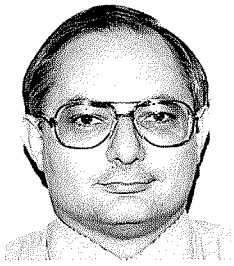
No liability? No way!

A High Court judgment has brought much-needed clarification to the position of companies wishing to change to no-liability status, writes ***Derek Parker****. The finding vindicates the ASC's interpretation of the Corporations Law. However, the implications for mining companies are significant and the result may be intense lobbying for legislative change.*



In 1992 Marlborough Gold Mines Ltd, a Queensland gold explorer whose principal asset was a number of mining tenements, found itself in urgent need of funds — about $450,000, according to *The Australian Financial Review* (7 May 1993) — to comply with investment conditions imposed by the Queensland government.

Shares in Marlborough, a public company, were trading below par, so it was not feasible to raise capital through a share placement, a rights issue at par or an issue of partly-paid shares. But if the company could become a no-liability company, it would be able to issue shares at a discount under section 190(1) of the Corporations Law.

Section 9 of the Corporations Law defines a no-liability company as "a company that does not have under its constitution a contractual right to recover calls made on its shares from a shareholder who defaults in payment of those calls".

Marlborough apparently formed the view that the lack of this contractual right in a company's articles was the defining trait of a no-liability company and that therefore, if the articles were suitably amended by a special resolution, the company could transform itself, by a scheme of arrangement, into a no-liability company. Such a move, however, since it affected the company's creditors, would require the approval of a court under section 411 of the Corporations Law.

The company had looked at ASC Policy Statement 22, which indicated that such a scheme may be possible.

The policy statement had been issued on 4 May 1992. It did not take account of the case *Windsor v National Mutual Life Association of Australasia Ltd*[1] (although the decision of the Full Court of the Federal Court was handed down on 23 March 1992, it was not reported until 29 May). The Full Federal Court had considered the interaction between sections 69 and 315 of the Companies (Victoria) Code, which corresponded to sections 167 and 411 of the Corporations Law. The court's decision was that section 315 of the Code and a scheme of arrangement could not be used to convert a company to no-liability status; section 69 constituted an exhaustive list of possible changes in status which did not include a change to a no-liability company.

On 23 June the ASC, having become aware of the *Windsor* decision, informed the company that it was reconsidering its position regarding such schemes. It also indicated that it would, as a friend of the court, inform the Supreme Court of Western Australia, which Marlborough intended to approach for approval, of the decision.

On 14 July the ASC publicly with-

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drew Policy Statement 22 and on 23 July notified the company that it would oppose the scheme.

Nevertheless, on 20 October Commissioner Ng in the Supreme Court of Western Australia made an order approving the scheme, which had received the approval of the company's members. On 27 October, the ASC filed a notice of appeal.

The basis of the ASC argument was that there was no provision in the Corporations Law which allowed for a company's conversion to no-liability status. The possible changes of status were dealt with under section 167 of the Corporations Law: an unlimited company to a limited company; a no-liability company in which all the shares were paid up to a company limited by shares; a company limited by shares to a company limited by both shares and guarantee; a company limited by guarantee to a company limited by both shares and guarantee; and a limited company to an unlimited company. The section incorporated a range of safeguards for members and creditors.

The ASC argued that section 411 was essentially "a machinery provision which did no more than make an agreement binding on its members and creditors, notwithstanding that some members or creditors may have no joined in the agreement".[2]

The Full Court of the Supreme Court declined to follow *Windsor* and upheld Commissioner Ng's decision. It took the view that the attention of the Federal Court in *Windsor* had not been drawn to what it regarded as an important distinction between section 167 of the Corporations Law and section 411. It focused on the court supervision aspect of section 411, asserting that members and creditors could be sufficiently protected by conditions imposed by the court. The lack of safeguards in section 411 was seen as an omission in the legislation that could be redressed by astute judicial action. In the WA Supreme Court's view, the legislature intended that section 411 could be used as a means to convert a company to no-liability status.

This argument notwithstanding, the ASC took the view that the decisions of *Windsor* and *Marlborough* were essentially incompatible. To establish certainty in the area, it sought and was granted leave to appeal to the High Court. The ASC recognised the difficult position in which the appeal, and its related decision not to issue a certificate of registration, placed Marlborough. The company claimed that it was effectively prevented from raising new capital. However, other fundraising options, such as an application to the Federal Court for approval to issue shares at a discount, remained open to Marlborough. The company, for its part, asserted that it had completed "60 to 70 per cent" of the procedures necessary for a conversion under section 411.[3]

Following the decision of the Full Federal Court, Marlborough began estoppel action against the ASC to force the issue of the certificate, asserting that the ASC's withholding of the certificate until the outcome of the High Court appeal was known was unfair and unreasonable, and that the ASC had not opposed the matter before Commissioner Ng.

The key lesson of the case is that individuals contemplating establishing a company, especially a mining company, should carefully consider the type of company required for their purposes.

In its unanimous decision, the High Court said that it was "somewhat surprising" that Commissioner Ng and the WA Supreme Court declined to follow *Windsor*.[4] It also refused to accept the WA Supreme Court's reasoning regarding court oversight of schemes of arrangement under section 411, noting that the legislation was quite clear in section 167, which explicitly allowed other changes of status. The High Court stated that "the possibility that a statutory omission to protect the interests of creditors and members could be made good by judicial order is a weak ground for concluding that the legislature intended schemes of arrangement to have such an operation". In other words, a change of status was either in section 167 or simply not permissible.

The protection of members and creditors was a pivotal point of the High Court's reasoning, and the explicit lack of such protection in section 411 led to the conclusion that "it is inconceivable that such a change of status could basically be achieved by the simple expedient of passing a special resolution without an insistence on any requirement for the protection of past members and creditors".

On this basis, the High Court upheld the appeal and set aside the orders made in the lower courts, following *Windsor*. The estoppel action regarding the issue of the certificate of registration was also quashed, with the High Court noting that the ASC had not been a party before Commissioner Ng. Marlborough was ordered to pay costs.

For the ASC, the decision clarified the legal situation regarding conversions to no-liability status. The key lesson of the case is that individuals contemplating establishing a company, especially a mining company, should carefully consider the type of company required for their purposes. If a no-liability vehicle is required, then the entity should be incorporated as such from the start.

There is always, of course, the possibility of law reform. Following the High Court decision, *The Australian Financial Review* reported that there were "other mining companies poised to pursue such schemes". If this is so, then it is possible that the mining industry, through its representative association, will lobby the government to amend the Corporations Law (presumably by an extension of section 167). Until any such legislative change, however, the High Court has made the situation clear. ■

NOTES

1. *Windsor v National Mutual Life Association of Australasia Ltd (1992)*, 106 ALR 282.

2. *Australian Securities Commission v Marlborough Gold Mines Ltd (1993)*, Draft Judgment, p. 11 (Mason CJ, Brennan, Dawson, Toohey and Gaudron JJ).

3. Marlborough chairman J. Walls, quoted in *Australian Financial Review*, 7 May 1993.

4. *Australian Securities Commission v Marlborough Gold Mines (1993)*, Draft Judgment, p. 2.