

**SONS OF GWALIA LTD v MARGARETIC; ING INVESTMENT MANAGEMENT
LLC v MARGARETIC
[2007] HCA 1 (31 January 2007)**

Case Review

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Introduction

1. This case is one of an increasing number of “*shareholders’ actions*” brought in recent times. It concerns how a shareholders’ claim against a company should be treated in the context of a winding up or administration.
2. The outcome is likely to encourage shareholders’ claims against companies, in which event, indirectly, claims against directors and officers of those companies may also be encouraged.

Facts

3. In August 2004 Mr Margaretic purchased 20,000 fully paid ordinary shares in the capital of gold mining company, Sons Of Gwalia Ltd (“SOG”). The purchase took place on the market conducted by the ASX.
4. Eleven days after the share purchase the company went into voluntary administration.

5. It was agreed by the parties that upon appointment of the administrator the value of the shares was zero and would remain zero.
6. There are two principal bases to Mr Margaretic's action against SOG.
7. First, he claims that the company was in breach of section 674 of the Corporations Act 2001. This section imposes obligations on listed companies whose shares can be purchased on the open market to make continuous disclosure of information which is not generally available but a reasonable person would expect, if it were generally available, to have a material effect on the price or value of the shares. The Corporations Act permits an action for compensation by a person who suffers loss as a consequence of such a breach.
8. Additionally, Mr Maragaretic seeks damages on account of alleged misleading and deceptive conduct in breach of section 52 of the Trade Practices Act and section 12DA of the ASIC Act.
9. The company being in administration, Mr Margaretic intended to submit his claim for proof in the deed of company arrangement of SOG. There were other shareholders who had either made or intended to make similar claims.
10. The deed administrators applied to the Federal Court for a declaration that Mr Margaretic's claim is not provable in the deed of company arrangement.

11. Alternatively, they sought a declaration that the claim be postponed until all debts owed to or claims made by creditors other than shareholders claiming in their capacity as members were met.

12. ING Investment Management LLC, a creditor of SOG, was named as second respondent in the action.

13. Mr Margaretic, also sought a declaration that he is a creditor of SOG and entitled to the same rights as other creditors, such as attendance at meetings, voting rights and the like.

The Earlier Decisions

14. At first instance, Mr Margaretic was successful. Emmet J held that he was a creditor of SOG within the meaning of Part 5.3A of the Corporations Act for such amount as the Administrators admit to proof, or are ordered to admit to proof, and that he is entitled to all the rights of a creditor under that part. Emmet J also declared that the claim is not postponed until debts to ordinary creditors are satisfied.

15. SOG and ING appealed to the Full Court of the Federal Court. The appeals were unsuccessful, the Full Court affirming the decision of Emmet J.

16. Special leave was granted to appeal to the High Court.

The High Court's Decision

17. The issues before the High Court were:

- ii. Is the claim admissible to proof against the company: s 553 of the Corporations Act?

iii. If so, is any potential liability owed to Mr Margaretic in his capacity as a member of the company, meaning that payment is postponed until other creditors are satisfied: s 536A of the Corporations Act?

18. The High Court held by a 6:1 majority (Callinan J dissenting) in favour of Mr Margaretic, dismissing the appeal and answering the above questions yes and no.

Section 553 – Admissibility to proof of claim

19. Section 553 (1) of the Corporations Act is in the following terms:

“(1) Subject to this Division, in every winding up, all debts payable by, and all claims against, the company (present or future, certain or contingent, ascertained or sounding only in damages), being debts or claims the circumstances giving rise to which occurred before the relevant date, are admissible to proof against the company.”

20. Did the circumstances giving rise to Mr Margaretic’s claim occur before “*the relevant date*”? For current purposes, the relevant date was the date on which the directors appointed administrators to the company under Part 5.3A, being the day that the administration began.

21. This issue is analysed by Hayne J, with whom the other majority members agreed.

22. He observes that when Mr Margaretic purchased his shares he paid the market value for them. After appointment of administrators the shares became worthless but, there was a market for the shares until that point.

23. The relevant conduct said to comprise the statutory breaches founding the claims (the non disclosures, misleading and deceptive conduct) occurred before the relevant date, but the loss was not apparent until the appointment of administrators. The “*extinction of value*” arose because of the administrators’ appointment.

24. His Honour held that this latter fact did not mean that the circumstances giving rise to the claim did not arise before the relevant date.

25. If Mr Margaretic had known the relevant facts before SOG appointed administrators he would have had complete causes of action against SOG for identical relief. His claim would have been for damages representing the difference between the cost of purchase of the shares and the true value of what he bought as determined by a properly informed market (that is to say, he had a cause of action on purchase as he had bought a “*lemon*”). Hayne J puts it in the following terms at [176]:

“It follows that, although the agreed facts demonstrate that the appointment of administrators reduced the value of Mr Margaretic’s shares to zero, his claim is one the circumstances giving rise to which occurred before the administrators’ appointment. Had the facts upon which Mr Margaretic now relies been known then, they would have been known to the whole market, not just him, and he would have had the same claim he now makes^[208]. His knowledge of the relevant facts bears only upon whether he makes a claim; his knowledge of those facts does not bear upon whether

he has a claim. His claim is of a kind that is within [s 553](#) of the 2001 Act.”

Section 563A – Is “debt” owed in capacity as member

26. Section 563A is in the following terms:

“[Payment](#) of 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, is to be postponed until all debts owed to, or claims [made](#) by, [persons](#) otherwise than as [members](#) of the [company](#) have been satisfied.”

27. Whilst any liability would be a debt owed to a member does it follow that it would be owed to Mr Margaretic in his capacity as a member?

28. The majority answered this question in the negative. Gleeson CJ summarises the position as follows at [31]:

What determines the present case is that the claim made by the respondent is not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the first appellant. He does not seek to recover any paid-up capital, or to avoid any liability to make a contribution to the company's capital. His claim would be no different if he had ceased to be a member at the time it was made, or if his name had never been entered on the register of members. The respondent's membership of the company was not definitive of the capacity in which he made his claim. The obligations he sought to enforce arose, by virtue of the

first appellant's conduct, under one or more of the statutes mentioned in the earlier description of the respondent's claim.

29. Hayne J makes the following observations at [205] – [206]:

“...absent specific legislation giving subscribing members particular remedies as members, no distinction is to be drawn between shareholders who complain that a company's deceit or misleading or deceptive conduct induced them to acquire shares in the company according to whether that acquisition was by subscription or transfer.

In the present case, the obligation which Mr Margaretic seeks to enforce is not an obligation which the 2001 Act creates in favour of a company's members. The obligation Mr Margaretic seeks to enforce, in so far as it is based in statutory causes of action, is rooted in the company's contravention of the prohibition against engaging in misleading or deceptive conduct and the company's liability to suffer an order for damages or other relief at the suit of any person who has suffered, or is likely to suffer, loss and damage as a result of the contravention. In so far as the claim is put forward in the tort of deceit, it is a claim that stands altogether apart from any obligation created by the 2001 Act and owed by the company to its members. Those claims are not claims "owed by a company to a person in the person's capacity as a member of the company".

Status of Houldsworth and Webb Distributors

30. ING sought to argue that there is a principle of common law emerging from the House of Lords' decision *Houldsworth v City of Glasgow Bank*¹, which precludes a shareholder from proving in a winding up a claim for damages for misrepresentation inducing the acquisition, unless the shareholder has first rescinded the "membership contract". Once a company goes into liquidation or administration, rescission is not possible, and, therefore, a claimant such as Mr Maragaretic is precluded from pursuing his claim.
31. The decision in *Houldsworth* obtains some recognition in the High Court's judgment in *Webb Distributors (Aust) Pty Ltd v Victoria*².
32. In *Webb Distributors* the High Court refrained from determining whether *Houldsworth* was right or wrong but addressed the issue of whether the propositions distilled by the House of Lords from the Companies Act 1862 were incorporated into the Victorian Companies Code, then under consideration.
33. The High Court in *Webb Distributors* regarded *Houldsworth* as relevant to interpreting s 360(1)(k) of the Victorian Companies Code and held that the shareholders in that case could not prove in a liquidation as they were precluded from rescinding the contracts under which they acquired their shares.

¹ (1880) 5 App Cas 317

² (1993) 179 CLR 15

34. *Webb Distributors* is not expressly over ruled³ but it is distinguished to the point where it has little ongoing influence. The High Court in *Webb Distributors* was said to be concerned with the construction of s 360 of the Vic Companies Code. Section 563A, the section currently under construction, is in different terms, its genesis being in the new provisions introduced into the Corporations Law in 1992.

35. Hayne J, at [190], states that neither *Houldsworth* nor *Webb Distributors* established a common law principle that a shareholder must rescind a contract for purchase of shares in order to bring an action of this type. The current case was also distinguishable on the facts as Mr Margaretic had not contracted with the company in order to acquire the shares. Significantly, however, his Honour went on to say that Mr Margaretic's position would have been no different if he had been a subscriber of shares from the company.

36. It is emphasised in a number of the judgments that the case is very much concerned with the proper interpretation of provisions of the Corporations Act 2001. In this context, the terms of that Act and its legislative history, rather than any longstanding common law principles are relevant.⁴

Conclusion

³ Gummow J expressly doubts its correctness at [97]. Kirby J expressly agreed with Gummow J on this point and states at [104], "*Webb Distributors is proof once again (if further proof is needed) of the dangers in attributing undue weight to what was said in England in the 19th century when attempting to construe contemporary Australian legislation*".

⁴ As observed by Hayne J at [183], the *Houldsworth* decision pre dated the House of Lords' decision in *Salomon v Salomon*, 1897 AC 22, the decision that established the "separate legal personalities of the corporation and its corporators".

37. The High Court's decision confirms that shareholders' claims to recover losses due to wrongdoing by a company rank equally with the claims of other unsecured creditors. In this regard, there is to be no distinction between claimants who acquired their shares by subscription or those who acquired them on the open market.
38. Against the background of the High Court's decision in *Campbells Cash & Carry P/L v Fostif*⁵, in relation to litigation funding, and the user friendly class action provisions of the Federal Court Act, the decision may encourage further shareholders' actions. Although this case deals with claims against companies in administration or liquidation, if further shareholders claims are brought it is likely shareholders will, where there is a basis to do so, also try their luck against directors and officers of those companies.
39. There has been some speculation that there may be a legislative response to the decision, in order to bring Australia in line with the US position.
40. However, there is nothing in the judgment that can be said to be inconsistent with the policy behind the Corporations Act 2001. This Act, along with beneficial legislation such as the Trade Practices Act and ASIC Act, imposes certain obligations on companies and directors regarding their conduct and provide rights for aggrieved parties to recover losses incurred due to breach of those obligations. Shareholders would argue

⁵ [2006]HCA 41

that there is no proper reason why their claims, legitimately brought, should be subordinated to the claims of others.

41. At a practical level, the decision confirms insolvency practitioners will be required to give full consideration to all such claims made against a company in the context of a liquidation or administration, rather than postpone dealing with them. It also means a risk of reduced returns to other unsecured creditors.

42. Further, the analysis by Hayne J by which it was determined that the circumstances of the claim arose pre administration, despite the loss crystallising on the appointment of administrators, is likely to be utilised to determine similar issues in this and other legislation.

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