

IN THE FEDERAL COURT OF AUSTRALIA

VICTORIA DISTRICT REGISTRY

GENERAL DIVISION

No. of 2009.

On appeal from the Federal Court of Australia

IN THE MATTER OF:

OPES PRIME STOCKBROKING LIMITED

(Receivers & Managers Appointed) (In Liquidation)

ACN 086 294 028

LEVERAGED CAPITAL PTY LTD

(Receiver & Managers Appointed) (In Liquidation)

ACN 097 720 495

HAWKSWOOD INVESTMENTS PTY LTD

(Receivers & Managers Appointed) (In Liquidation)

ACN 098 040 683

OPES PRIME GROUP LIMITED

(Receivers & Managers Appointed) (In Liquidation)

ACN 120 372 223

BETWEEN: ROBERT FOWLER

Applicant

AND: JOHN ROSS LINDHOLM, ADRIAN LAWRENCE BROWN AND PETER DAMIEN McCLUSKEY  
Respondents

### OUTLINE OF SUBMISSIONS FOR APPLICANT

1. This outline commences with an examination of the judgments of Justice Finkelstein given on 3 and 4 August 2009 and of the relationship between them.

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Filed on behalf of the applicant by

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2. The judgment given on 3 August 2009 (“the first judgment”) constituted the reserved reasons for judgment relating to orders which his Honour had made on 23 June 2009. Those orders permitted the Scheme to be put to meetings of creditors. The judgment dated 4 August 2009 (“the second judgment”) was delivered orally upon that date and the written form became available on 12 August 2009. It was an *ex tempore* judgment. The second judgment approved the scheme and it is this judgment which is the subject of the application for leave to appeal.

### THIRD PARTY RELEASES

3. The first judgment deals with this issue at paras 35-55. His Honour declined to follow the leading Australian authority, a decision of Needham J in *Re Buildmat (Australia) Pty Ltd and the Companies Act (1981) 5 ACLR 689* following *Bridges v Hershon* and instead adopted the reasoning of a number of foreign decisions.
4. *Bridges v Hershon* was a decision of a very strong Court of Appeal (Asprey JA (adopted by Wallace P and Walsh JA). It has never been doubted. It was cited with approval by Brennan J sitting as a member of a Full Court of the Federal Court in *Commissioner of Taxation v Betro Harrison Constructions Pty Ltd (18 August 1978)*<sup>1</sup> (judgment paragraph 5). It has been cited in many other Australian cases and never before departed from. None of these cases was referred to by his Honour.
5. Justice Finkelstein criticised Needham J’s decision as having been expressly based upon *Bridges v Hershon* which, his Honour said “goes against his conclusion” [judgment para 38]. His Honour’s analysis of why *Bridges v Hershon* goes against the conclusion in *Re Buildmat* is incorrect. In *Bridges v Hershon* the scheme effected a compulsion on members to sell their shares. Thus, it compelled them *qua* shareholders, as Needham J appreciated in *Re Buildmat*. As Asprey JA said, a s181 arrangement will, if approved “to some extent alter or modify the relationship between the company and its members *in their membership capacity*” (emphasis added).
6. Sitting as a single judge, Justice Finkelstein should have followed *Re Buildmat* unless convinced it was wrong. His conclusion that it was wrong was incorrect. *Bridges v Hershon* entirely supported the conclusion in *Re Buildmat*, which has been undoubted law in Australia for more than 40 years. It was referred to with approval by a Full Court of the Federal Court in *Re Boral Johns Perry Industries Pty Limited v Kurt and Gerlinde Piccardi; Dick & Dons Pty Limited; Fire Fighting Sprinkler Co Limited and George Gregory Grivas* [1989] FCA 227 (23 June 1989) [para 22] and in decisions at first instance<sup>2</sup>. It has never previously been doubted.

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<sup>1</sup> *Commissioner of Taxation v Betro Harrison Constructions Pty Ltd* [1978] FCA 32; (1978) 37 FLR 150 (18 August 1978)  
<http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/cth/FCA/1978/32.html?query=bridges%20v%20hershon>

<sup>2</sup> *Re Zdenek Weiss Ex Parte: Official Trustee In Bankruptcy* [1986] FCA 287 (29 August 1986)  
Federal Court of Australia; 29 August 1986

*Re Zero-Population-Growth (Formerly David Roy Hughes)* [1990] FCA 168 (30 May 1990)  
Federal Court of Australia; 30 May 1990

7. Justice Finkelstein commented that Justice Needham's reasoning in *Re Buildmat* was "very brief" [judgment para 37]. It is likely that this was for the usual reason. What Needham J was expressing was uncontroversial. It did not require elaboration. Everyone prior to Justice Finkelstein's decision knew that a s411 scheme could bind a creditor or shareholder only in that capacity. That included the solicitor for the liquidators, Mr Troiani, who told the creditors at the first meeting that this was the law in Australia. Mr Troiani was correct. *Re Buildmat* was long established, undoubted good law. Justice Finkelstein's decision changed that position.
8. The decision of Justice Finkelstein to alter the law for Australia [judgment para 55] was, in the circumstances, if for a court at all, a role limited to the High Court, not one for a judge sitting at first instance. In all probability, the High Court would conclude that such a change was one for the Parliament.
9. Very great importance attaches to the certainty of operation of s.411; creditors are advised and structure their arrangements according to the existing law. Such a radical change, which imperils creditors' private rights of action against third parties, should not have been made at first instance.
10. His Honour's conclusion [judgment para 55] that "the approach to the construction of s411 should ensure that the section has a flexible operation" is also wrong, given that his Honour meant by that observation that the boundaries of s411 should be expanded to encompass rights of shareholders, other than *qua* shareholders, against third parties. Such an expansion was a radical change in the law, which took s411 outside its purpose of regulating the relationship between a company and its shareholders.
11. The reasoning in the first judgment outlined above was inferentially adopted in the second judgment [judgment para 2]. It is implicit from the fact that he appeared to be no longer troubled by this issue [judgment para 12] that his Honour adhered to the conclusions which he had expressed in the first judgment.
12. The applicant adopts the written submissions of counsel for the IMF funded Lavan Legal intervenors (J T Gleeson SC and R W Douglas) dated 10 June 2009, paragraphs 7-32. Those submissions accompany this outline.
13. As Mr Gleeson SC submitted in summary "there is a long line of uncontradicted Australian authorities which hold that a scheme does not affect interests other than creditors *qua* creditors or members *qua* members" [para 8]. That line includes *Bridges v Hershon*.

#### PRIORITY PAYMENTS TO LITIGATION FUNDERS AND TO CERTAIN CREDITORS' LAWYERS

14. Justice Finkelstein dealt with this issue in the first judgment at paras 82-85.
15. The applicant adopts the submissions of Mr Gleeson SC and Mr Douglas for the Lavan intervenors [Tab A] at paras 83-86 to the effect that the "Plaintiff's Costs Fund" was a device to reward compliance and to punish objectors, was objectionable because they permitted distributions to creditor other than on the basis of their claims and tainted votes, represented an effort to bargain with some of the creditors to give them a particular benefit and as such was a fraud<sup>3</sup>.

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<sup>3</sup> "Gleeson SC and R W Douglas: "The 'Plaintiffs' Costs Fund' has the hallmarks of what it is or may become: a device to reward compliance and to punish objectors. Such funds are objectionable because they permit distributions to creditors other than on the basis of their claims and taint votes that may be encouraged by the deployment of the creditors' funds...As Isaacs J held in *Isles* (at 204) that "if it should be found that the bargain was tainted with fraud, the arrangement will not be binding on the non-assenting creditor. If, for example, it

16. Justice Finkelstein dealt with this subject in the first judgment at paras 82-85. His Honour expressed serious concerns at paras 82-84. The applicant submits that his Honour's serious concerns were well founded. At para 85, his Honour stated that he would consider the fairness of dividing assets unevenly at the approval hearing.
17. The second judgment deals with these issues at paras 20-24. His Honour reversed his previous position and approved the provisions upon the ground that "there is no true departure from the statutory regime for the distribution of assets in a winding up. The reason is that the money which is to be distributed between creditors has been put up by the banks...So, in real terms, the money that is to be distributed belongs to the banks and, at the risk of over-precision, does not form part of the liquidators' assets."
18. His Honour stated what might have been a second basis for approval in para 24, namely that "while the amount involved (\$11.5 million) is not small, it is, in reality, only a very small proportion of the funds available for distribution amongst creditors. If the amount were to be divided between creditors, each creditor would receive an additional 1.9 cents in the dollar."
19. The applicant submits that both of the grounds propounded by his Honour are wrong.
20. The funds are in no relevant sense the banks' money. The scheme depends upon the creditors being forced to give up their claims against the banks. The money being paid by the banks is the consideration for that confiscation.
21. The requirements of the Act and the authorities cannot be avoided by characterising the funds as *de hors* the legislation and the caselaw because it is being provided by beneficiaries of the scheme rather than directly from the company's assets.
22. The preference given by the provisions is not small. The difference of 1.9 cents to the losing creditors is about 5% and the benefit to the beneficiary creditors is much more.
23. The payments are in the nature of an impermissible inducement to buy blocks of votes and are inconsistent with principle.
24. The corrosive effect of the priority payments drove a wedge between creditors, who should have stood in the same interest. It also enabled the beneficiaries of the priority payments to hold the Court to ransom by insisting that if the Court were to reject the priority payments as unfair, it would have to reject the entire scheme. The IMF funded parties also told the Court that they withdrew all their objections to the Scheme but only on condition that the Court made no changes to the Scheme and if the Court made any changes to the Scheme, all its objections were to be treated as having been revived. Justice Finkelstein expressed discomfort at this submission but in the end, the outcome of the case before him had the effect of rewarding it.
25. The conduct of the proceedings in the manner described in the preceding paragraph by the parties there identified flowed directly from the decision of the liquidator to make a special accommodation with the litigation funders and the lawyers acting for the funded clients. The departure by the liquidator from the path of his fiduciary duty enabled and encouraged opportunistic conduct by the favoured groups which corrupted the integrity of the scheme process and placed the court in an invidious position of having to either disapprove the scheme or accept its corrupted elements.

## INDEMNITY TO BANKS

26. The second judgment deals with this at paras 25-27.

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was found that there was a bargain with some of the creditors to give them some particular benefit, that would be a fraud."

27. His Honour opined that “perhaps some creditors will pursue such claims. I doubt many will; but for those who do I do not think the indemnity will be a bar.” He considered that there “might only be one or two actions brought in this State.”
28. There was no evidence to support any of these conclusions. The indemnity, especially the second limb, is calculated to encourage a third party to join the banks in order to deter a creditor from proceeding with his claim against the third party. By the time the banks (indemnity) costs are included, the prospect of a creditor obtaining any net funds is seriously reduced. His Honour’s predictions about how few claims might be brought would certainly be accurate if the indemnity remains in force. The probability is that the least sophisticated creditors were likely to be the ones whose claims against third parties were strongest.
29. His Honour’s reasoning at para 27 is not correct in application to a provision of a scheme which discriminates between creditors. The choice for a creditor is stark: to vote for or against the scheme. The fact that a creditor would rather take the scheme, unfair as it is, than not take it is no indication of fairness. That is only one of the reasons why differential treatment of creditors is never permitted except as authorised by statute.

#### THE SCHEME WAS NOT IN THE PUBLIC INTEREST

30. Leaving aside the extinction of third party rights for the purpose of this submission, the payments to funders had the effect of buying votes and was contrary to commercial morality and the public interest for two reasons. First it favoured the large, sophisticated funded groups and secondly it was a breach by the liquidator of his fiduciary duty to all the creditors, especially in light of his strongly expressed statement urging creditors not to sign with a funder. The time limits imposed upon the hearing of this appeal mean that separate proceedings will have to be brought against the liquidators, their advisers and the banks in which it will be alleged that the liquidator and his solicitors made, at the behest of the banks, representations to creditors which were dishonoured but whether that is the case or not, it affronts commercial morality for the liquidator to agree with special interest creditors to give them a preference at the expense of those creditors who accepted his advice in good faith and acted upon it.
31. Upon this appeal, all the Court can comfortably decide is that the liquidator undoubtedly urged creditors not to sign with funders prematurely, that many creditors acted upon that advice and that the scheme in its final form imposed a detriment upon them.
32. It is antithetical to ethical insolvency administration that the liquidator should be influenced to buy off the commercially stronger groups of creditors to the detriment of the weaker even if that is the only means by which the scheme will obtain sufficient support to pass. Insolvency can never be simply about numbers. The obligation to treat all equally except where the statute expressly authorises a departure, which it does only in extremely limited circumstances which the Courts do not construe expansively, is immutable and not subject to the whim of the majority. Nor may it be displaced in order to assemble a majority.
33. The use of a scheme by the liquidator to make priority payments to litigation funders and lawyers was a fraud on the s411 power as Mr Gleeson’s submissions correctly contended.
34. The use of the scheme by the liquidator to extinguish creditor rights against the Banks was a fraud on the s411 power as they were not his to bargain away, different

creditors had claims of different strengths and it was wrong to compulsorily confiscate the most deserving claims at the behest of the majority of creditors who might have had poorer claims.

35. In order to compel one section of creditors to subsidise another, it would be necessary to constitute the donor group as a separate class. In the present application, the applicant asks the respondents to admit that at least 77 of the Dover Gardens creditors voted in favour of the amendments to remove the priority payments to the funded groups and that many of those creditors who voted against the amendments, stood to gain from these payments. His Honour overlooked the significance of the fact that there was virtually unanimous opposition within the most substantial group of creditors who stood to lose from the priority payments. His Honour might have been misled in this respect by the third affidavit of Adrian Brown and by statements of the liquidators' counsel which preceded it, which did not disclose that the votes against the scheme referred to in that affidavit included donee creditors. As to the balance of donor creditors, they should not have been put in a take it or leave it situation where to vote for the scheme they had to accept the priority payments. To place them in such a dilemma was unfair.
36. Mr Gleeson SC was correct in his contention that the only way in which the banks could lawfully extinguish the claims against it by creditors of Opes Prime was to propound their own schemes of arrangement, in which context the extinction would be of the rights of creditors qua creditors. It could not be done by a scheme of arrangement of Opes Prime, which was, at the insistence of the banks, an over reach of the power in s 411.
37. This outline is incomplete but it is all that has been possible in the time available.

C A Sweeney  
L W Maher  
1 September 2009