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Class action denied inquisition under the Corporations Act

ACN 004 410 833 Ltd (formerly Arrium Limited) (in liq) v Michael Thomas Walton [2020] NSWCA 157, 30 July 2020

[1] The decision of the Court of Appeal of the New South Wales Supreme Court in *Re Arrium Ltd* (cited above) offers a poignant reminder that the examination powers conferred by the *Corporations Act* to inquire into the "examinable affairs" of a company may only be used for a predominant purpose that benefits the company, its contributors and its creditors. A private or personal purpose which does not offer any apparent benefit to those parties is an abuse. This decision makes it plain that a prospective collateral benefit is not enough where the predominant purpose is beyond power. The case also resolved what may have been perceived as an inconsistency between intermediate appellate courts on the breadth of the examination power.

Facts

[2] The appellant (**Arrium**) was a listed public company. It produced steel and held assets including an iron mining operation. Shortly after publishing its results for the FY 2014, it announced a capital raising. It promoted that the proceeds were to be used to pay down debt. Retail shareholders were provided with an Information Memorandum in respect of a one for one pro rata entitlement offer. The capital raising was completed by mid-October 2014. As a result of the transaction, Arrium received $754 million. In January 2015, Arrium announced the suspension or closure of its mining operation. In February 2015, in its half yearly results, it recognised a $1,335 million impairment in the value of its mining operations. Arrium was placed into administration on 7 April 2016. On 20 June 2019, the administrators were appointed liquidators.

[3] The respondents were shareholders of Arrium on or after 19 August 2014, who subsequently sold their shares. They were participants in a class action. Based on a letter written by their lawyers, ASIC approved the respondents as "eligible applicants" within the meaning of s 597(5A)(b) of the *Corporations Act* in April 2018. The letter expressed concern about whether the FY 2014 results and the Information Memorandum "adequately or fairly" portrayed the "true state of Arrium's business". The letter disclosed that the respondents wished to examine certain persons to determine whether any claims should be brought against Arrium, its directors or its auditor.

[4] The respondents applied for orders that a summons for examination be issued to a director of Arrium until December 2015, who was also chair of its Governance and Nominations Committee and a member of its Audit and Compliance Committee. They also sought document production from Arrium, KPMG (the company's auditor), and UBS AG (who advised on the capital raising).

[5] On 15 May 2019, the Registrar in Equity made those examination and production orders.

[6] Arrium sought to have the examination and production orders stayed or set aside. That application was determined by Black J. His Honour observed that the information provided to prospective class members referred to possible proceedings against certain directors and auditors of Arrium to recover losses incurred by investors who bought securities in Arrium after its FY 2014 results announcement and its 2014 capital raising. It was indicated that the claim was based on allegations of misrepresentations concerning the financial position of Arrium in the second half of 2014, the adoption of the FY 2014 accounts and the 2014 capital raising, and also an alleged failure by Arrium's auditors to identify the true position of Arrium in respect of the FY 2014 reporting documentation. Relevantly, though, the respondents eschewed joining Arrium in the prospective proceedings or obtaining recovery against it. Nor did the respondents rely on the possibility of any derivative action.

[7] Despite concluding that the information which the respondents provided to ASIC "does tend to indicate that their predominant purpose in seeking the issue of the examination summons was to investigate, and pursue, a personal claim in their capacity as shareholders against directors of Arrium or against its auditors", Black J dismissed the application by Arrium. His Honour found that there was no abuse of process because the respondents wished to examine the director on matters which the liquidators could properly (although did not move to) have examined the director on and the information likely to be produced by the examination would also likely advance the interests of Arrium and its creditors, so far as it produces relevant information that supports other potential causes of action by Arrium.

The appeal

[8] Upon closer scrutiny, the prospective litigation which the examination was designed to assist would not bring any commercial benefit to the company. The capital raising was used, in part, to pay down debt. While Arrium issued shares to those investors who participated in the capital raising, it suffered no loss as a consequence of doing so. The case posited by the respondents had Arrium receiving consideration well in excess of the value of the shares it allotted to the shareholders. On that hypothesis, it benefited financially from the transaction. Absent any suggestion that it would be liable to shareholders who acquired shares on the basis of representations in the Information Memorandum, it could not be said that Arrium suffered any loss. There is no suggestion of any such claim, the Court of Appeal reinforced.

[9] The Court of Appeal unanimously held that the examination was sought for a private purpose for the benefit of a limited group of persons who bought shares in Arrium at a particular time irrespective of whether they held their shares at the time of the appointment of the administrators. Their Honour found that to be foreign to the purpose for which powers to order an examination and production of documents were conferred, resulting in an abuse of process: [122]-[142].

[10] In doing so, the Court of Appeal applied what it regarded as "clear authority" drawn from *Re Excel Finance Corp Ltd (Receiver and Manager Appt); Worthley v*

England (1994) 52 FCR 69 (***Re Excel***) that "an application for the predominant purpose of advancing the cause of the applicant in litigation against third parties and not for the benefit of the corporation, its contributories or its creditors is a use of the provision for a purpose foreign to the power.": at [137].

[11] Beforehand, their Honours conducted a thorough examination of conflicting authorities at intermediate appellate level on the question of whether the 1992 amendments (repealing s 597(1), (2) and (3) and inserting ss 596A, 596B, 596C, 596D, 596E, 596, along with defining "eligible applicant" in s 9) had expanded the scope of the power. Before those amendments, the prevailing view was that the purpose of the power was limited to assisting the liquidator in the winding-up of a corporation or to support the bringing of criminal charges against former officers of the company. Subsequent courts, including at appellate level in *Flanders v Beatty* (1995) 16 ACSR 324 and *Boys v Quigley* (2002) 26 WAR 454, had expressed the scope of the power more broadly after the 1992 amendments and emphasised what might be said to be the public benefit in exposing conduct which may affect other creditors or go to the protection of shareholders. The Full Court of the Federal Court had expressed the contrary view (per Landers J in *Re New Tel Ltd (in liq); Evans v Wainter Pty Ltd* (2005) 145 FCR 176, at [206], applying *Re Excel* at [247]).

[12] After reviewing the relevant authorities, the Court of Appeal held that the cases advanced as supporting a broader view should not be understood as endorsing private examinations that might reveal matters demonstrating such conduct if that was not the purpose of the examination and no benefit to the company could be identified. In each case, the proposed litigation benefited the company, its creditors or its contributories. The added public benefit in those cases from exposing conduct which may affect other creditors or go to the protection of shareholders, did not render those cases as supporting any broader proposition.

[13] There are several takeaways.

[14] *First*, the "purpose" in this context means the result intended to be achieved by the examination. When determining whether the examination is an abuse of process, it is

the subjective purpose of the applicant (that is the result intended by the applicant to be achieved) which is relevant to the question of whether there is an abuse of process.

[15] *Second*, the predominant purpose of the examination must benefit the corporation, its creditors or its contributories. One example of the latter is an examination by a creditor for the purpose of obtaining information to support a potential claim against former directors (in fact or deemed) under the insolvent trading provisions (see *Re Marvin Manufacturers (Aust) Pty Ltd; New Zealand Steel (Australia) Pty Ltd v Burton* (1994) 13 ACSR 610). As directors or persons taking part in the management of the company at the time a debt is incurred if the company is insolvent may be jointly and severally liable, the indebtedness of the company is prospectively reduced if such a claim can be made out.

[16] *Thirdly*, a private examination is not within the scope of the power merely because it might reveal matters demonstrating criminal conduct or other causes of action if that was not the predominant purpose of the examination and no apparent benefit to the company can be identified: see [136]-[137].

[17] *Fourthly*, a party seeking "eligible applicant" status should accurately and plainly disclose the purpose for which the examination is to be undertaken. Although expressed in *obiter dicta*, the Court of Appeal emphasised that "[t]here may be cases where the issue of an examination summons by an eligible applicant is open to challenge and apt to be set aside where it can be shown that the applicant is attempting to use examination summons in a way that *differs* from the basis put to ASIC in order to obtain eligible applicant status.": at [122], with my emphasis.

The decision is published at:
https://www.caselaw.nsw.gov.au/decision/173310d3a9880b0415ca08e2

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