HEATHER COLLINS
Investment Manager, Omni Bridgeway

KATE CONNEELY
Partner
KordaMentha

legal update

CLASS ACTION DENIED EXAMINATION UNDER THE CORPORATIONS ACT

Shareholders not entitled to conduct public examinations for private claims.

In the decision of *ACN 004 410 833 Ltd (formerly Arrium Ltd) (in liquidation) v Michael Thomas Walton* [2020] NSWCA 157, the NSW Court of Appeal held that where orders for an examination were sought by a limited group of persons, for a private purpose and not for the benefit of the company, its creditors or contributories, then the examination was for a purpose foreign to which the examination power is conferred and therefore was an abuse of process.

BACKGROUND FACTS

A NSW Supreme Court registrar granted the representative of a potential class action being considered by a limited group of shareholders (Shareholders) of ACN 004 410 833 (formerly Arrium Ltd) (in liquidation) (Arrium) orders for:

- production of documents from Arrium, KPMG, UBS and Mr Simon Galbraith who was a former director of Arrium, and
- a summons for examination of Mr Galbraith.

Prior to the grant of the above orders, the Shareholders wrote to ASIC seeking that the respondents be given 'eligible applicant status' under s 597(5A)(b) of the *Corporations Act 2001* (Cth). None of the proposed examinees identified in the letter to ASIC were subsequently the subject of the summons for examination, and Mr Galbraith was not identified in the letter to ASIC.

Arrium applied to a judge of the NSW Supreme Court to have the orders for production and summons for examination discharged or stayed. *(In the matter of ACN 004 410 833 Ltd (formerly Arrium Ltd) (subject to deed of company arrangement)* [2019] NSWSC 1606])

The Shareholders submitted to the court that the purpose of the proposed examination was to investigate whether any claims had sufficient prospects of success to warrant pursuing them.

The Shareholders identified the prospective claims as a claim against:

- Arrium's officers for misrepresentations concerning the September 2014 capital raising and financial position of Arrium in FY 2014 and FY 2015.
- KPMG for misleading and deceptive conduct and negligence in relation to the preparation and publication of Arrium's financial statements for the year ended 30 June 2014 and half-year ended 31 December 2014.

Arrium's liquidators had already conducted public examinations and another eligible applicant had participated in the public examinations. The Shareholders had foreshadowed the possibility of also participating but at that time had failed to do so.

The liquidators of Arrium did not examine the directors of Arrium regarding the September 2014 capital raising because they considered it unlikely to give rise to a cause of action that would benefit Arrium or the creditors.

The Shareholders were not creditors of Arrium and any claim against Arrium was abandoned when they failed to lodge a proof of debt under the deeds of company arrangement.

RELEVANT LEGAL PRINCIPLES

An examination order may be discharged if the court finds the applicant had an improper purpose for securing the examination order or it otherwise amounts to an abuse of process.

Setting aside an examination order on the basis that it is an abuse of process will be exercised by the courts with caution and only in exceptional or extreme cases.

The courts have previously held that it would be an abuse of the court's process to secure an examination summons 'not for the benefit of the corporation, its contributories or

creditors' but only for the advantage of a person to be used in other litigation.

It is acceptable for the examination procedure to be used by a creditor whose purpose was to ensure that their debts were paid.

It is widely acknowledged that the two purposes for the statutory provision regarding the examination procedure are:

- 'to enable the public to know how corporations are being managed', and
- 'to achieve the deterrent effect of a public examination'.[1]

In earlier decisions the courts have found that:

> *... it is an abuse of process to use the Pt5.9 procedure if the predominant purpose of the applicant seeking the order is not for the purpose of benefiting the corporation, its contributories or its creditors.*[2]

However, if the applicant has one purpose which does not benefit the corporation and another purpose which does, then that would not be an abuse of process.

The applicant for an examination summons does not need to demonstrate that the evidence that may be gathered during the examination will expose conduct that substantiates a claim.

The heavy onus of demonstrating that an examination summons should be set aside rests on the party seeking to stay the summons.

DECISION AT FIRST INSTANCE

In the first instance decision, the court found that the predominant purpose in seeking the examination summons was for the shareholders to 'investigate, and pursue, a personal claim' against the directors of Arrium or against its auditors.

However, the court also found that, through the examination process, there might be potentially proper purposes to the benefit of Arrium, its creditors or contributories, including information gathering regarding claims that should not be pursued by Arrium.

In those circumstances the Black J held:

> *With considerable hesitation, I am not satisfied that Arrium (or Mr Galbraith, so far as he adopted its submissions) has discharged the heavy onus of establishing that an examination of Mr Galbraith would be an abuse of process. The requirements for an examination of Mr Galbraith under s 596A of the Act are satisfied, and no abuse of process arises from him now being examined by the plaintiffs where he was not previously examined (but informally interviewed) by the liquidators and there is no evidence that the Plaintiffs' legal representatives had the opportunity to participate in that informal interview.*

APPEAL DECISION

The Court of Appeal found that the examination was an abuse of process for the following reasons:

- The litigation foreshadowed by the respondents in the application for examination would not provide any commercial benefit to Arrium. Arrium did not suffer any loss from the September 2014 capital raising; rather it benefited from it.[3]
- The proposed members of the class action did not include all contributories of Arrium, nor did it include contributories who held shares at the time the administrators were appointed. That highlighted the 'essentially private nature of the proposed claim'.[4]
- The Shareholders had advised ASIC and the court at first instance that the 'predominant purpose in seeking the issue of the examination summons was to investigate and pursue a potential claim in their capacity as shareholders against the directors or auditors or Arrium'.[5] While the shareholders submitted to ASIC that any recovery from the proposed litigation 'would ensure that the pool of funds available to either the company or other shareholders would increase'6 that submission was not made to the court at first instance. Rather the Shareholders made it clear that no derivative action was sought to be commenced.

For the above reasons, the Court of Appeal held that 'the predominant purpose was to pursue what we described as the essentially private nature of the proposed claim'.[7]

In conducting its review of the relevant authorities, the Court of Appeal concluded that *Re Excel*:

> *... is clear authority for the proposition that an application for the predominant purpose of advancing the cause of the application in litigation against third parties and not for the benefit of the corporate, its contributories or its creditors is a use of the provision for a purpose foreign to the power.*[8]

OBSERVATIONS

In obiter comments, the Court of Appeal noted that the application for status as 'eligible applicants' by the Shareholders differed from the examination summons in that:

- None of nominated examinees contained in the application to ASIC were replicated in the examination summons.
- Mr Galbraith was not identified in the application to ASIC.

The Court of Appeal considered that the examination summons might also have been open to challenge and being set aside where the examination summons use differed from 'the basis put to ASIC in order to obtain eligible applicant status'.[9]

1 *In the matter of ACN 004 410 833 Ltd (formerly Arrium Ltd) (subject to a deed of company arrangement)* [2019] NSWSC 1606 at [20]. **2** *Re Excel Finance Crop (rec and mgr apptd); Worthley v England* (1994) 52 FCR 69 at [143]. **3** *ACN 004 410 833 (formerly Arrium Ltd)(in liq) v Michael Thomas Walton* [2020] NSWCA 157 at [123] to [127]. **4** *Ibid* at [128]. **5** *Ibid* at [129]. **6** *Ibid*. **7** *Ibid*. **8** *Ibid* at [137]. **9** *Ibid* at [122]