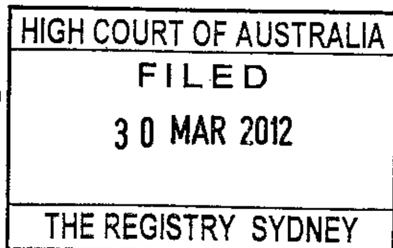
IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No. S56 of 2012

BETWEEN:

TAMAR RIVQA BECK
Appellant

and



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AMIRAM DAVID WEINSTOCK
First Respondent

HELEN WEINSTOCK
Second Respondent

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

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RESPONDENTS' SUBMISSIONS

Part I: Internet publication

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

Part II: Issue

2. The issue in the proceedings is whether the C class shares[1] were "preference shares" within the meaning of the *Corporations Act 2001* (Cth) as at the date of their redemption.

Part III: *Judiciary Act 1903*

30 3. The respondents have considered whether notices should be given pursuant to s 78B of the *Judiciary Act 1903* (Cth) and submit that no such notices are required.

[1] Except where otherwise indicated, the respondents adopt the abbreviations and definitions used in the appellant's submissions ("AS").

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Part IV: Factual issues in contention

4. The appellant's observations at AS5 about the value of the C class shares and the financial consequences of their redemption must be understood in the context of two further matters.

5. First, the assumption that the C class shares will carry a right to a pro rata distribution of the capital of the Company on a winding up is not necessarily sound. Certainly the articles do not provide for a return of capital beyond their paid up amount ($8) [AB 119]. It is only in the event that the Company is wound up without first having issued ordinary shares that such a distribution might come to be made on the basis assumed by the appellant. However, subject to the outcome of the appellant's appeal to the Court of Appeal, the effect of the orders made by Barrett J in *Beck v LW Furniture Consolidated (Aust) Pty Limited* [2011] NSWSC 235 is that the Company is in a position to issue ordinary shares.

6. Secondly, it is true that the effect of the orders made by Hamilton AJ at trial in this matter was to restore the eight C class shares to the Company's register in the name of the estate of Hedy Weinstock, in which estate the appellant and first respondent are entitled to benefit equally. However, the appellant and first respondent are also entitled to benefit in the estate of Leo Weinstock (in the proportions 2:1 in favour of the first respondent), which owns all of the issued A class shares. Making the same assumption about the entitlement of the A class shares to share in a distribution of capital as made by the appellant in relation to the C class shares, the consequence of the redemption of the C class shares was to increase the value of the other shares in the Company, including the A class shares owned by the estate of Leo Weinstock.

7. Thus the effect of the redemption was not to deprive the appellant of the value of the C shares altogether; it was to alter the ratios in which the appellant and first respondent are entitled to the capital of the Company and, even then, only on the further assumption that the Company might be wound up without ever issuing ordinary shares.

8. The effect of the orders made by Barrett J was not to place the Company in the control of the first and second respondents: cf AS5. The first and second respondents had been in de facto control of the Company for many years, as his Honour found at [122].

9. Lastly in relation to the facts, it is relevant to note the form of the orders made on 21 September 2010 by Hamilton AJ [AB 96]. In addition to declarations that the C class

shares were not "redeemable preference shares" and that they were not validly redeemed, his Honour also made an order rectifying the register of the Company "...to record Hedy Jadwiga Weinstock as continuing to be the holder of the [subject C class shares] on and from the date of the purported redemption": Order 2(a). His Honour otherwise made no orders in relation to the rights attaching to the C shares.

10. The appellant seeks to revive those declarations and orders. She does not seek to impugn the issue of the C class shares.

Part V: Legislation

11. The respondents submit that the legislation identified in Part VII of the appellant's submissions is complete save for the following.

12. Sections 8 and 12 of the *Companies Act 1862* (UK) were in the following terms:

> "8. Where a company is formed on the principle of having the liability of its members limited to the amount unpaid on their shares, hereinafter referred to as a company limited by shares, the memorandum of association shall contain the following things; (that is to say,)
>
> (1) The name of the proposed company, with the addition of the word "limited" as the last word in such name:
>
> (2) The part of the united kingdom, whether England, Scotland, or Ireland, in which the registered office of the company is proposed to be situate:
>
> (3) The objects for which the proposed company is to be established:
>
> (4) A declaration that the liability of the members is limited:
>
> (5) The amount of capital with which the company proposes to be registered divided into shares of a certain fixed amount:
>
> Subject to the following regulations:
>
> (1) That no subscriber shall take less than one share:
>
> (2) That each subscriber of the memorandum of association shall write opposite to his name the number of shares he takes."
>
> "12. Any company limited by shares may so far modify the conditions contained in its memorandum of association, if authorized to do so by its regulations as originally framed, or as altered by special resolution in manner hereinafter mentioned, as to increase its capital by the issue of new shares of such amount as it thinks

expedient, or to consolidate and divide its capital into shares of larger amount than its existing shares, or to convert its paid-up shares into stock, but, save as aforesaid, and save as is hereinafter provided in the case of a change of name, no alteration shall be made by any company in the conditions contained in its memorandum of association."

Part VI: Argument

13. The parties are in agreement that the issue in the appeal is one of statutory construction: were the C class shares "preference shares" within the meaning of the Corporations Act when they were redeemed following the death of Hedy Weinstock?

10 *The respondent's argument*

14. The respondents submit that the expression "preference share" in the Corporations Act means a share carrying a right to a preference as to dividends or capital or both and which satisfies the requirement of s 254A(2), namely that the "rights attached" to the share with respect of the matters in s 254A(2)(a)-(e) have been set out in the company's constitution or a special resolution of the company. This construction is consistent with such authority as may be found on the point: *Re Powell-Cotton's Resettlement* [1957] Ch 159 at 161. It is the meaning to be derived from the text of the Corporations Act. There is nothing in that text or in its context that requires the expression to be construed as meaning only those shares in respect of which junior-ranking shares are already on
20 issue, nor is there anything in the objects or purposes of the Corporations Act which compels that narrow construction. The respondents also submit that the appellant's recourse to history does not assist in resolving the issue.

The immediate statutory context

15. The relevant references to "preference shares" are to be found in Chapter 2H of the Corporations Act, entitled "Shares." Chapter 2H broadly contains two sets of provisions touching on preference shares. The first is Part 2H.1 which governs the issue of shares and the determination of the rights and restrictions attaching to shares generally. The second is Part 2H.2 which specifically deals with the redemption of redeemable preference shares.

30 16. As to Part 2H.1, the power to issue preference shares is conferred by s 254A(1)(b) in conjunction with the general power in s 124. Section 254A(2) contains an express limitation on the issue of preference shares except where the requirements of that

section are met. Those requirements are that rights and restrictions in relation to certain matters be specified. The substance of those rights and restrictions is for the company to determine: s 254B.

17. Section 254A(3) contains a definition of "redeemable preference shares". Redeemable preference shares are those preference shares that are issued on a specific term, namely that they are liable to be redeemed in one of the three ways specified in the section.

18. Section 254G provides that a company may convert an ordinary share into a preference share and a preference share into an ordinary share. The section places the same limitation on conversion as is placed on issue, namely that it may only occur where the
10 holders' rights in respect of the prescribed matters are "set out in the company's constitution (if any) or have been otherwise approved by special resolution of the company."

19. As to Part 2H.2, the Corporations Act specifies the requirements which must be met in each case where redeemable preference shares are redeemed: ss 254J and 254K. Those requirements relate to the existence and nature of the fund from which the redemption is to occur. The facility to redeem shares under Part 2H.2 is in addition to the ability of a company to return capital under Part 2J by way of a reduction of capital or share buy-back: s254J(2).

20. The respondent makes the following points in relation to this immediate legislative
20 context. Insofar as it deals specifically with issue of preference shares (whether or not redeemable) the Corporations Act specifies the kinds of "rights attached" which must be "set out", but it does no more. The Corporations Act does not prescribe the content of those rights in any way, nor does it prescribe the manner or degree to which any such right might be enjoyed. Section 254A(2) in context more easily and naturally focuses on the existence of rights, not on their exercise or enjoyment.

21. The Corporations Act also contemplates that a company may alter its capital structure as between ordinary and preference shares in any way it sees fit, subject only to the requirements governing the protection of class rights contained in ss 246B-G. The Corporations Act does not contain any requirement as to how the balance between
30 ordinary and preference shares might be reached in any given case, nor the terms on which such a balance might be struck. By design, it permits the capital structure to change to meet the needs of the company and its shareholders. It contemplates that the

rights of classes of shares will change, that shares will be bought back, that new shares will be issued, that shares will be converted from one kind to another, that shares will be issued but not paid up fully or at all and that shares may be forfeited.

22. Nor does the Corporations Act place any restriction on the ability of a company to redeem redeemable preference shares by reference to the circumstances existing at the time of redemption, save for the important requirements that the shares be fully paid up, that the company have sufficient profits available for redemption or that the company shall have raised additional capital to fund the redemption: ss 254J and 254K.

23. It may be noted that in relation to no liability companies, shares on which calls have been made but which are unpaid may be forfeited: Part 2H.3. In the event that no amount had been paid up on a company's ordinary shares, those provisions leave open the possibility that all of those shares might be forfeited[2] without any credit, leaving only paid-up preference shares on issue.

24. References to "shares" in Chapter 2H must also be understood as referring to shares of any description. So, for example, the references to "shares" in s 254B(1) (which permits a company to determine the terms on which its shares are issued), s 254H (which relates to the conversion of shares into a larger or smaller number), Part 2H.3 (which relates to the liability of a shareholder to pay calls on shares) and s 254W(2) (which provides that directors may pay dividends on shares as they see fit, subject to their terms of issue), must all be understood as including preference shares.

25. It is lastly relevant to note that Part 2H contains one additional provision which restricts a company's ability to confer a preferential return to members, namely in the case of a preferential return to the vendors or promoters of a no liability company (or a company that was originally a no liability company) in a winding up: s 254B(4).

26. Nothing in this immediate statutory context supports the narrow construction of "preference share" for which the appellant contends. Chapter 2H is overwhelmingly concerned with the terms on which shares are issued and the identification of the rights of shareholders. It is not in any way concerned with the actual enjoyment of those rights.

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[2] It may also be noticed that s 254R uses the expression "redemption" to refer to redemption by the holder, not the company.

Wider statutory context

27. Nor does anything in the wider statutory context, particularly Chapter 2J "Transactions affecting share capital", support the appellant's construction. Chapter 2J applies to all shares, regardless of class or rights attaching. The statutory power to redeem redeemable preference shares is expressed to be entirely independent of the company's power to return its capital by reduction or buy-back under Chapter 2J: s 254J(2).

28. The appellant's argument depends to a considerable degree on the proposition that her construction accords with the statutory objects of maintenance of capital: AS51. That proposition finds no foothold in Chapters 2H and 2J of the Corporations Act. There are protections afforded to shareholders and creditors within Chapter 2J, however those protections apply to all reductions and buy-backs regardless of whether or not the capital was subscribed on a preferential basis. There are also protections afforded to shareholders and creditors by Part 2H.2, however those protections are different from and independent of those contained in Chapter 2J.

29. The appellant's point in relation to the relationship between Chapters 2H and 2J ultimately depends upon a concern that a company which only had *redeemable* preference shares on issue might redeem all of its capital other than in accordance with Chapter 2J to the detriment of creditors: AS45, 47, 48, 51. That argument is addressed more fully below, however in summary the concern is entirely unfounded for four reasons:

(a) Redeemable preference shares may only be redeemed from profits or from the proceeds of a fresh issue of shares and only where they are fully paid up: s 254K. As such, redemption does not affect the interests of creditors in any way.

(b) Reductions of capital which occur under Part 2J affect creditors because they reduce the commitment, whether paid or unpaid, that shareholders have made to a company. It is (notionally, at least[3]) on the strength of that commitment that

[3] As Gleeson CJ pointed out in *Sons of Gwalia Ltd (Subject to a Deed of Company Arrangement) v Margaretic* (2007) 231 CLR 160 at 175[5], statutory manifestations of the principle that creditors of a company being wound up are entitled to look to a fund of paid-up capital for the discharge of their debts "have been modified over the years, and it may be doubted that it reflects the reality of modern commercial conditions, where assets and liabilities usually are more significant for creditors than paid-up capital. As Lord Browne-Wilkinson said in *Soden v British & Commonwealth Holdings Plc* [1998] AC 298 at 326, it is 'wholly irrelevant' to the position of a member who has acquired fully paid shares on the market."

creditors choose to deal with the company. Those considerations do not apply where the commitment is of capital that is liable to be redeemed in any event. The prohibition on converting non-redeemable shares to redeemable shares (s 254G(3)) reflects this same concern.

(c) Not all preference shares are redeemable. To construe the expression "preference shares" in a narrow way in order to avoid the result that such shares, if made redeemable, might be redeemed in a manner contrary to the policy of the Corporations Act is to start at the wrong point. The expression must first be construed in a way that accommodates preference shares of any kind.

10 (d) It is not this case in any event. The A class shares, which were issued prior to the C class shares, have been on issue at all times and are not redeemable. The Company could not be left without capital or members by the redemption of the C class shares.

30. There is nothing in the balance of the Corporations Act that reflects an intention to limit the expression "preference shares" to shares which enjoy an actual preference.

The appellant's argument – two preliminary points

31. The key steps in the appellant's argument are identified at AS16. Before addressing that argument in detail it is necessary to identify with precision the process of statutory construction on which it depends. "Preference share" is not defined in the Corporations
20 Act, nor has the common law ever propounded a definition of that term. The particular feature of the term for which the appellant contends has never been recognised in any decided case nor has it been the subject of any enactment, either in Australia or elsewhere.

32. In *Aid/Watch Incorporated v Commissioner of Taxation* (2010) 241 CLR 539 the Court was invited to construe the expression "charitable institution" in s 50-5 of the *Income Tax Assessment Act 1997* (Cth) by reference to what was said to be the state of the common law in relation to that expression which had been developed in the United Kingdom. French CJ, Gummow, Hayne, Crennan and Bell JJ pointed out at [22] that this was not a proper approach to the construction of the legislation. Their Honours
30 referred to *Esso Australia Resources Ltd v Federal Commissioner of Taxation* (1999) 201 CLR 49 at 59-60 [18], where Gleeson CJ, Gaudron and Gummow had been careful

to distinguish between the process of development of the common law by analogy with statute, on the one hand, and the process of statutory construction, on the other.

33. The appellant's argument depends, to varying degrees, on considerations of historical fact and on inferences to be drawn from cases decided by reference to statutory provisions that were never in force in Australia. None of those considerations affords a satisfactory basis upon which to construe the expression "preference share" in the Corporations Act.

34. It is also important to recognise that, to the extent the expression "preference shares" takes its meaning from the general law, it does so from time to time and not by reference to the state of law when the relevant provisions of the Corporations Act came into force, much less when the statutory predecessors to those provisions were enacted: *Aid/Watch* at [23]-[24].

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Historical considerations

35. The respondent takes issue with several aspects of the appellant's description of the historical development of preference shares at AS24-42.

36. First, it may well be that preference shares were originally devised as a means of raising additional capital to complete engineering works in the early days of corporate finance following the industrial revolution, particularly during the first half of the 19th century. In those early years preference shares were issued by companies chartered by private acts of parliament, whose authority to issue preference shares was expressly conferred by further private acts of parliament passed for that purpose. The *Company Clauses Act 1863* applied only to such companies and not to companies incorporated under the reforming *Companies Act 1862* (UK). Sections 13 and 14 of the 1863 Act had no general application: cf AS27. Where they did apply, they did so only where express parliamentary authority to issue preference shares had otherwise been given. A useful illustration of how preference capital was raised under that regime is to be found in *Corry v The Londonderry and Enniskillen Railway* Co (1860) 54 ER 628, 29 Beav 263. The issue of preference shares under that regime has no relevant modern analogy. The "preferred" and "deferred" half shares in issue in *In re Brighton and Dyke Railway Company* (1890) 44 Ch. D 28 (referred to at AS29-30) were issued by the authority of just such a private act.

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37. These early historical observations do not in any event make good the point at AS26 (and AS42) that shares which gave priority "not over existing shareholders but over shares which were unissued and which might remain unissued would not have been attractive 'bait'." It is doubtful that that observation was true in the early 19th century and it is certainly not true today. An important feature of any preference share is that it enjoys priority over all ordinary shares, whether then existing or later issued. The protection against the interests of later investors is no less important "bait" than the preference over existing investors.

38. Secondly, the *Companies Act 1862* contained no reference to preference shares. In fact, general companies legislation in the United Kingdom contained no reference to preference shares until the enactment of s 46 of the *Companies Act 1929* (UK). Nevertheless, preference shares of all kinds were issued on the authority of s 8 of the *Companies Act 1862*. That section merely required that the memorandum contain, amongst other things, a statement of "the amount of capital which the company proposes to be registered divided into shares of a certain fixed amount." Early cases and texts reveal a wide variety of capital structures devised for companies regulated by the 1862 Act, including "deferred", "preferred", "founders" and other shares, each carrying varying degrees of preferential rights: see for example *Re Floating Dock Co. of St Thomas Ltd* [1895] 1 Ch 691.[4] In 1877, the first edition of what was to become known as *Palmer's Company Precedents* was published under the title *Conveyancing and Other Forms and Precedents Relating to Companies Incorporated Under the Companies Acts, 1862 and 1867*. It suggests that preferred shares of varying descriptions were in very common use by that time: pp 252-259. It also suggests that there was a practice of issuing "deferred" shares of various descriptions, which in fact conferred some preferential rights to profits, to the promoters of companies prior to the issue of other shares: see the precedent at p 43.

39. Thirdly, for some considerable time after the enactment of the *Companies Act 1862*, there was uncertainty about the basis upon which holders of preference shares were to be treated, in terms of their relationship with both other shareholders and the company itself. That uncertainty relevantly manifested itself in three ways: in relation to a

[4] It is relevant to note that in this case, decided in the year following *British and American Trustee and Finance Corporation v Couper* [1894] AC 399 (discussed at 45 and 50 below), Chitty J affirmed a selective reduction of capital that left only preference shares on issue.

company's ability to create additional preference shares; in relation to the treatment of preference shares in a winding up; and in relation to the treatment of shareholders (including preference shareholders) in a reduction of capital. In all cases, the rights of a company in relation to the issue of preference shares and the rights of preference shareholders vis-à-vis other shareholders were originally seen to be constrained by notions of "equality" derived from partnership law. That perceived constraint was rejected in all cases.

40. *The creation of preference shares*: The question of the ability of a company incorporated under the *Companies Act 1862* to create preference shares other than those
10 for which the memorandum provided came before Kindersley VC twice in the 1860s. In 1865 the members of Scarborough Cliff Hotel Co Ltd purported, by special resolution, to issue a portion of their unissued shares as preference shares: *Hutton v Scarborough Cliff Hotel Co Ltd* (1865) 46 ER 1079, 4 DE.G.J. & S 672. That resolution was held to be invalid. The directors then attempted to increase the capital of the company over and above that provided by the memorandum by issuing preference shares, relying on s 12 of the 1862 Act. That attempt was also rejected by Kindersley VC: *Hutton v Scarborough Cliff Hotel Co Ltd* (1865) 62 ER 717, 2 Dr. & Sm. 521.

41. However, the second *Scarborough Cliff Hotel* case was emphatically overruled in *Andrews v Gas Meter Co* [1897] 1 Ch 361. Lindley LJ explained that the rationale
20 which underlay the decision in the second *Scarborough Cliff Hotel* case was that the memorandum contained an implied condition that all shareholders were to be treated "on an equality" (at 370). The existence of that condition, derived from partnership law, was rejected. It was instead held that the power to increase capital by the issue of preference shares was to be ascertained from the articles of the company, which could be changed from time to time subject to the *Companies Act 1862.*

42. *Treatment of preference shares in a winding up*: Prior to the decision in *Birch v Cropper* (1889) 14 App Cases 525 there was uncertainty as to the basis upon which preference shareholders were entitled to participate in a winding up. The case arose following the very profitable sale by the company of its canal business, which left a
30 surplus of about £550,000 to be divided among shareholders. The difficulty was that holders of preference shares represented a relatively small portion of the total capital of the company but represented a relatively large portion of the paid-up capital. The terms of issue of the preference shares were silent as to participation in surplus.

43. It was held that the distribution was to be made according to the shares held in the company and not by reference to the amount actually paid up on those shares. Lord Herschell's reasons for that specific conclusion commence at 536. His Lordship at 530-531 expressly rejected an argument that the case ought to be decided by reference to principles of partnership law.

44. *Treatment of shares on a return of capital*: The question of the entitlement of shareholders to participate in a reduction of capital came before the Courts on numerous occasions following the enactment of ss 9-20 of the *Companies Act 1867*.[5] Those sections for the first time permitted a company to return capital to members.

10 45. In *British and American Trustee and Finance Corporation v Couper* [1894] AC 399 the House of Lords considered a scheme for the selective reduction of capital of a company which had interests in both the United States and the United Kingdom. The scheme was to split the company geographically by delivering the American operations to the American shareholders in return for the cancellation of their shares plus a cash payment. The House of Lords unanimously approved the scheme. At 417 Lord Macnaghten identified Mr Couper's objection to the scheme as being founded on the same proposition as Kindersley VC had relied on in the second *Scarborough Cliff Hotel* case, namely that the memorandum of a company contains an implied condition of "equality" derived from partnership law. His Lordship rejected that implied constraint and doubted
20 the relevance of any analogy with the law of partnership.

46. In all of these cases, the courts emphasised the dominance of the articles of association in working out the respective rights and liabilities of shareholders including preference shareholders. In all cases they rejected any suggestion that the interests of shareholders might be determined by reference to an implied doctrine of equality between them. The early notion of participation according to "equality" (cf AS23) among shareholders was entirely rejected in favour of participation according to the terms of the articles.

47. The appellant's ultimate complaint nevertheless appears in substance to be that the Court of Appeal erred by assessing the nature of the C class shares by reference to the terms of the articles and not by reference to the state of affairs which existed as between

[5] Section 3 of the *Companies Act 1877* clarified that the power to reduce capital extended to unpaid capital, thus reversing the effect of the decision of Sir George Jessel in the *Ebbw Vale Case* 4 Ch. D. 827: see *British and American Trustee and Finance Corporation v Couper* per Lord Macnaghten at 412.

the current shareholders at the time of the redemption: AS56-57. That approach to the identification of an interest in a company was rejected by *Birch v Cropper* and the other cases referred to above and should not now be revived.

48. Fourthly, in spite of the developments referred to above, the state of the law in relation to the rights of preference shareholders continued to change in significant respects for many decades: see generally Chapter 6 of *The Law of Public Company Finance*, Austin and Vann (Ed), The Law Book Company 1986.[6]

49. Fifthly, the status of the "doctrine" of maintenance of capital to which the appellant refers at AS31-34 is somewhat doubtful: see footnote 3 above. To the extent that such a
10 doctrine is recognised in Australia, it is to be found in the terms of the Corporations Act and in the "rule" recognised in *Industrial Equity Ltd v Blackburn* (1977) 137 CLR 567, 576 that "a reduction of capital can only be effected in accordance with the statutory procedure and that there can be no return of capital except in accordance with that procedure."[7]

50. In any event, it has always been recognised that a return of capital, however it occurs, is necessarily inconsistent with that doctrine. It is no answer to a redemption of shares permitted by the Corporations Act to say that it otherwise offends the doctrine of maintenance of capital. As Lord Herschell LC pointed out in *Trevor v Whitworth* (1887) 12 App Cas 409 at 416, in describing the provisions of the Companies Acts of 1867 and
20 1877 which first permitted a reduction of capital, "nothing can be stronger than these carefully worded provisions to shew how inconsistent with the very constitution of a joint stock company, with limited liability, the right to reduce its capital was considered to be." See also *British and American Trustee and Finance Corporation v Couper* at 404 per Lord Herschell and at 414 per Lord Macnaghten.

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[6] In *The Isle of Thanet Electricity Supply Co* [1950] Ch. 161 at 175 Evershed MR remarked that "...during the sixty years which have passed since *Birch v Cropper* was before the House of Lords the view of the courts may have undergone some change in regard to the relative rights of preference shareholders, and to the disadvantage of the preference shareholders, whose position has, in that interval of time, become somewhat more approximated to the role which Sir Horace Davey attempted to assign to them in *Birch v Cropper*, namely, that of debentureholders."

[7] This and the similar conclusion of the New Zealand Court of Appeal in *Jenkins v Harbour View Courts Ltd* [1966] NZLR 1, were adopted by Harman J in *British & Commonwealth Holdings Plc v Barclays Bank Plc* [1996] 1 BCLC 1, 7-10, upheld by the Court of Appeal [1996] 1 All ER 381.

51. Sixthly, whatever may have been the nature of preference shares in the 19th century and the early 20th century, by the middle of the 20th century their role had evolved far beyond the original conception of such shares. As the facts of this case demonstrate, preference shares are routinely issued for a range of reasons, many of which have nothing to do with the exhaustion of the so-called original capital. In their redeemable form they may be issued for purposes to do with tax and estate planning, in their convertible form they are commonly issued to venture capital investors, and in their non-redeemable form they are a mainstay of modern prudential capital management.

Redeemable shares and legislative history

10 52. The appellant's observations about the development of redeemable preference shares (AS35-37) do not assist her argument.

53. Even prior to the enactment of specific statutory authority to redeem preference shares, it was recognised that redemption should not be permitted where to do so might prejudice the interests of creditors. It was for that reason that Chitty J approved the scheme in *Re Dicido Pier Company* [1891] 2 Ch 354 and not merely because the cancellation of the preference shares left ordinary shares on issue.[8]

54. Even so, *Re Dicido Pier Company* is only a partial template for later statutory authority to redeem shares. Section 46(1) of the 1929 UK Act, like all subsequent statutory authority to redeem preference shares, was granted on far stricter conditions than were
20 recognised in that case as being necessary for the protection of creditors. Thus, redemption has only ever been authorised where the shares are fully paid up (s 46(1)(c)) and where the redemption is from realised profits or the proceeds of a fresh issue of shares. Those specific requirements ensure that the interests of creditors are in no way affected by the redemption of redeemable preference shares.

55. As the appellant points out at AS38-40, statutory authority to redeem has always been limited to "preference shares." However it is doubtful whether that limitation simply reflects an assumption (or statutory "premise": AS41) that there would in all cases be ordinary shareholders left in place. This is particularly so given the accompanying comprehensive regime for alteration, reduction and forfeiture of share capital from time

[8] It should be noted that Chitty J was equally prepared to sanction a reduction of capital that left only preference shares on issue: see footnote 4 above.

to time. Rather, it reflects the reality that preference shares are in many respects much like debt and that there exists a corresponding desire to have the ability to redeem them as the opportunity arises.

56. However that may be, neither the 1929 UK Act nor any later statutory authority for the redemption of preference shares in the UK or in Australia has ever imposed an additional requirement that ordinary shares, or shares of any kind, must continue to be on issue following redemption. No such requirement has ever been perceived to be necessary, either for the protection of creditors or shareholders. That is not surprising. Creditors are adequately protected by the requirement that the shares be fully paid up prior to redemption and that they be redeemed only out of existing profits or the proceeds of issue of new shares. Any other dealing in redeemable preference shares, such as a buy-back or capital reduction, is governed by provisions which contain full protection for creditors and shareholders and which operate according to their own terms.

57. The respondents make two short points in response to the submissions at AS43-45 about s 149 of the *Companies Act 1936* (NSW). The first is that the requirement that preference shares be issued only by special resolution (AS43) was a measure plainly designed to protect the interests existing shareholders. There was however no requirement as to what the members might agree in that special resolution. The 1936 Act did not lay down any rule preventing a company from having only preference shares on issue at a particular point in time.

58. The second is that the fear of a company being left with only redeemable preference shares on issue (AS44-45) is not one which has ever prompted any legislature to impose an additional constraint on a company's ability to nominate that "part" of its share capital which may be redeemed.

59. Lastly in relation to the legislative history, it is incorrect to suggest (AS47-48) that a redemption of redeemable preference shares is an opportunity for a company to return capital "without any overriding protection for the interests of creditors." It is important to recognise that the Corporations Act provides different protections in relation to redemption and reduction of share capital. The protections afforded to creditors when shares are redeemed are far greater than those that exist when capital is reduced under Chapter 2J, because redemption is only permitted in circumstances where creditors

cannot be affected in the first place. That is because the redemption can only be of paid up shares (thus it never involves a diminution of any shareholder's liability to the company); and can only be made from realised profits or the proceeds of a fresh issue (thus it never involves a diminution of the company's net capital position).

60. There is the potential for wider scrutiny in relation to reductions of capital (whether or not that scrutiny involves court supervision) precisely because a reduction of capital under Chapter 2J, unlike a redemption under Chapter 2H, has the potential to affect the interests of creditors and other shareholders generally. That is because it involves a net reduction of the company's capital.

10 61. But those two propositions do not combine to form a "doctrine" of maintenance of capital that imports additional, unstated restrictions on a company's ability to redeem shares under Chapter 2H in circumstances otherwise contemplated by the Corporations Act.

The appellant's construction

62. The crux of the appellant's case appears at AS49-51, where it is argued that her construction accords with the "practical commercial problem" which preference shares were designed to overcome (AS50) and with the statutory object of maintenance of capital (AS51). The first of those matters is no more than an observation about historical and factual circumstances which existed long before redeemable preference shares gained their current utility. For all of the reasons described above, that historical development tells little about the meaning of the expression today and is an unsound basis upon which to construe the Corporations Act in any event. The second depends heavily on the proposition that there is a "statutory object of maintenance of capital" that is not contained in Chapter 2J of the Corporations Act but which is to be inferred from it. That proposition should be rejected for the reasons explained above.

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63. The scheme of Chapters 2H and 2J of the Corporations Act is that companies may only redeem, forfeit, return or buy back capital in accordance with the Corporations Act. The prospect of capital being returned to shareholders other than in accordance with the Corporations Act is not created (or heightened) by the circumstance that a company has only preference shares on issue at a particular point in time. That circumstance does not expose shareholders or creditors to any particular risk, much less any risk which the legislation has seen fit to protect against, nor does it circumvent any statutory safeguard.

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The decision of the Court of Appeal

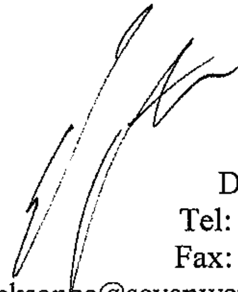
64. The respondents submit that the appellant's case fails for the reasons given by Handley AJA. As his Honour noted at CA[134]-[135], it is important to distinguish between the existence of rights attaching to shares and the enjoyment of them. Both the *Companies Act 1961* (NSW) and the Corporations Act prescribe the rights which holders of preference shares and redeemable preference shares must have (that is, the rights which must exist and attach to the shares) but they do not require or presuppose that such rights will in fact be exercised. As Handley AJA pointed out at CA[149], preferential rights might never be exercised, depending upon such contingencies as the existence of profits, the declaration of dividends and the availability of assets on a winding up. Those considerations cannot be dismissed as mere incidents of investment: AS59. The appellant's case is, after all, that Hedy did not in fact enjoy any preferential rights in the Company.

65. Handley AJA did not simply assume the answer to the question: cf AS56. The Corporations Act does not invite a consideration of whether or not a share is a "preference share" in the abstract or in isolation. Nor does the Corporations Act invite a consideration of that question by reference to general notions of equality among shareholders. It does so in Chapter 2H by reference to the "rights attached" in the memorandum and articles of association. His Honour was therefore entitled to look to the articles to discern the rights attaching to the C class shares, the issue of which was not and is not now impugned.

66. The important point made by the appellant at AS59 is an observation about historical fact which is quite divorced from the modern conception of a preference share. The point gives undue prominence to the "practical commercial problems" of privately chartered 19th century companies and ignores the modern uses of preference shares. It also ignores one of the basic protections offered to preference shareholders, which is that their shares will enjoy a preference over later investors. There is nothing about the history of preference shares that is inconsistent with the raising of preference capital before the raising of capital by the issue of ordinary shares.

67. The respondents submit that the appeal should be dismissed with costs.

Date: 30 March 2012



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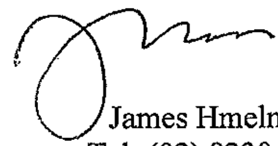

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