From shareholder to creditor

When blue chip mining company Sons of Gwalia collapsed in 2004, a shareholder took them to court. This legal test case had profound implications for all shareholders, reports *Kristy Richardson*.

In the recent case of Sons of Gwalia (Subject to Deed of Company Arrangement) v Margaretic (2006) FCAFC 17, the Full Court of the Federal Court was asked to consider the capacity in which the shareholder (Luka Margaretic) was making a claim for loss against the company arising from the shareholder's earlier acquisition of shares in that company. The issue on appeal was simple: was the shareholder making his claim in his capacity as a member of the company or as a creditor of the company? The determination of this issue has important implications for companies the subject of administration and their administrators.

On 18 August 2004, Margaretic bought 20,000 shares in Sons of Gwalia and on 23 August his name was entered in the Register of Members. But only six days later on 29 August 2004 administrators were appointed to the company and Margaretic's newly purchased shares became worthless.

Margaretic claimed that the company's conduct was such that it was misleading and deceptive and that it breached section 674 of the Corporations Act 2001 (Cth) and section 52 of the Trade Practices Act 1974 (Cth). He said if the provisions of that Act had been complied with by the company (disclosure to the Australian Stock Exchange of information that might have a material affect on the going concern of this company), he would not have purchased the shares.

THE PRIMARY DECISION

The administrator sought a declaration from the Federal Court that Margaretic's claim was not provable under the proposed deed of company arrangement or alternatively that payment of Margaretic's claim should be postponed until all debts owed to, or claims made by persons otherwise than in their capacity as members of the company were satisfied. Margaretic cross-claimed arguing before Justice Emmett that because of the nature of his claim, he should be entitled to be regarded as a creditor of the company. He specifically asserted that his claim for loss and damage should not be treated as a debt or claim due to him in his capacity as a member. Rather his claim should be treated as a debt or claim due and owing to him in the capacity of a creditor of the company. Margaretic also argued that as a creditor of the company he should be treated as a creditor. That is, being involved in the administration process and participating in the meetings of creditors to be convened by the administrators.

Justice Emmett found in favour of Margaretic as a creditor of the company and said there was no restriction on Margaretic exercising the rights granted to a creditor as part of the administration process. The finding also ensured Margaretic's claim was not postponed to higher order claims. The administrators subsequently appealed to the Full Court.

THE DECISION ON APPEAL

The Full Court, constituted by Justices Finklestein, Gyles and Jacobson, dismissed the appeal after agreeing with Justice Emmett's findings. In the days following the primary decision, The Australian's Andrew Trounson reported on 16 September 2005, that the success of Margaretic's claim would have "significant consequences to commercial life in Australia" and a dramatic impact on the process of company administration. Concerns were raised that including such claims as provable debts under administration may ultimately cut returns to 'true' creditors by expanding the nature and number of potential creditors, also that the "adjudication of damages claims could add years to administrations", and that administrators will be required to consider disparate claims made by shareholders under the auspices of consumer protection legislation and that the application of Justice Emmett's decision may only add to the already existing complexities in the administration process.

What is certain is that the door is now open for shareholders to make a claim under the auspices of consumer protection legislation for any perceived irregularity in the purchase of their shares despite the company entering into external administration.

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