

update

17 October 2008

Friday Facts: Beware allotting shares for an improper purpose

In the recent case of Life Therapeutics Limited v Bell IXL Investments Limited & Ors [2008] FCAFC 144, the Full Court of the Federal Court of Australia considered whether an allotment of shares was made for an improper purpose.

The proceeding concerned the allotment of shares in the company Life Therapeutics Limited (**LTL**), a company listed on the Australian Stock Exchange. Prior to the allotment of shares in dispute, LTL had issued 123,223,857 shares with voting rights.

From 14 May 2008 to 4 June 2008, Bell IXL Investments Limited (**Bell IXL**) together with its associate, K Pagnin Pty Limited, acquired approximately 10.17% of the issued capital of LTL.

On 23 May 2008, Bell IXL requisitioned LTL to convene an extraordinary general meeting of shareholders to consider a resolution to remove the current board of directors and replace them with three persons nominated by Bell IXL. This meeting was subsequently adjourned pursuant to a Court Order to decide the issues of the current proceeding.

Prior to the date set for the extraordinary general meeting, LTL received a subscription application from Aegis Partners Limited ("AEGIS") for 15% of LTL's issued shares. Under the subscription agreement, AEGIS could nominate to whom the shares were to be issued. On 4 July 2008, the shares were allotted to Bell Potter Nominees Limited ("Bell Potter") who then allocated them to various nominee account holders in accordance with instructions from AEGIS.

The allotment to Bell Potter representing 13.04% of the voting shares in LTL had the effect of reducing Bell IXL's interest in LTL's capital from 10.17% to 8.85%.

Bell IXL contended that the allotment of shares to Bell Potter was invalid and had been made by the directors of LTL for an ulterior purpose, namely to keep the existing directors in office rather than for the benefit of the company.

It was alleged that on 20 May 2008, LTL became concerned that Bell IXL was positioning itself to take over LTL and, in response, decided to issue more shares in the company to reduce Bell IXL's interest and voting rights.

Bell IXL issued proceedings seeking orders to cancel the allotted shares and to restrain the voting of shares at the extraordinary general meeting at which the resolutions to remove the directors and replace them with persons nominated by Bell IXL was to be considered.

At first instance, the primary judge held that the allotment of shares to Bell Potter had been made for an ulterior purpose, namely to keep the existing directors in office and not for the benefit of the company. The primary judge also found that the directors had become aware that Bell IXL had acquired a substantial shareholding and as a result, met with a stock broker to discuss capital raising for LTL with the effect of diluting Bell IXL's interest. This meeting led to the chain of events which resulted in the allotment of shares to Bell Potter which was in issue in this proceeding. The primary judge made interlocutory orders restraining Bell Potter from exercising its right at the

meeting pending the outcome of the final trial.

LTL issued an appeal against this order and alleged that there was no evidence to support the finding of the primary judge and that he failed to provide any proper reasoning for his finding of the allotment of shares for an ulterior purpose.

The Full Court of the Federal Court on appeal held that the primary judge had erred in drawing the inference that the directors had actual knowledge of Bell IXL's substantial interests that it had acquired at the time they initiated the process to raise capital by allotting new shares.

However on the evidence available to the Full Court, it was not prepared to dismiss the possibility that Bell IXL had a cause of action against LTL for its conduct and ordered that the matter be remitted to the lower court for re-trial.

For more information

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