IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No. S56 of 2012

BETWEEN:

TAMAR RIVQA BECK
Appellant

-and-

AMIRAM DAVID WEINSTOCK
First Respondent

HELEN WEINSTOCK
Second Respondent

LW FURNITURE CONSOLIDATED (AUST) PTY LIMITED
(ACN 000 894 557)
Third Respondent

APPELLANT'S SUBMISSIONS

PART I: Internet publication

1 These submissions are in a form suitable for publication on the Internet.

PART II: Issue

2 Whether a share can be a "preference share" for the purposes of the *Corporations Act* 2001 (Cth) (**Corporations Act**) when the rights attaching to the share do not confer any preference or priority over the rights attaching to any other share actually on issue in the company.

PART III: Section 78B of the *Judiciary Act* 1903 (Cth)

3 The appellant has considered whether notices should be given pursuant to s78B of the Judiciary Act. No such notices are required.

PART IV: Citations

4 The reasons for judgment of the primary judge, Hamilton AJ, are not reported. The Internet citation is [2011] NSWSC 235. The reasons for judgment of the Court of

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Appeal of the Supreme Court of New South Wales are reported at (2011) 252 FLR 462. The Internet citation is [2011] NSWCA 228.

PART V: Facts

5 The third respondent (**the Company**) is a family company, the shares in which were at all material times held by members of the Weinstock family, including the appellant and the first respondent (**Amiram**). The effect of the orders of the court below was that the Company validly redeemed for $8 eight C class shares which, if valued based on a pro rata entitlement to distribution of capital, were worth substantially more (potentially "some millions of dollars" (CA [9])). If the eight C class shares have not been validly redeemed, the appellant and Amiram (who are brother and sister) are each entitled to 50% of those shares under the terms of the will of the late Hedy Weinstock (their mother). The effect of orders made by Barrett J in related proceedings (*Beck v L W Furniture Consolidated (Aust) Pty Limited* [2011] NSWSC 235) was to place the Company in the control of Amiram and the second respondent (who is Amiram's wife).[1]

6 The Company was incorporated on 30 April 1971. On the date of incorporation, Leo Weinstock subscribed for and was issued five A class shares (one of which was held by a trustee under a nominee arrangement during the life of Leo Weinstock). Subsequently, the directors of the Company allotted eight C class shares to Leo Weinstock's wife, Hedy Weinstock (CA [7], [19]-[20]). The only other persons to whom shares have been issued are Amiram and the appellant, being respectively the son and daughter of Leo and Hedy Weinstock, each of whom was issued a single C class share, and a company associated with Amiram to which D class shares were purportedly issued later in time.

7 As expressed in the Articles of Association, the A class shares carry no right to vote, but carry rights to return of capital and to fixed cumulative dividends which rank in priority to all other shares in the Company. Those shares are not redeemable. The A class shares could have been converted into voting shares during the lifetime of Leo Weinstock, but this did not happen (and can no longer happen following the death of Leo Weinstock) (CA [17]-[18]).

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[1] Justice Barrett validated the appointment of the second respondent as the sole director of the Company in circumstances where there are no voting shares on issue in the Company. An appeal from the orders of Barrett J to the Court of Appeal of the Supreme Court of New South Wales is currently reserved.

8 As expressed in the Articles, the C class and D class shares carry no right to vote, rank *pari passu* with Ordinary Shares in respect of dividends and carry rights to return of capital in a winding up and in a reduction of capital in priority to any other shares other than A and B class shares (the C and D class shares rank *pari passu* with respect to each other). The C and D class shares are expressed to be redeemable at the option of the Company on or before 30 June 2016, and are separately expressed to be redeemable on the death of the holder (CA [21], [30]).

9 No shares in the Company other than A, C and D class shares were ever issued (CA [11]). Specifically, no "ordinary" shares (or any other shares over which the C class shares were capable of conferring any priority or preference) were ever issued. Nor were there ever issued any shares which conferred an entitlement to vote at a general meeting.

10 On 6 July 2004, Hedy Weinstock died. Shortly thereafter, the directors of the Company resolved to redeem the eight C class shares held by her for $1 each (CA [7]-[8]).

11 The appellant commenced proceedings in the Supreme Court of New South Wales seeking, amongst other relief, declarations that the eight C class shares were "not preference shares within the meaning of the *Corporations Act* and, accordingly, were not able to be redeemed by the [Company]" and that the purported redemption of the eight C class shares was void and of no effect. The applicant also sought consequential rectification of the share register (CA [22]).

12 At the time the proceeding was commenced, Amiram and the appellant were executors of Hedy Weinstock's estate. They were subsequently replaced by Mr Michael Henley as administrator as part of the settlement of aspects of the proceeding before the primary judge. No step was taken in the courts below to join Mr Henley to the proceeding.

13 The primary judge (Hamilton AJ) held that the C class shares "fail to be preference shares within the meaning of the legislation" (CA [38]) because "the preference given must be a differentiation from issued shares; a differentiation from unissued shares is not sufficient" (CA [35], [38]). His Honour made the declarations and orders sought by the applicant.

14 The respondents' appeal to the Court of Appeal of the Supreme Court of New South Wales (Giles JA and Handley AJA; Young JA dissenting) was successful.

15 Specifically, the majority held that the C (and D) class shares were validly issued and conferred the preferential rights contained in the Articles. The fact that such rights remained at all times potential only, and lacking effective content absent any issue by the directors of "ordinary" shares, was no different to the various other ways in which the rights were potential. It did not destroy their character as at all times being preference shares, and accordingly there was no bar to them being redeemable preference shares which could be redeemed on the terms of the Articles (see CA [148]-[149]).

PART VI: Argument

Key steps in the argument

16 The critical steps in the appellant's argument are:

(a) The expression "preference share" in the Corporations Act should be construed to mean a share which confers a relevant preference or priority over some other class of shares actually on issue in the company, typically described as "ordinary shares".

(b) As will appear, that construction accords with the development of the "preference share" as a practical means of encouraging additional investment in companies in financial difficulty and with the terms and the legislative history of the relevant provisions of the Corporations Act.

(c) On that construction, the eight C class shares were never "preference shares" because they conferred no preference or priority over A or D shares, being the only other classes of shares on issue in the Company.

(d) If the eight C class shares were not "preference shares", they could not be "redeemable preference shares" for the purposes of the Corporations Act (s254A(3)).

(e) If the eight C class shares were not "redeemable preference shares" within the meaning of s254J of the Corporations Act, they could only be redeemed or cancelled under Part 2J.1 of the Corporations Act, with which there was no attempt to comply.

(f) The true character of the eight C class shares was that of "ordinary shares" and the attempt to redeem them was an unlawful reduction of capital.

(g) Insofar as any separate issue of construction of the Articles arises, they must be construed subject to, and so far as possible harmoniously with, the law. The Articles created the framework for a bargain between various classes of shareholders. Activation of that bargain, and its precise operative content at any point in time, was dependent on what shares were actually on issue. The liability of C class shares to suffer redemption was inactive in the absence of the issue of ordinary shares over which the C class shares had an actual entitlement to preference.

The issue between the parties

17 The expression "preference share", upon which the definition of "redeemable preference share" depends, is not defined in the Corporations Act.

18 What case law there is on the subject indicates that a "preference share" is a share which "*has some preference or priority over ordinary or common*" shares: *Re Powell-Cotton's Resettlement* [1957] Ch 159 per Roxburgh J. To similar effect, albeit in a different context, Barrett J has observed that *"[i]t is not possible for 'preference shares' to exist except as a result of a process of differentiation from shares which are not 'preference shares' which sees the 'preference shares' entitled to some comparative advantage..."*: in *Re Capel Finance* (2005) 52 ACSR 601 at 605 [11]. See also the authorities referred to by Young JA in the court below (CA [66]-[75]).

19 The parties accept the basic conception of a "preference share" as one which has some "preference or priority", or "comparative advantage", over other shares. The point of difference is whether the statutory expression requires that those other shares be on issue at the relevant time, as contended for by the appellant, or whether it is sufficient that the rights attaching to the putative "preference share" are defined in the company constitution to be preferential to a class of shares which are not on issue and which may never be issued, as contended for by the respondents.

20 The appellant contends that an examination of the history of preference shares, their relationship to ordinary share capital, and the doctrine of maintenance of capital, assists in resolving this debate.

The origins of share capital and the ordinary share

21 Prior to the *Joint Stock Companies Act* 1844 (7 & 8 Vict, c 110), there was no general regime for incorporation of companies. Rather, incorporation was conferred by Crown

grant or specific Act of Parliament. The nature, structure and powers of the company depended entirely on the authorising grant or statute. Thus, care must be taken in making generalisations. Further, concepts such as "share capital" and limited liability developed over time and at different points in time.

22 At the beginning of the seventeenth century, the terms "share" and "capital" had not acquired their modern meaning: see eg *Formoy, RR, Foundation of Modern Company Law* (Sweet and Maxwell, 1923, p6). At that time, the expression "share" was used to refer to an appreciable part of the whole undertaking not as a multiple of units of the capital. As has been said, "*in this way, the Elizabethan company may be regarded as an extended partnership in which each participant possessed a considerable portion of the business*": *Scott, WR, The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720* (Cambridge University Press, 1912, p45).

23 What is important for present purposes is that the starting point, consistently with principles of partnership law, was that the "shareholders" were regarded as owners of a portion of the business, but otherwise did not have differential rights attaching to their "shares". A notion of equality was evident in this early period.

The origins of the preference share

24 Without suggesting any sharp dividing lines, it is apparent that from fairly early on, some promoters, and companies themselves, sought ways to depart from that base position of equality between "shareholders". The concept of a "preference share" developed as a practical solution to a commercial problem, namely the capital raising and financing difficulties faced by transportation and infrastructure companies in the 18th and 19th centuries. As George Evans explained in his work *British Corporation Finance 1775-1850: A Study of Preference Shares* (The John Hopkins Press, 1936, p149):

> *Preference shares grew out of the financial embarrassments of the early transportation companies. Such projects were almost invariably started without an adequate understanding of the engineering difficulties to be overcome, and in consequence the construction costs exceeded expectations. In many cases, before the works were completed the original capital had been exhausted...*

25 Attempts by such a company to raise debt or equity finance were subject to various practical and legal impediments: Evans at pp 149-150. The result was that the issue of new shares was:

> *the only device to which these companies could have had recourse if they were to act in a legal manner. But a sale of shares could not have been effected in view of the desperate condition of the companies unless the shares were made attractive to the existing proprietary or the public. Two methods for doing this were developed. One was to sell shares at a discount; the other was to attach a preferential dividend to the new shares.* (Evans, p150)

26 Preference shares were attractive to investors precisely because they conferred a right to receive a dividend ahead of existing shareholders. As Evans put it (at p6) "*[t]he preferential features of shares were used as bait to procure the needed sums*". A share which conferred an entitlement to a dividend which had a priority not over the existing shareholders but over shares which were unissued and which might remain unissued would not have been attractive "bait".

27 Authority to issue "preference shares" was required to be given by the company's constituting statute or subsequent amendment. Those specific statutes or amendments trace back prior to the middle of the 19th century. General provision regulating the issue of "preference shares" by joint stock companies carrying out public undertakings was first made in the *Company Clauses Act* 1863 (26 & 27 Vict, c 118) **(1863 Act)** as follows:

> ***13. Regulations as to creation and issue of new preference shares or new preference stock. Saving rights of preference shareholders***
>
> *Where any such company is authorized by any special Act hereafter passed and incorporating this part of this Act to raise any additional sum or sums by the issue of new preference shares, or by the issue of new preference stock... then and in every such case the company... may for the purpose of raising such additional sum or sums from time to time create and issue such new shares or new stock, either ordinary or preference... as the company from time to time thinks fit.*
>
> ...

14. Preference shares to be entitled to dividends only out of the profits of each year

The preference shares or preference stock so issued shall be entitled to the preferential dividend or interest assigned thereto, out of the profits of each year, in priority to the ordinary shares and ordinary stock of the company... (emphasis added)

28 The expression "the ordinary shares and ordinary stock of the company" is a reference to the issued capital of the company. First, the expression is a composite expression introduced by the definite article. Secondly, "stock" was a term that was applied to a consolidation of issued shares (see eg s12 of the *Companies Act* 1862 (25 & 26 Vict, c 89) and ss61-65 of the *Company Clauses Consolidation Act* 1845 (8 & 9 Vict, c 16); there was no concept of "unissued stock". Thirdly, there would be no need to allocate priority to dividends declared from each year's profits as between issued capital and unissued capital; what mattered was the priority which "preference shares or preference stock so issued" had over the identified class of issued capital. Fourthly, the section is to be read with s13, which was confined to the issue of "preference shares" by an existing company (ie one with an existing share capital) in order to raise additional sums.

29 Subsequently, in *In Re Brighton and Dyke Railway Company* (1890) 44 Ch. D 28 at 36, Cotton LJ identified s14 of the 1863 Act as providing the "definition" of "preference shares" and contrasted what was done in that case with the statutory "definition". While the other members of the Court of Appeal (Lindley and Lopes LJJ) did not expressly refer to s14 of the 1863 Act, Lopes LJ (at 38) adopted the same substantive definition of "*a right conferred upon the holder to receive interest in priority to the ordinary shareholders*".

30 *In Re Brighton and Dyke Railway Company* concerned whether "preferred half shares", which had been formed pursuant to resolution by dividing ordinary shares into preferred and deferred half shares, were "preference shares" for the purposes of s12 of the *Railway Companies Act* 1867 (30 & 31 Vict, c 127) such that a scheme of arrangement had to be separately assented to by the holders of the "preferred half shares". The Court of Appeal held that the "preferred half shares" were not "preference shares" because they did not confer any preferential right to dividends in priority to ordinary shares; rather the entitlement of an ordinary share to dividends had been split

or divided into two halves. The point was that a "preferred half share" conferred a priority over a "deferred half share", but not over an ordinary share.

Reduction of capital and the doctrine of maintenance of capital

31 Over time, and particularly following the adoption of limited liability (by the *Limited Liability Act* 1855 (18 & 19 Vict, c 133)), the ideas respecting sanctity of nominal and paid up share capital and protection of the rights of creditors in their dealings with companies coalesced in the "doctrine" of maintenance of capital. A company might increase its share capital, but it could not decrease it. This was enshrined in the *Companies Act* 1862 (25 & 26 Vict, c89): see eg *Trevor v Whitworth* (1887) 12 App Cas 409 at 423 per Lord Watson.

32 That position was subsequently modified by statutory recognition that in certain circumstances a reduction of capital might be desirable provided that the process was subject to court sanction to ensure the protection of creditors. Thus, the *Companies Act* 1867 (30 & 31 Vict, c 131) empowered a company to reduce its share capital: ss9-20. The reduction would only take effect by court sanction following a procedure in which every creditor of the company with a debt or claim for which it could prove in a winding up was entitled to object to the reduction.

33 In 1877 that procedure was amended, and the rights of creditors to object qualified, such that the court was not required to hear from creditors unless the proposed reduction involved "*either the diminution of any liability in respect of unpaid capital or the payment to any shareholder of any paid-up capital*": *Companies Act 1877* (40 & 41 Vict, c 26), s4. It is the last part of that qualification, relating to paid-up capital, which was to prove most significant in the development of the redeemable preference share.

34 Subsequently, in 1887, the House of Lords in *Trevor v Whitworth* (1887) 12 App Cas 409 held that a company had no power to purchase its own shares under the Companies Act. The reasoning turned on the "doctrine" of maintenance of capital. Creditors dealing with a company are to be taken as having understood and accepted that capital may be lost through ordinary trading activities, but are entitled to expect that the capital remaining will be undiminished by any unauthorised expenditure including particularly a return of capital to shareholders: see particularly at 415 per Lord Herschell and at 423 per Lord Watson. In *Davis Investments Pty Ltd v Commissioner of Stamp Duties (NSW)* (1958) 100 CLR 392 at 413, Kitto J cited *Trevor v Whitworth* as authority for the

"fundamental principle of company law that the whole of the subscribed capital of a company with limited liability, unless diminished by expenditure upon the company's objects (or, of course, by means sanctioned by statute) shall remain available for the discharge of its liabilities". This in turn was approved in *Australian Oil Exploration Ltd v Lachberg* (1958) 101 CLR 119 at 132.

Origins of the redeemable preference share

35 No doubt following the passing of the statutory provisions requiring reductions of capital to be exposed to court sanction as referred to above, companies began to look for ways to streamline a process of return of capital. One such attempt was considered by Chitty J in *In re Dicido Pier Company* [1891] 2 Ch 354. In that case, the company Articles had provided that for each of the first five years the company was to set aside from its profits a sum equal to 20% of the amount of the preference shares on issue *"for the formation of a fund for paying off such shares at the expiration of five years*". At the end of five years, a special resolution was passed that the capital be reduced by returning to the preference shareholders the amount of their paid up capital from the fund of company profits and by cancelling the preference shares.

36 Justice Chitty characterised the cancellation as one occurring in accordance with the contract constituted by the Memorandum and Articles (at 358). Nevertheless, it was accepted that the cancellation was a reduction of share capital and as such required court sanction. The question was whether creditors were required to be notified under the provisions of the *Companies Act* 1877 referred to above. His Lordship held that the reduction did not involve the payment to any shareholder of "paid up capital" within the meaning of that section, such that it did not require consent of creditors.

37 This was because *"it is the right of both classes of shareholders that on this payment being made to the preference shareholders, out of the profits of the company, of the full value of their shares the rights of the preference shareholders as shareholders shall cease*" (at 359) (emphasis added). It is apparent from the judgment that two "classes of shareholders" to which his Lordship referred were the holders of the issued preference shares and the issued ordinary shares. (This notion of the Articles of Association providing the framework for a bargain between the various persons or classes of persons actually holding issued shares from time to time came to be embodied in statutory provisions such as the current s140 of the Corporations Act).

38 The *Companies Act* 1929 (UK) (**1929 UK Act**) contained a further development. Section 46(1) permitted a company limited by shares, if so authorised by its Articles, to "*issue preference shares which are, or at the option of the company are to be liable, to be redeemed*" provided, amongst other things, such shares were redeemed out of profits available for dividend or out of the proceeds of a fresh issue of shares. Redemption could only occur on the terms, and in the manner, provided by the Articles.

39 Four points should be made here. First, notwithstanding Chitty J's description of *In re Dicido Pier Company* as "*a very peculiar [case] and not likely to occur again*" (at 359), it may be seen that the circumstances accepted by Chitty J as justifying the sanction of the cancellation of the preference shares were adopted and reflected in the terms of s46(1) of the 1929 UK Act. Secondly, the 1929 UK Act went further than the position in that case because a redemption which occurred in accordance with s46(1) no longer required court sanction under the reduction of capital provisions (in ss55 and following). Thirdly, as with the 1863 Act, it conferred a power on a company already established, and therefore having an existing issued share capital, to issue new shares of the relevant kind. Fourthly, a form of protection was accorded to both creditors and existing shareholders by the requirement that the power to issue such preference shares be authorised by the Articles and therefore presumably discoverable at the time of dealing with the company.

40 The 1929 UK Act ensured that the object of maintenance of capital was complied with in four ways. First, as indicated above, creditors were presumed to know what was in the company Articles. Secondly, if the redemption payment were made from profits (or a fresh issue of shares), the capital contributed to the company would not be diminished. Thirdly, where the redemption was out of profits, a sum equal to the amount applied to redeem the shares was required to be paid out of profits into a "capital redemption reserve fund", which in turn was made subject to the provisions of the Act protecting maintenance of capital: s46(1)(c). Fourthly, because only "preference shares" could be redeemed or cancelled in this manner, the second class of shareholders referred to by Chitty J, namely the holders of the ordinary shares, would continue to exist and would continue to hold the "capital" of the company.

41 The significance of the fourth matter must not be understated. The legislature could have provided that any share which was expressed in the Articles to be redeemable could be redeemed in accordance with the terms of the Article and on the conditions in

s46(1). Instead, the legislature made a deliberate choice that only shares which were "preference shares" could be redeemed outside of the reduction of capital provisions involving court scrutiny. The underlying premise was that creditors could deal with a company in the knowledge that any capital contributed to the company with the character of "preference" share capital might be returned to shareholders in accordance with the terms of the Articles and subject to the conditions in s46, but that the company's "ordinary" share capital was subject only to trading risk and that any reduction of that capital was subject to court scrutiny and approval.

42 Further, from the standpoint of the company and shareholders themselves, it is hardly surprising that the ability to redeem was only required and submitted to in respect of "preference shares". As demonstrated above, those shares typically were issued upon a financial crisis of some kind (or at least a particular need for additional capital) and were issued on terms preferential to the existing "ordinary" shareholders. From the new investors' perspective, it is not surprising that they would seek to be able to obtain return of their investment at an early stage. From the existing "ordinary" shareholders' perspective, it is no less surprising that upon the resolution of the financial crisis or need which prompted the issue of the new shares, they would wish to see the impact of those new shares on the continuing enjoyment of their rights removed.

Adoption in Australia and the more recent legislative history

43 The 1929 UK Act was effectively adopted in New South Wales by the *Companies Act* 1936 (NSW) (**1936 Act**). Section 149 of the 1936 Act provided that a company "if so authorised by its articles, <u>may by special resolution</u> issue preference shares which are, or at the option of the company are to be liable, to be redeemed" (emphasis added). The requirement that the issue of preference shares occur by special resolution constituted an additional protection for existing shareholders.

44 That the focus of the recognition of redeemable preference shares remained with their relationship to ordinary shares, actually on issue, was confirmed by s149(2) of the 1936 Act (in turn following s46(2) of the 1929 UK Act). Any company which issued redeemable preference shares was required to include in every balance sheet a statement of what part of the <u>issued</u> share capital consisted of those shares as well as the date on which they were liable to be redeemed. If there were no ordinary shares on issue, there could be no "part" to identify.

45 In short the 1936 Act did not sanction for the first time that which had never been sanctioned, namely the creation of a company where the entire share capital could be redeemed to members at their election without any overriding protections for the interests of creditors.

46 Subsequent statutory provisions, namely ss61 and 66 of the *Companies Act* 1961 (NSW), s192 of the *Corporations Act* 1989 (Cth), Part 2H of the *Corporations Law* and Part 2H of the current Corporations Act, operated and continue to operate on the same basis, although there is no longer any requirement for a "capital redemption reserve fund". Thus, subsection 254A(1) of the Corporations Act provides that the general power to issue shares includes the power to issue "*preference shares (including redeemable preference shares)*" and subsection 254A(2) contains the current iteration of the legislative protections for existing shareholders, namely that the power to issue preference shares, and the rights which they confer, must be set out in the constitution or approved by special resolution. Pursuant to ss254J and 254K, redemption can only occur on the terms on which the shares are on issue and can only occur out of profits or the proceeds of a new issue of shares. Such a redemption is an authorised cancellation of shares for the purposes of the reduction of capital provisions in Part 2J.1 of the Corporations Act.

47 While the current legislative scheme has removed court control from every reduction of capital, s256B retains overriding requirements of law that the reductions be fair and reasonable to all shareholders and not materially prejudice creditors, in addition to shareholder approval. These are matters the court can adjudicate on. Redemption out of available profits or proceeds of a new issue, without any other scrutiny of the interests of creditors and shareholders, is still something limited to "preference shares": s254J, s254K and s258E(1)(a).

48 Accordingly, it remains the case today that it is not possible to create a company where the entire issued capital can be returned to members at their election without any overriding protections for the interests of creditors.

The proper construction of the statutory term

49 The statutory expression "preference share" in the Corporations Act 2001 (Cth) should be given a construction which is available on the language and which accords with the historical and legislative development of "preference shares" and "redeemable

preference shares" referred to above. That construction is the one advanced by the appellant, namely that in order for a share to be a "preference share" or specifically a "redeemable preference share" within the meaning of the statute, it must confer some relevant advantage or priority over existing issued shares or "ordinary shares".

50 In contrast, the construction advanced by the respondents pays insufficient regard to the practical commercial problem which the issue of "preference shares" was designed to overcome and which underlies the relevant legislation from the 1863 Act through to the Corporations Act. The point was to encourage new investors to take the risk of contributing capital to an enterprise in financial difficulty or need by offering them in return some advantage or priority over the existing investors. No investor would have been encouraged to contribute capital in such circumstances by the promise that his or her rights conferred no priority over existing shareholders but rather a priority over shares yet to be issued and which might never be issued.

51 The construction advanced by the appellant also accords with the statutory object of maintenance of capital. The term "preference share" in the current Corporations Act, through its adoption in the definition of "redeemable preference share", opens a gateway through which a company may reduce its share capital otherwise than by the procedure for capital reductions in Part 2J.1 of the Corporations Act. As demonstrated above, an underlying premise of Chitty J in *In re Dicido Pier Company*, as reflected in the 1929 UK Act and subsequent legislation, was that because it was only "preference shares" that could be redeemed, creditors could be assured that the "ordinary" share capital of the company could not be touched except with court approval (or, more recently, review). The respondents' construction would depart from this basis and would permit the safeguards surrounding capital reductions to be circumvented by the simple expedient of inserting a notional base class of shares into the company's constitution, over which all other shares are notionally "preferential", even though no shares of the base class are ever issued.

Time at which the C shares must be "preference shares"

52 On the present facts, there were at no time any other shares on issue over which the eight C class shares had any priority or preference. Accordingly, those shares did not have the character of preference shares, or redeemable preference shares, at the time of issue or at the time of their attempted redemption.

53 Section 254J of the Corporations Act is a statutory permission to do that which otherwise would be unlawful, namely to cancel shares otherwise than through the provisions of Part 2J.1. That statutory permission is accorded only in relation to preference shares which are liable to be redeemed. It follows from that characterisation of s254J that the relevant point in time at which to test whether the eight C class shares answer the statutory description is at the time of the attempted redemption. As there were on issue in the Company no "ordinary" shares, or shares over which the C class shares conferred a preference or priority, the C class shares were not "preference shares" within the meaning of the Corporations Act 2001 (Cth) and could not be redeemed under s254J of that Act.

54 There is a separate question which may not need resolution on the present facts as to what would happen if a company issued shares which at the date of their issue did not have the character of preference shares because there were on issue no other shares over which they had priority and the company subsequently issues such "ordinary" shares. Is it legally possible for the first-mentioned shares to become "preference shares" for the purposes of the statute upon the issue of "ordinary" shares? Can a lawful ability to redeem them spring up on the happening of that event, when no such ability existed on their issue? The better view would be that the shares were required to meet the statutory description as at the time of issue.

55 Under the relevant provisions prior to the Corporations Act (ie s46(1) of the 1929 UK Act through to s61 of the Companies Act 1961), there was no separate permission to redeem "redeemable preference shares"; rather, the one section conferred the power to issue "preference shares which are... liable to be redeemed" and required the redemption to be effected in accordance with the Articles. Under the current Corporations Act, the permission to redeem is contained in s254J and not s254A. However, it may be doubted that any substantive change in the operation of the sections was intended. Like its predecessors, the Corporations Act implements a deliberate legislative decision that the only shares which can be cancelled without going through the reduction of capital provisions are those shares which are issued as, and continue to be, preference shares. If at the time of their issue the C class shares were in fact ordinary shares (despite their label under the Articles), then they were never shares which satisfied that condition.

Errors of the majority of the Court of Appeal

56 Acting Justice Handley (with whom Giles JA agreed) assumed rather than demonstrated the answer to the question of statutory construction presented by the appeal. His Honour's fundamental proposition was in effect that shares which are validly issued have all of the rights and incidents set out in the Company Articles. A situation where shares have only some of the rights or incidents set out in the Company Articles would be equivalent to amending the Articles or converting shares from one class to another, which neither the directors nor the Court could do (CA [128], [129], [131], [132], [133]).

57 With respect to his Honour, it was not and is not in dispute that the C class shares have the rights and incidents set out in the Articles, the relevant question is whether the Corporations Act permits one of those incidents to be given effect at the relevant time. Whatever the Company Articles provided, the effect of s254J of the Corporations Act was that the Company could only redeem the C class shares if they answered the statutory description of "redeemable preference shares". The situation where the Company Articles provide for certain rights or incidents to attach to shares but those rights or incidents cannot be exercised is one which the legislation itself brings about. It does not involve the amendment of the Articles or the conversion of shares from one class to another.

58 The distinction between the existence of rights attaching to shares and the enjoyment of those rights (CA [134]-[135]) does not point in favour of the respondents' construction. *White v Bristol Aeroplane Co Ltd* [1953] Ch 65 concerned the construction of company Articles and, in particular, whether the issue of additional preference shares ranking *pari passu* with the existing preference shares "affected, modified, varied, dealt with, or abrogated" any of the rights or privileges of the existing preference shareholders within the meaning of the Articles. The decision says nothing about the meaning of the statutory expression "preference share".

59 The characterisation of the rights of the C shares while no ordinary shares were on issue as "potential only, without effective content" and the analogy that the right of any shareholder to dividends is potential until a declaration is made are not to the point (CA [148]-[149]). As indicated above, the important point was that a preference shareholder would be induced to invest because it would stand in a better position to the existing shareholders. That there is no entitlement to a dividend unless and until there is a

relevant declaration by the directors (which in any event was a position which evolved over time with respect to preference shareholders) is an incident of investment in shares, not a question of priority vis-à-vis other shareholders.

Construction of the Articles

60 The above argument has sought to demonstrate that the primary issue in this case is one of the construction and application to the facts of the Corporations Act, rather than simply an overly literal reading of the Articles.

61 To the extent that it is necessary to approach the matter through a construction of the Articles, they should so far as possible be read harmoniously with the requirements of the Corporations Act. That is so because s140 of the Corporations Act gives force to them as a statutory contract, and one between the persons who are members from time to time, which in the present context means persons holding issued shares.

62 That analysis leads to two grounds of harmonisation. First (as Article 3(4)(c) in its preface makes clear, but is true anyway), the Articles have effect subject to the statute and its provisions as to when shares can be redeemed. Second, the Articles create the framework for a bargain between various classes of shareholders. Activation of that bargain, and its precise operative content at any point in time, was dependent on what shares were actually on issue. The liability of C class shares to suffer redemption was inactive in the absence of the issue of ordinary shares over which the C class shares had an actual entitlement to preference. Thus, the bargain in relation to the C class shares (as embodied in cl 3(4) of the Articles) was that the *quid pro quo* for being subject to the power to redeem was the enjoyment of the preferential entitlement to return of capital over ordinary shareholders (which the Articles assumed would exist). Put another way, sub-paragraphs (c) and (d) of Article 4(3) are subject to the same condition as sub-paragraph (b), namely that the specified incident is exercisable only if ordinary shares are actually on issue. Accordingly, the eight C class shares were not at the relevant time "preference shares liable to be redeemed" under the terms of the Articles themselves and therefore were not "redeemable preference shares" for the purposes of the statute.

PART VII: Legislation

Companies Act 1867 (30 & 31 Vict, c 131), ss9-20
Companies Act 1877 (40 & 41 Vict, c 26), s4

Companies Act 1929 (UK), s46

Companies Act 1936 (NSW), s149

Companies Act 1961 (NSW), ss61, 66

Company Clauses Act 1863 (26 & 27 Vict, c 118), ss13 & 14

Corporations Act 2001 (Cth), Parts 2H and 2J.1

PART VIII: Orders sought

1. Appeal allowed with costs.
2. Set aside orders 1 to 5 of the Court of Appeal of the Supreme Court of New South Wales made on 17 August 2011 and in place thereof dismiss the appeal to that Court with costs.

Dated 9 March 2012

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