
unfairness, not only as between shareholders and ordinary trade creditors but also, as Callinan J points out, between shareholders themselves.

45. To deny the equality of a claim such as Mr Margeretic’s however, is to deny, in these circumstances, a rightful and certain claim under the Act. Recalling that the decision before the High Court was not one of common law principle, but one of statutory interpretation. Although the present claim was not found to be a conventional “debt” owed by the company to Mr Margeretic, s 553 and s 563A of the Act do not operate to automatically preclude the claim. Here, we have the coexistence of two types of liability. Again, with reference to the Deed of Company Arrangement we have a “claim” (for damages), and also a “debt”, admitted to proof in winding up SOG.

46. It may however be fruitful to further pursue narrow factual distinctions of this kind because, as Gummow J remarks,

   Unless the means by which a person became a member (that is, by acquiring shares by subscription or by transfer) is relevant to the characterisation of the “debt” owed by the company to the person as one owed to the person in his or her capacity as a member or not, the distinction is difficult to maintain as a matter or principle [at 52].

47. Nevertheless, the High Court found that Mr Margeretic was not claiming in his capacity as a member. This conclusion is critical to advancing the argument that the claim should not be subordinated. In this sense, while I acknowledge arguments for the claim as being ‘unfair’, I do not think, for the reasons set out above, the argument is a persuasive one. With regard to the decision opening the flood gates, I also hold the opinion that the argument is not particularly convincing. When properly thought through, shareholders who have held their shares in ignorance of the true position of the company must, as did Mr Margeretic, prove that at the point in time the shares were acquired, reliance was placed on the information disclosed to the market.

48. They must be able to successfully prove, at that point in time, that the company was in contravention of the consumer protection and investor protection provisions and that they were a victim of misleading and deceptive conduct and entitled to compensation. Similarly, the decision before the Court would be one of statutory construction.

49. I do not agree that the present matter should rest on the principle that the company’s share capital represents a “guarantee fund” and protection to creditors which should not be returned to shareholders other than on a permissible reduction of capital. It is a basic policy objective of the insolvency laws in this country to comprehensively deal with all debts and liabilities of the insolvent company. As the Report of the Australian Law Reform Commission on the General Insolvency Inquiry (“the Harmer Report”) sets out, “[i]n the case of a company, the aim is to deal with all the claims against a company so

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53 Per Callinan J at [256]. See also, Kirby J at [105].
54 Webb’s case at [32-33].
that its affairs can be fully wound up…”, otherwise, “if the creditors are unable to make
their claims in the insolvency, they are unable to recover at all.55

50. Despite a show of sympathy for the appellants’ case, it was not the view of the majority
of the High Court that the language of s563A reflects an intention on the part of the
Parliament to postpone all shareholder claims until the debts owed to creditors had been
satisfied, only their claims in their capacity as “members”. It can be assumed that the Act
was intended to effect only a limited subordination of claims brought by people who
happen to be shareholders.56 In the present matter, these reasons favour the respondent.

51. As a question of law, and in keeping with the policy objectives of the insolvency
provisions of the Act, I am of the view that a claim of the nature of Mr Margaretic’s
claim should not be postponed, but recognised as a valid claim against the company in
winding-up and ranked equally with unsecured creditors.

International provisions

52. As Justice Kirby notes, [at 128], in matters of basic principle in the law of corporate
insolvency it is increasingly important to consider the legal provisions applicable in the
major countries with which Australia conducts its trade. As set out in the Discussion
Paper, [at paras. 6.2 to 6.4], it is relevant to repeat here the provisions as they stand in the
United Kingdom, United States and Canada.

53. United Kingdom: The position in the United Kingdom is consistent in effect with that in
Australia as determined in the Sons of Gwalia decisions. The UK Companies Act was
amended in 1980 abrogating the rule in Houldsworth. It makes it clear that shareholders
are not to be precluded from claiming against a company in their capacity as creditors.
Section 111A of the UK Companies Act 1985, now s 655 of the UK Companies Act 2006,
provides that,

A person is not debarred from obtaining damages or other compensation from a
company by reason only of his holding or having held shares in the company or any
right to apply or subscribe for shares or to be included in the company’s register in
respect of shares.

Subsequently, in Soden, the House of Lords, in interpreting the UK equivalent of s 563A
of the Act, concluded that claims such as the type brought by Mr Margaretic, ranked
equally with conventional unsecured creditor claims.

54. United States: In the United States, s 510(b) of the US Bankruptcy Code specifically
postpones claims arising from the purchase or sale of securities behind those of
unsecured creditors in a liquidation. The relevant part of the provision states,

For the purpose of distribution [in an insolvency], a claim … for damages arising

[774 and 777].
56 Per Kirby J at [133].
from the purchase or sale of [securities] … shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security …

55. *Canada:* Corporate restructurings under Canada’s insolvency regime are governed by the provisions of the *Bankruptcy and Insolvency Act*, however, there are as yet no statutory provisions dealing specifically with claims of the nature examined. As a matter therefore of general law, Canadian courts have adopted the approach of subordinating such claims in an insolvency. An Amendments to the *Bankruptcy and Insolvency Act* and *Companies’ Creditors Arrangement Act* have been proposed that would be consistent with the US position.

**Reform or not to reform?**

56. I am of the reasoned opinion that Parliament should not amend the legislation, and that the effect of *Sons of Gwalia* should stand. I will briefly say why.

57. *US drafting was not adopted:* The issue brought to bear in *Sons of Gwalia* has not been examined by the High Court since its decision in *Webb*. Until this time, it was widely regarded that a claim such as Mr Margaretic’s would be subordinate to conventional unsecured creditors. The High Court has now turned the page and decided otherwise, yet, all the while, had it been the purpose of the Parliament in Australia to adopt a general principle postponing, to the claims of general creditors, claims of the nature in the present case against a company which becomes insolvent, it would have been relatively easy for that purpose to be given effect in the Act. This was not done.

58. Had it have been the purpose of Parliament to deal expressly with such claims, then it was open to it to the drafters to have copied the drafting of the US Bankruptcy Code, but it did not. Instead, as set out briefly above but in detail in Justice Hayne’s judgment, s 563A derives its drafting from UK statutory provisions. Why would the Parliament now settle on US drafting?

59. *Principles must be upheld:* I do not favour the US position for several reasons. I am of the view that it is not in keeping with the policy objectives of Australian insolvency laws, I do not find favour with the reasoning on which its general law is premised, and I do not share the views of its legal commentators (which go to policy). In *In re Telegroup, Inc,* and in *In Re Worldcom,* for example, the courts seem readily apparent to conclude that shareholders should bear the risk of any illegality in the issue, therefore the acquisition, of their shares. In other words, setting aside insolvency, this reasoning suggests that a shareholder should suffer the injustice of a company’s misleading corporate conduct affecting their shares (albeit though an action may be able to be brought against individual directions of the company). I am of the opinion that this is at

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58 Per Kirby J at [129].
60 (2005) 329 BR 10 (Bankr SDNY, 2005).
complete odds with the fundamental objective of Australia’s federal consumer and investor protection laws; justitia non est neganda, non differenda.

60. I acknowledge that neither should an unsecured creditor bare the loss in this instance, but why would the two competing claims not be regarded as equal? I do not accept the commercial arguments given in support as sufficient enough reason. US legal commentators for example would have you believe that this gives investors, who should apparently bear the risk of illegal corporate conduct, the best of both worlds. Recalling that in Sons of Gwalia Mr Margaretic did not bring his claim in his capacity as a “member” (and his action was for a breach of the consumer protection provisions). It was not a claim for unpaid dividends for example as would otherwise be postponed under s 563A.

61. This, I believe, sets his case apart from the assumption that he ought to be regarded as a longer-term shareholder waiting in the wings, so to speak, for a (retrospective) opportunity to file a claim which if successful would only serve to dilute the paid-up capital of the company in winding-up. If that were the case, then I would argue his claim should not succeed and thus s 563A ought to be amended. However, this is not the case. Mr Margaretic’s membership of the company was not definitive of the capacity in which he made his claim. In other words, mere membership of the company was not essential to the claim. The obligations he sought to enforce arose, by virtue of the company’s conduct, under federal consumer and investor protection laws.61

62. In the present matter we are dealing with a case where a company, in liquidation, was in breach of federal law, and an injustice caused as a result of its unjust conduct. Mr Margaretic’s claim was a present and certain claim, and ought to be recognised as an equally ranked liability alongside the claims of unsecured creditors.

Conclusion

63. For these reasons, I cannot set aside the principle of the matter and conclude that s 563A should be amended to favour the US position. I do not support Option 2 as proposed. It follows that I do not also favour the Canadian position.

64. Option 1, as proposed, should therefore be adopted.

65. However, as a derivation to Option 1, I suggest that if the Parliament were to consider redrafting s 563A of the Act so as to clarify its limits, then it should do so by giving further effect to the UK provisions.

66. If, in the event, the Parliament determines that s 563A is to be amended such that it favours US drafting, then I would support proposed Option 3.

61 Per Gleeson CJ at [31].
Fraud on the market

67. For the reasons given above, it is not necessary to consider an alternative ‘fraud on the market’ approach to investor protection.

Concluding remarks

68. I have endeavoured to explain that if one closely examines the High Court’s reasoning, and fully recognises the principle of the matter as a question of law, policy, and ethics, then the conclusion reached is, for all intensive purposes, quite a logical and well reasoned one. In the end, it concludes that a claim such as Mr Margaretic’s, against a company in liquidation, should not be subordinated but stood equal with conventional unsecured creditors.

69. I urge Parliament to publish detailed reasons of its grounds for legislative reform, if that is the path chosen, before further opinion is given.

I thank CAMAC for the opportunity to make this submission, and I am keen to contribute to further discussion on the issues raised in the Discussion Paper. If any further information is required in relation to this submission please contact Duncan Brakell as per below.

Yours sincerely,

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