

Report to Creditors' Committee on ION shareholder claims and *Sons of Gwalia* appeal

In previous reports to the Creditors' Committee we have kept the Committee informed of the progress of Federal Court proceeding instigated by the Deed Administrators of Sons of Gwalia Pty Ltd and ING Investment Management LLC (a non-shareholder creditor). The findings of the Federal Court in the Sons of Gwalia proceeding are binding on the Deed Administrators of the ION DOCA Group.

On 27 February 2006 the Full Court of the Federal Court (the **Full Court**) delivered its reasons for judgment in the Sons of Gwalia appeal. In essence, the Full Court held that:

- a transferee shareholder (is a shareholder who purchased his shares "on-market") is entitled to prove under the Sons of Gwalia deed of company arrangement in relation to his misleading conduct claim against the company; and
- his claim is not postponed until non-shareholder creditors' debts and claims have been paid.

For the purposes of both the hearing before the judge at first instance and the Full Court on the appeal, the Court was asked by the parties to assume that the substantive case for misleading conduct had been made out.

1. Background

In the Report to the Creditors' Committee dated 28 October 2005, we advised that the Deed Administrators of Sons of Gwalia Pty Ltd had brought an application in the Federal Court of Australia seeking declarations in relation to an informal proof of debt submitted by Mr Margaretic, a shareholder who purchased his shares in the company on market. As you will recall, Mr Margaretic asserts that he has a claim for damages against Sons of Gwalia for:

- (a) breach of its continuous disclosure obligations; and
- (b) misleading and deceptive conduct; and

that on the basis of those claims, he is a creditor of Sons of Gwalia, entitled to prove in its deed of company arrangement and his claims are not liable to be postponed until payment in full of all claims of non-shareholder creditors of Sons of Gwalia.

2. Decision at first instance – Justice Emmett

Justice Emmett of the Federal Court, who heard the application, held that Mr Margaretic, as a transferee shareholder with a claim against the company for misleading conduct and breach of the company's continuous disclosure obligations, was a creditor who was entitled to vote and to receive information about the administration in his capacity as a creditor. Justice Emmett also held that Mr Margaretic's claim was not postponed to the claims of external creditors pursuant to section 563A of the Corporations Act.

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3. Appeal to the Full Court

As you are aware, the Deed Administrators of Sons of Gwalia and ING Investment Management LLC appealed from Justice Emmett's decision. The appeals were heard together by the Full Court on 1 December 2005. The appellants contended that:

- (a) Justice Emmett should have found that, Mr Margaretic is not a creditor, of Sons of Gwalia in respect of his claim; or
- (b) Justice Emmett should have found that, if Mr Margaretic is a creditor, his claim is postponed until other non-shareholder debts and claims have been paid in full.

4. Decision of the Full Court

The Full Court (Justices Finkelstein, Gyles and Jacobson) considered the 1993 High Court case of *Webb Distributors v Victoria*. The Full Court interpreted the decision of the High Court majority as having held that *subscriber* shareholders could not, in a winding up, prove for damages against the company for the misrepresentation that induced their share purchase so long as they remained shareholders. The Full Court said that the majority had not made the same decision about transferee shareholders, and accordingly transferee shareholders could prove in a winding up in relation to their misleading conduct claims against the company.

Further, the Full Court held that if Mr Margaretic were to submit his proof of debt in relation to his claim of misleading conduct, payment of his claim (if subsequently made out on the facts) would not be postponed until after the debts and claims of non-shareholder creditors had been paid in full.

Section 563A of the Corporations Act provides that payment of a debt owed to a person in his or her capacity as a shareholder is postponed until all debts or claims of non-shareholder creditors have been satisfied. This provision articulates the principle that the capital of the company should be maintained.

However, the Full Court held that the nature of Mr Margaretic's claim against Sons of Gwalia (i.e. for misleading conduct) had nothing to do with the return of share capital and had no relevant connection with the rescission of any contract with the company. Therefore, Mr Margaretic was not bringing his claim in his capacity as a shareholder, and accordingly was not subject to the postponement effect of section 563A.

5. Future appeal to the High Court of Australia

5.1 Applying for special leave to appeal

Given the significance of these issues, it is likely that the Deed Administrators and ING will apply to the High Court for special leave to appeal.

There is no appeal 'as of right' to the High Court. A party wishing to have the High Court hear an appeal from a decision of a lower court must first seek 'special leave'. The Deed

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Administrators and ING have 28 days from the date the Full Court handed down its judgment to seek special leave to appeal to the High Court.

5.2 When will the application for special leave be heard?

At this stage, with no appeal having yet been lodged, it is difficult to predict when the special leave application will be dealt with by the High Court. Early indications from the High Court Registry are that any application for special leave by the Sons of Gwalia Deed Administrators may not be heard before May 2006.

5.3 What are the criteria for granting special leave?

In considering whether to grant special leave to appeal, the High Court may have regard to any matters that it considers relevant, but will also have regard to:

- (a) whether the Sons of Gwalia proceeding involved a question of law—
 - (i) that is of public importance; **or**
 - (ii) in respect of which a decision of the High Court, as the final appellate court, is required to resolve differences of opinion between different courts, or within the one court, as to the state of the law; **and**
- (b) whether the interests of the administration of justice require the High Court to consider the Full Court's judgment.

5.4 What happens at the end of the hearing of the application for special leave?

- (a) If the High Court does not grant special leave, there are no further rights of appeal, and the judgment of the Full Court will stand until such time as Parliament passes legislation to alter the law (if it does so at all).
- (b) If the High Court does grant special leave, an appeal might not take place for at least six months, and judgment may not be delivered for up to a further twelve months after the hearing (ie. the High Court's decision might not be handed down until late 2007).

As we reported to you in October 2005, the Deed Administrators of Sons of Gwalia have indicated that if special leave is granted, they may apply to the High Court for the expedition of the appeal hearing, on the basis that they, and administrators of companies similar to Sons of Gwalia (such as the ION Deed Administrators), cannot finalise their respective positions on distributions until the matter is ultimately determined.

It is unlikely, however, that any application for expedition would succeed, given the High Court's preference for dealing as a matter of priority with cases involving 'liberty of the subject' (ie. criminal matters and administrative detention).

6. Status of ION Shareholders' Claims

Unless and until such time as the High Court makes a different finding, the ION Deed Administrators are bound to apply the Full Court's reasoning in the Sons of Gwalia

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proceeding in their administration of the ION DOCA. This means that claims made by shareholders who acquired their shares in ION on-market, alleging misleading conduct or non-disclosure by the company, should be treated on the same basis as the claims of other unsecured creditors.

The Committee should note, however, that shareholders with claims in the ION DOCA still bear the onus of making out their claims on the merits. To date approximately 3000 proofs of debt, totalling in excess of \$100 million, have been lodged by shareholders of ION. In assessing each of the shareholder claims, the Deed Administrators have a duty to act in a quasi judicial capacity according to standards no less than those of a court, reflective of their duty to distribute the assets of ION only among those persons truly entitled. The process of adjudicating the shareholder claims is likely to take some time and will involve the incurrance of not insignificant costs in the administration of the ION DOCA, given the large volume of claims and the complexity of the numerous issues raised about which the Deed Administrators are required to make a determination.

7. Impact on interim distribution to creditors

Until such time as the High Court finally decides the *Sons of Gwalia* matter, there exists a possibility that the status of such shareholder claims may change. Against this background the Deed Administrators are considering if, and when, it may be appropriate to make an interim distribution to creditors of ION. As part of their deliberations the Deed Administrators also need to consider whether it is possible to make an adequate provision in anticipation of any further shareholders lodging proofs of debt.

Given the legal issues involved, the Deed Administrators are presently considering these issues with Allens Arthur Robinson. The Creditors' Committee will be notified once the Deed Administrators have formed a view on these matters.

Allens Arthur Robinson

8 March 2006