

THE SHAREHOLDER



A BIENNIAL NEWSLETTER PRODUCED BY IMF

September 2009
Issue 8

CONTENTS

Sons of Gwalia (“SOG”) Update	1
Claimants’ Access to Defendants’ Insurance Policies	2
Octaviar Limited (formerly MFS Limited)	3
Court exercise Broad Powers in Class Action 3	3
Opes Prime Settlement	3
A cry of frustration from the High Court of Australia—Aon v ANU3	4
IMF Funds its first case in New Zealand	4
IFSA Conference	5
IMF News	5

SONS OF GWALIA (“SOG”) UPDATE

As outlined in Issue 7 of The Shareholder and by way of background, when SOG went into administration it seemed that its shareholders who had suffered loss due to SOG’s failure to disclose material information to the market would not be entitled to any recovery. The funds available to the administrators were to be paid out to its general creditors but not to its shareholder creditors.

IMF believed that, as persons entitled to damages from SOG, shareholders should be able to claim alongside and *pari passu* with general creditors.

IMF agreed to fund a group of shareholders, with claims totaling about \$300m, who had purchased their shares during the period of non disclosure and therefore suffered loss.

A test case was funded through to the High Court. In January 2007 the High Court held that the claim of a shareholder who had been misled at the time of purchasing shares is entitled to rank equally with other unsecured creditors in the company’s administration.

Following this decision, the creditors represented by IMF reached a compromise solution with the administrators of SOG, Ferrier Hodgson, whereby the shareholders’ claims were accepted for what they had lost plus interest and the shareholders would transfer their claims against the directors and auditors into the general creditors’ pool.

IMF then provided the administrators with full proofs of debt for each shareholder creditor client, most of which were accepted by the administrators. These arrangements were accepted by the general creditors as being to the advantage of all, and resulted in a dividend payment ranging between 4-8c in the dollar (depending on the admitted loss amount).

IMF also marshalled the vote of its clients to ensure the sale of the Tantallum assets went to the buyer offering cash.

IMF organised legal representation for the shareholders and proceedings were issued on

their behalf against the Sons of Gwalia directors and the group’s auditors, Ernst & Young. These proceedings ran in parallel to the legal action by SOG against its former directors and auditors.

These proceedings were settled at mediation in August 2009, and subject to creditor approval, will result in a further return to IMF clients and general creditors alike.

As a result, IMF’s clients will end up with close to 24c in the dollar of their losses plus interest - a recovery of about \$75m in circumstances where had IMF not funded the case, they would have received nothing.

IMF’s significant investment in funding this case to the High Court has resulted in a landmark change to Australian law and a significant recovery for shareholder creditors of SOG, in circumstances where had the law remained unchanged they would have received nothing.

When the High Court decision was handed down there was consternation in many circles. The finance industry believed foreign lenders would no longer lend to Australian borrowers, insolvency practitioners were concerned that administrations would go on forever and some lawyers simply said that the decision was incorrect.

Notwithstanding these concerns, following a lengthy consultation process, the Corporations and Markets Advisory Committee (“CAMAC”) at the request of the federal government published its report in December 2008 recommending that the status quo following the High Court’s decision be maintained. It now seems unlikely that the Commonwealth Parliament will seek to amend the *Corporations Act* to reverse the High Court’s decision, despite strong lobbying to do so. This is good news for IMF’s shareholder clients in matters where the defendant target is under external control.

Once the settlement is approved by creditors, the SOG administration will stand as a monument to what can be achieved by common sense and competent negotiating.

CLAIMANTS' ACCESS TO DEFENDANTS' INSURANCE POLICIES

Shareholders and other claimants in Australia have received mixed results recently in their efforts to gain access to defendants' insurance policies.

Claimants often contend that whether the defendant is insured, the level of the cover and the terms of the policy concerned are all critical pieces of information in determining whether to commence, continue or compromise litigation to enforce the claimants' rights. Indeed the overriding purpose of civil litigation, to achieve the "just, quick and cheap resolution of the real issues in the proceedings" (in the words of the NSW Act¹) and the efficient management of the litigation itself, may be undermined if the defendant's insurance remains obscure.

Defendants and their insurers, on the other hand, argue that insurance arrangements are not relevant to the "real issues in the proceedings" and that compelling disclosure of policies would provide claimants with an unfair advantage in settlement negotiations by revealing the insurer's limit of indemnity. Companies fear increased litigation and insurers fear more full limit losses if insurance policies are disclosed to claimants.

Traditionally the law has favoured the defendants' position. In our last edition of *The Shareholder* we noted a welcome 2007 decision of the English High Court² in which the defendant was ordered to provide its insurance details so the claimant could assess "whether further litigation will be useful or simply a waste of time and money."³ However, courts in England⁴ and Australia generally remain reluctant to go this far, which has led to an unsatisfactory patchwork of rules.

In Australia, the Federal Court ordered the parties in the Centro litigation to attend a mediation in an effort to resolve the dispute. Centro's financial position is uncertain and the claimants sought access to Centro's insurance policy to ensure that the mediation would be a worthwhile exercise. Their lawyers also argued that they would be unable to recommend a settlement to the claimants or to the Court without disclosure of Centro's insurance cover. Ryan J rejected these arguments and held that "it is not within the power or discretion of the Court to compel disclosure to the applicant of the . . . insurance policies."⁵ In the event, the mediation was not successful.

In the *Lehman Brothers* case, however, the Full Court of the Federal Court held that the Court *did* have the power to compel disclosure of a defendant's insurance policy and of its asset position under section 23 of the Federal Court of Australia Act 1976⁶, but decided that as a matter of discretion no such order would be made because there was no evidence that disclosure was required to prevent any abuse of the Court's process.⁷ The Full Court overturned the earlier decision of Rares J who had ordered production of the insurance policies and correspondence between the defendant, its insurers and brokers.⁸ Both Courts emphasised the fact that the defendant was in administration and insolvent – yet another distinction in the patchwork of rules.

In the third case, *Style Ltd*,¹⁰ a shareholder was successful in gaining access to the company's insurance policy under section 247A of the Corporations Act 2001, so that the shareholder could decide whether to bring a derivative action¹¹ against the company.

Section 247A allows the Court to authorise a shareholder to inspect the books of the company provided the shareholder is acting in good faith and for a proper purpose.

In this case, the Court was satisfied that the shareholder had genuine concerns over the financial position and conduct of the company and that an order was justified. Goldberg J decided that the order should extend to the company's directors' and officers' insurance policy because the cover granted under it is relevant to the shareholder's decision to bring a derivative action against the directors and officers. However, the disclosure of information obtained under section 247A is strictly controlled – disclosure can only be made to the applicant or to ASIC – and in this case the documents could not be used for any purpose other than the proposed derivative action.

Conclusion—Despite the courts' increasing use of case management techniques and court-ordered mediation in an effort to achieve the "overriding" aims of the civil justice system - being the just resolution of disputes as quickly, cheaply and efficiently as possible - the courts remain reluctant to order defendants and their insurers to "put all their cards on the table" and reveal the true extent of the defendant's cover. The practical importance of this information, to litigants and ultimately the court system itself, means that challenges will continue to be made to the long held, but increasingly embattled, right of insureds and insurers to keep policy details secret. It seems likely that, in time, greater disclosure will become the standard.

¹ Section 56(1), Civil Procedure Act 2005 (NSW).

² *Harcourt v FEF Griffin* [2007] EWHC 1500 (QB).

³ Note 5 at [19].

⁴ *West London Pipeline and Storage Ltd v Total UK Ltd* [2008] EWHC 1296 (Comm).

⁵ *Kirby v Centro Properties Ltd* [2009] FCA 695 at [28].

⁶ *Lehman Brothers Australia Ltd v Wingecarribee Shire Council* [2009] FCAFC 63, at [32].

⁷ The applicant in that case, Wingecarribee Shire Council, had invested in collateralised debt obligations, or CDOs, it had purchased from a company subsequently acquired by Lehman Brothers. Lehman Brothers was in voluntary administration. Its administrators had proposed a Deed of Company Arrangement ("DOCA") to the creditors, including the Council, which if accepted would have extinguished the Council's claims against Lehman Brothers, its affiliates, directors and officers. The Council sought information on Lehman Brothers' insurance so as to be fully informed about its rights when voting on the DOCA. The Full Court considered there was no abuse of process in the administrators recommending the DOCA without disclosing Lehman Brothers' insurance position and that there was no evidence that the DOCA was likely to be passed by the creditors because of the lack of such disclosure.

⁸ *Wingecarribee Shire Council v Lehman Bros Australia (No 2)* [2009] FCA 532.

⁹ Both the Federal Court and the Full Federal Court distinguished a South Australian decision that had denied access to a defendant's insurance policy in circumstances where the defendant was solvent: *Beneficial Finance Corporation Ltd v Price Waterhouse* (1996) 68 SASR 19.

¹⁰ *Re Style Ltd; Merim Pty Ltd v Style Ltd* [2009] FCA 314.

¹¹ A derivative action is one in which the shareholder sues in the company's name to recover damages for a wrong done to the company, typically when those who are in control of the company refuse to take action: section 236, Corporations Act 2001.

OCTAVIAR LIMITED (FORMERLY MFS LIMITED)

After going into Administration in October 2008, Octaviar Ltd ("OCL") and Octaviar Administration Pty Ltd ("OA") entered into Deeds of Company Arrangement ("DOCAs") in January 2009, which had been put to the creditors of the companies by Fortress Credit Corporation ("Fortress").

The Public Trustee of Queensland ("PTQ") sought to terminate the DOCAs and also sought orders in relation to the validity of a charge over the assets of OCL granted in favour of Fortress in January 2008, pursuant to which Fortress had appointed receivers ("the Charge").

In March 2009, the Supreme Court of Qld (McMurdo J) ordered by way of separate determination that the Charge was void, as notice of it had not been given as required by the Corporations Act. Whilst a notice of appeal was filed by Fortress in relation to that decision, Fortress did not seek to expedite the appeal which was therefore not heard prior to the hearing of the balance of the application to terminate the DOCAs. A separate application was filed by Fortress to seek an extension of time in which to give notice of their charge.

On 31 July 2009, McMurdo J terminated the DOCAs and rejected the application by Fortress for an extension of time. Due to previous undertakings given to the

Court in relation to the application to wind up OCL by the PTQ, provisional liquidators (Deloitte) were appointed to OCL. Additionally, Deloitte were appointed as liquidators of OA.

Since that order an application was made by the PTQ to replace Deloitte with alternative liquidators. On 9 September 2009 McMurdo J ordered that OCL be wound up and that Bill Fletcher and Katherine Barnet of Bentleys be appointed liquidators. Mr Fletcher and Ms Barnet have also been appointed as liquidators of OA.

Whilst what further actions that are to be taken on behalf of those companies will be examined by the new liquidators, it appears likely that a public examination of the company's directors and officers as well as other relevant persons will take place in relation to the affairs of the company leading to its downfall including a number of significant transactions, many of which are already the subject of litigation.

How much money is left in OCL is not currently known, but the lion's share of what is left will be argued by the ATO to be subject to its statutory rights and priorities. Whether shareholder creditors receive any return from OCL may depend upon the ability of the liquidators to claw back assets from third parties, and/ or the opportunity to claim under OCL's D&O policy.

COURT EXERCISE BROAD POWERS IN CLASS ACTION

The right to opt out is an essential element of class actions. Persons who opt out will not be bound by (and will not receive the benefit of) any settlement or judgment in the class action.

In a class action funded by IMF against Village Life Ltd a settlement was entered into before any formal opt out notice had been given to group members. Court approval was sought to the settlement and was given.

In addition, the Court exercised its very wide powers under s33ZF of the Federal Court of Australia Act, which allow the Court to make any order it thinks appropriate or necessary to ensure that justice is done in the proceedings. Pursuant to that power the Court dispensed with the requirement to give an opt out notice and to fix a time before which a group member may opt out.

The Court said that it was satisfied that sufficient information had already been given to group members about their rights to opt out and that no group member had indicated a wish to do so. The court also took into account the cost of providing a further notice.

The decision confirms the courts approach to giving s33ZF a generous interpretation.

OPES PRIME SETTLEMENT

In March 2008, the margin lending business operated by Opes Prime collapsed. This attracted significant publicity given the scale of losses suffered by investors. Litigation ensued, including proceedings brought against Opes Prime, ANZ Bank and Merrill Lynch. IMF funded proceedings in the Federal Court for the largest group of claimants who had damages claims of approximately \$165M.

On 4 August 2009, the Federal Court approved the settlement of the Opes Prime litigation by way of a series of Schemes of Arrangement. The Schemes had been overwhelmingly approved at an earlier vote of creditors.

The Schemes of Arrangement provide for a \$253M fund out of which creditors are expected to receive around 37c in the dollar for their claims. This was one of the largest settlements of corporate litigation in Australia in recent times and, unusually for litigation, it occurred in a relatively quick period of time. The litigation IMF funded had a significant impact on the final settlement outcome that was achieved.

As the litigation was settled by the liquidator rather than IMF's clients, the funding return to IMF was reduced to \$6.5m representing the repayment of some \$4m of funding and a fee of \$2.5m.

An important aspect of the case was the Court's approval at first instance and on appeal of the Scheme of Arrangement as a mechanism to resolve litigation not only against the Scheme company but also against third parties (in this case, ANZ and Merrill Lynch).

This is a significant development of the law in Australia and is likely to be used in the future as a useful method to resolve complex multi party litigation – an area IMF continues to be actively involved in.

A CRY OF FRUSTRATION FROM THE HIGH COURT OF AUSTRALIA – AON V ANU

On 5 August 2009 the High Court delivered its decision in *Aon Risk Services Australia Ltd v ANU* [2009] HCA 27. The decision related to the conduct of a matter before the Supreme Court of the ACT.

The proceedings in the ACT had involved claims against the ANU's liability insurer and its insurance broker, Aon. The Court had allocated four weeks to hear ANU's claims against the insurer and Aon.

At the commencement of the trial, ANU reached a commercial settlement with its insurer and then asked the Court to adjourn the trial so it could make substantial changes to its claims against Aon. The Court granted the adjournment and the application to amend the claims against Aon was heard.

Some 11 months later and after the four weeks of Court time allocated to the matter were essentially wasted, the Court ruled that ANU should be granted leave to amend. ANU's application succeeded on the basis that the Court considered the new allegations were not totally inconsistent with its existing claim and the allegations raised triable issues against Aon. The Court found that the interests of justice were served by allowing the amendment application and any prejudice to Aon could be cured by a costs order.

Aon's appeal failed but succeeded in the High Court.

The importance of this decision relates to the changing dynamic between case management principles on the one hand and the Court achieving justice as between the parties to the specific proceedings. While it is difficult to distill a clear and succinct principle from the High Court's judgment, the case will inform how lower Courts balance these competing principles in the future.

Some points made by the judges of the High Court:

- undue delay undermines confidence in the rule of law (essentially justice delayed can be justice denied);
- poor case management results in a waste of public resources and creates inefficiency;
- waste and undue delay are relevant and mandatory considerations when the Court has to consider amendment applications;
- case management should not overcome the objective of doing justice as between the parties;
- the Court must consider the interest of all users of the Court system, not simply the parties to the specific proceedings; and
- speed and efficiency are essential elements to the just resolution of disputes.

The case provoked a very strong response in Justice Heydon who found the conduct of the proceedings to be deplorable. He posed the question whether this case was simply an anomaly in an otherwise functional system or was the sign of a disturbing trend.

Many members of class actions and many private litigants are frustrated and concerned at the time it takes for litigation to progress through the Courts. The views of the High Court echo this concern and frustration. Given a range of recent reforms to enhance the 'just, cheap and quick' resolution of disputes and the strength of the views of the members of the High Court in the *Aon* case, it will be interesting to see whether real and measurable change can and does occur.

IMF FUNDS ITS FIRST CASE IN NEW ZEALAND

The recent marketing of our services in New Zealand has resulted in IMF funding proceedings in the Land Valuation Tribunal. The defendant is a government agency and the case stems from the resumption of a portion of land in Auckland by a government agency.

The timing of the resumption could not have been worse. The owner of the land (who we are funding) at the time of the resumption was poised to commence development by constructing a multi storey office and retail complex. The loss of a portion of the land meant that the proposed building had to be redesigned (to take account of plot ratios). The resultant delays (caused by redesigning the building and ongoing negotiations with the government agency involved) led to viability of the entire project being brought into financial question due to the down turn in the commercial real estate market and because of tenants, who had been committed to the project went elsewhere. Instead of the owner having a commercially viable development, it has been left with debt and a non income producing asset.

IFSA CONFERENCE 2009

IMF attended the annual IFSA conference held from 5-7 August 2009 on the Gold Coast. This year's conference was a very interesting one, held in the midst of the current global financial crisis, which has significantly impacted upon the financial services industry.

This year's conference highlighted that the financial services industry is expecting to experience significant change in the imminent future.

Of particular interest to industry participants were the various reviews currently underway in Canberra, including the Henry Review (into the taxation system), Cooper Review (superannuation) and the review of the Parliamentary Joint Committee on Corporations and Financial Services (PJC) into the financial services industry.

The PJC review is focused upon the significant retail wealth destruction and pain that has been experienced, including via the demise of Opes Prime, Storm Financial and a number of the highly publicised "agribusiness" schemes. The potential ramifications of all of these reviews to the financial services industry was discussed at length.

The GFC including its causes and symptoms was also the subject of much discussion. Overall there was analysis of the impact of the GFC on Australia relative to the rest of the world, and a degree of satisfaction that Australia appears to date to have weathered the crisis better than most other economies. This was attributed to various factors including the structure of our regulatory regime, our banking system and the government guarantee.

One of the most controversial topics aired at the conference was the current state of Australia's financial planning industry. In the wake of various corporate collapses, the push for reform to this industry is growing. The current fee/commission-based payment structure utilised by the majority of this industry was scrutinised in depth, with opinion proffered (including by regulators) that commission-based payment models or structures are not beneficial to clients and may be phased out. Also discussed was the need to examine industry qualifications and standards and to ensure regulators are able to identify and weed out "rogue operators".

Finally, the structure and performance of our regulators and the prospect of further regulatory change was debated. The overall sentiment was that our regulatory and prudential models had held up well during the global financial crisis compared to their overseas counterparts, however there was still room for improvement. On this final point there was a degree of trepidation on the part of the industry that "over-regulation" would occur, with calls for regulation to be balanced by the need for Australia to retain a stable financial services industry.

NEWS IN BRIEF

IMF's ADELAIDE OFFICE

IMF's Adelaide office opened in July 2009 and is located at 250 Flinders Street Adelaide. Please contact Tania Sulan on (08) 8232 4600 or tsulan@imf.com.au for any enquiries.

IMF's NEW CORPORATE BROCHURE www.imf.com.au/brochure

IMF's ANNUAL GENERAL MEETING

IMF's Annual General Meeting will be held on Friday, 6 November 2009 at the Sheraton Perth Hotel. IMF's annual report and investor presentation can be viewed via the following link:

www.imf.com.au/announcements

A LIST OF FUNDED MULTI-PARTY SHAREHOLDER ACTIONS AND PROPOSED ACTIONS CAN BE VIEWED AT: www.imf.com.au/cases

For editorial enquiries please contact Tania Sulan:

Phone: +61 8 8232 4600

Fax: +61 2 8223 3555

Email: tsulan@imf.com.au

To UNSUBSCRIBE, email editor@imf.com.au with UNSUBSCRIBE in the subject.

*To apply for
funding
please contact:*

SYDNEY

John Walker
Clive Bowman
Susanna Khouri
Wayne Attrill

Level 5, 32 Martin Place
Sydney NSW 2000

Tel: +61 2 8223 3567

Fax: +61 2 8223 3555

PERTH

Hugh McLernon
Charlie Gollow
Paul Rainford

Level 6, Citibank House
37 St George's Terrace
Perth WA 6000

Tel: +61 8 9225 2300

Fax: +61 8 9225 2399

BRISBANE

Andrew Charles

Level 5
232 Adelaide Street
Brisbane QLD 4000

Tel: +61 7 3221 7651

Fax: +61 2 8223 3555

MELBOURNE

Simon Dluzniak

Level 3
480 Collins Street
Melbourne VIC 3000

Tel: +61 3 9629 1211

Fax: +61 2 8223 3555

ADELAIDE

Tania Sulan

250 Flinders Street
Adelaide SA 5000

Tel: +61 8 8232 4600

Fax: +61 2 8223 3555