

update

2 February 2007

Friday Facts: High Court decides in Sons of Gwalia – Section 563A does not mean “members come last”

On Wednesday the High Court of Australia delivered its long await judgment in Sons of Gwalia Ltd v Margaretic [2007] HCA 1.

The Court by majority of 6:1 dismissed the appeal which had been brought by Sons of Gwalia (the “Company”), being a publicly listed gold mining company subject to a deed of company arrangement. The Company had been placed into administration on 29 August 2004 owing over \$800 million at the time. Just ten days prior, the respondent to the appeal Mr Margaretic (the “Respondent”) had purchased 20,000 shares in the Company at a cost of \$26,200.

The Respondent claimed that he had been misled by the Company into purchasing the shares in that the Company had failed to notify the Australian Stock Exchange that its gold reserves were insufficient to meet its gold delivery contracts and that as such it could not continue as a going concern. The Respondent argued that the Company had breached the Trade Practices Act 1974 (Cth) and the Australian Securities and Investments Commission Act 2001 (Cth) and that he was entitled to claim compensation for the difference between the cost of his shares and their value which was nil. There were a number of other shareholders with such claims.

The High Court acknowledged that the appeal had been brought to test the entitlement of shareholders in the position of the Respondent to claim competition with other creditors under a deed of company arrangement.

The main reason why the claim was brought was because whilst the Company had been placed into administration because of its inability to trade, it had significant assets.

The High Court considered lengthy argument about the way in which section 563A of the Corporations Act 2000 (Cth) should be interpreted and applied in the factual circumstances before it.

Section 563A provides that: “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”.

The Court concluded that what determined the claim made by the Respondent was not founded upon any rights he obtained or any obligations he incurred by virtue of his membership of the Company, but rather by virtue of the Company’s conduct and in particular, its failure to comply with its statutory requirements under the Acts referred to above.

The effect of this decision is that the Respondent would in this case rank alongside other unsecured creditors.

Many commentators have argued that the decision has significant ramifications for administration situations and the ability to ultimately achieve a deed of company arrangement. Clearly in this case there are significant ramifications however arguably the difficulties will arise in a very small number of cases and only when there are any assets available to warrant the claim being made.

It will be interesting to see whether the Federal Government will consider making changes to the Corporations Act similar to those which appear in the Bankruptcy Code in the United States. It provides that for the purposes of distribution, a claim arising from rescission of a purchase or sale of the bankrupt's property shall be subordinate to all other claims or interests. The High Court whilst considering the United States section concluded that the Commonwealth in Australia had not introduced such a provision and that section 563A did not embody a general policy that, in an insolvency "members come last".

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