**Sons of Gwalia Ltd (Subject to Deed of Company Arrangement) v Margaretic (2007) 81 ALJR 525, 232 ALR 232**

In this case the High Court considered the extent to which shareholders, who claim to have purchased shares in a company as a result of misrepresentations made by the company, rank after general creditors in a winding-up or company administration.

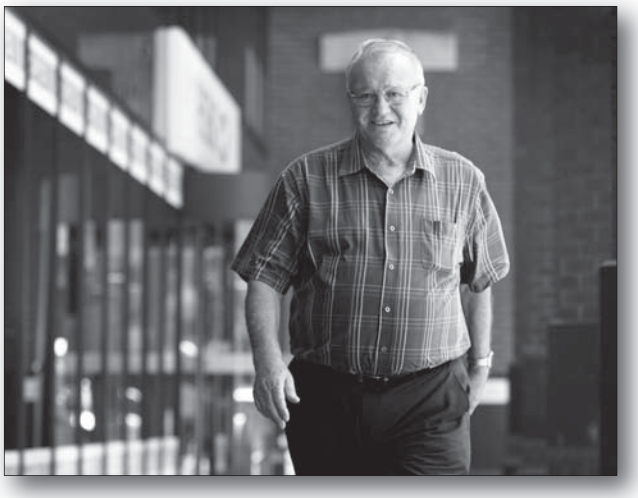
Sons of Gwalia Ltd ('Gwalia') was a publicly listed gold mining company registered in 1981. In August 2004, Mr Margaretic purchased 20,000 fully paid ordinary shares in Gwalia for approximately $26,200. Eleven days later, the board of Gwalia appointed administrators on the basis that Gwalia was insolvent or likely to be so. There was no dispute that the shares purchased by Margaretic became worthless from the date of appointment of administrators. A deed of company arrangement subsequently entered into by Gwalia contained a provision that incorporated s563A of the *Corporations Act 2001* (Cth) ('the Act'). Section 563A provided:

> 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.

Margaretic made a claim against Gwalia on the basis that it had failed to disclose that its gold reserves were insufficient to meet its gold delivery contracts and that it could not continue as a going concern, in contravention of the continuous disclosure obligations imposed by s674 of the Act. Margaretic sought compensation pursuant to s1325 of the Act and damages for misleading and deceptive conduct in contravention of s52 of the *Trade Practices Act 1974* (Cth) and s12DA of the *Australian Securities and Investments Commission Act 2001* (Cth). The compensation claimed was calculated by reference to the difference between the cost of Margaretic's shares and their market value (which was accepted to be nil).

The Gwalia administrators commenced proceedings in the Federal Court seeking, *inter alia*, a declaration that Margaretic's claim was not provable in the company administration. ING Investment Management LLC, a general creditor of Gwalia, was named as second respondent to the application. Margaretic cross-claimed for a declaration that he was a creditor of Gwalia and entitled to all the rights of a creditor under Pt 5.3A of the Corporations Act. Emmett J made a declaration that Margaretic's claim was not to be subordinated pursuant to s563A. His Honour's decision was upheld on appeal to the full court (Finkelstein, Gyles and Jacobson JJ).

The critical issue was whether Margaretic's claim against Gwalia could be characterised as a debt owed to him in his capacity as a member of the company. By majority (Gleeson CJ, Gummow, Kirby, Hayne, Heydon and Crennan JJ, Callinan J dissenting), the court held that Margaretic's claim was not owed to him in his capacity as a member and therefore did not fall within s563A. The majority concluded that the claim was not founded upon any rights Margaretic obtained, or any obligations he incurred, by virtue of his membership of Gwalia. As Gleeson CJ noted, 'membership of the company was not definitive of the capacity in which he made his claim'. In a similar vein, Hayne J distinguished



Luka Margaretic, shareholder of collapsed gold miner Sons of Gwalia, 31 January 2007. Photo: Colin Murty / Newspix.

between a claim with respect to money paid to a company under the statutory contract between member and company and a claim with respect to money paid to bring the contract into existence. In the latter case, the company's liability for loss occasioned by its misleading or deceptive conduct was not derived from an obligation confined to the company's relationship with members (none of the causes of action relied upon by Margaretic being dependent for their operation upon his status as a shareholder in Gwalia). Accordingly, the respondent's claim was not to be postponed by s563A to claims made by general creditors. In the words of Chief Justice Gleeson:

> One thing is clear. Section 563A does not embody a general policy that, in an insolvency, 'members come last'. On the contrary, by distinguishing between debts owed to a member in the capacity as a member and debts owed to a member otherwise than in such a capacity, it rejects such a general policy. If there ought to be such a rule, it is not to be found in s563A.

Two subsidiary questions were also considered by the court. The first concerned the proper scope of the so-called 'principle' in *Houldsworth v City of Glasgow Bank* (1880) 5 App Cas 317. ING submitted that *Houldsworth* prohibited a shareholder from making a claim for loss or damage incurred through the purchase of shares in the company as a result of the company's own fraud or misrepresentation unless the shareholder first rescinded the 'membership contract'. Because rescission is unavailable to a shareholder after a company has gone into liquidation or voluntary administration, it was said to follow that Margaretic's claim failed at the threshold and that there was, as a result, no need to consider the scope of s563A. The majority held that *Houldsworth* was not authority for a principle as wide as that asserted by ING. Moreover, for the reasons summarised above, the rights or liabilities sought to be enforced by Margaretic arose independently of any statutory contract between himself and the company. It followed that even a generous interpretation of the 'principle' in *Houldsworth* did not prevent the claim from being brought on the facts before the court.

Secondly, the court considered the continuing relevance of its earlier decision in *Webb Distributors (Aus) Pty Ltd v Victoria* (1993) 179 CLR 15. In that case, the court held that claims brought by shareholders against a company for misrepresentations regarding shares subscribed for by them concerned sums due to the claimants in their capacity as members of the company under s360(1)(k) of the *Companies (Victoria) Code*. Gleeson CJ, Kirby and Hayne JJ distinguished *Webb* on the basis that: (a) the sub-section considered in the earlier case differed from the terms of s563A; and (b) the shares at issue in *Webb* had been obtained by subscription, not by purchase from third parties, with the result that considerations regarding the need to maintain a company's capital underlay the court's decision. Gummow J was more forthright and questioned both the accuracy of the principles relied upon by the majority in *Webb* and the result reached.

The decision in *Gwalia* has been much criticised by elements of the finance industry. One effect of the decision is that the pool of assets to be shared by ordinary creditors will, in certain circumstances, be significantly smaller than otherwise expected. Lenders will have no real way of forecasting the likelihood of future claims by shareholders and up-front lending costs may increase to take the possibility of such claims into account. Moreover, an administrator faced with a number of claims from allegedly misled shareholders will be required to consider the merits of each claim individually, with the result that the complexity (and cost) of an administration will increase. At the time of writing, there is no firm indication as to whether the Australian Government will seek to amend s563A to reverse the High Court's decision. Several issues arising from the decision have been referred to the Corporations and Markets Advisory Committee (CAMAC) for further consideration. If the government does decide that an amendment is appropriate, one possible source of inspiration will be §510(b) of the United States Bankruptcy Code, which subordinates all claims for damages arising from the purchase or sale of a company's securities.

**By David Thomas**

### Commonwealth of Australia v Cornwell (2007) 234 ALR 148; [2007] HCA 16

The High Court's decision in *Commonwealth of Australia v Cornwell* highlights the importance of characterising damage when dealing with the legal consequences of an asserted loss.

From May 1967, Mr Cornwell was employed by the Commonwealth to work as a spray painter in a bus depot. He worked full time, but was classified as a 'temporary employee'.

In July 1965, Mr Cornwell asked his superior officer whether he could join a superannuation fund (1922 Fund) established under the *Superannuation Act 1922*. Although the fund was for permanent rather than temporary employees, Mr Cornwell had a right to apply to the treasurer to be deemed an employee to whom the Act applied. The trial judge found that if Mr Cornwell had applied, his application would almost certainly have been approved. However, on the basis of advice from his superior officer, found to be negligent, Mr Cornwell took no action.

The 1922 Fund was closed to new entrants in 1976. The *Superannuation Act 1976* created a new fund (1976 Fund), to which members of the 1922 Fund were transferred. Like the 1922 Act, the 1976 Act excluded temporary employees, subject to a special power for temporary employees to be deemed eligible.

On 24 March 1987, Mr Cornwell was reclassified as a permanent public service position. At the same time, he became a member of the 1976 Fund. Mr Cornwell retired on 31 December 1994 and was paid in accordance with his entitlements under the 1976 Fund.

Mr Cornwell commenced proceedings on 16 November 1999 for the difference between what he received when he retired and what he would have received if he had joined the 1922 Fund in 1965.

The Commonwealth sought to rely on s11 of the *Limitation Act 1985*, which fixed the relevant limitation period at six years from the date on which the cause of action first accrued. The Commonwealth's primary argument was that the cause of action accrued in 1976, when the opportunity to join the 1922 Fund was lost.

That argument failed. The majority (Gleeson CJ, Gummow, Kirby, Hayne, Heydon & Crennan JJ, Callinan J dissenting) held that the cause of action did not accrue until Mr Cornwell retired.

Generally, a cause of action for negligence accrues when damage is sustained. The time when economic loss is first sustained depends on the nature of the interest infringed: *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514 at 527. The economic loss in this case depended on Mr Cornwell's rights under federal statutes. The interest infringed here was the entitlement conferred by those statutes. Attention to the statutory regime creating Mr Cornwell's interest is crucial.

Under the 1922 Act, a member made contributions for 'units of pension'. The entitlement on retirement depended on the number of units being contributed at retirement. If Mr Cornwell had joined the 1922 Fund any time before 1976, Mr Cornwell may have been able to place himself in the same position he would have been in if he had joined the scheme in 1965, by paying more for each unit.

This changed in 1976. Under the 1976 Act, a member received a certain portion of his or her final salary, calculated by reference to the number of years as an eligible employee. The calculation included time spent as a member of the 1922 Fund.

This was the point on which the Commonwealth relied. When the 1976 Act commenced, Mr Cornwell lost forever the opportunity to count the 11 years from 1965 to 1976 towards his entitlement. Even if he had joined the 1976 Fund at once, Mr Cornwell could not have made up the quantum of his benefits to allow for those 11 years of service. The Commonwealth argued that Mr Cornwell's loss was irretrievably sustained at this time.

The argument failed because it is an incomplete characterisation of Mr Cornwell's entitlement and of his loss. The accrual of benefits under the 1976 Act depended on satisfying one or more statutory contingencies. To be entitled to the 'standard age retirement pension', a member needed to reach certain ages (depending on other criteria) before retiring. Entitlement to an 'early retirement benefit' depended on a