SUPREME COURT OF QUEENSLAND

CITATION:	*Herbert & Ors v Redemption Investments Ltd* [2002] QSC 340
PARTIES:	**KEITH HERBERT & LOYS ELSIE BARTLETT, KENNETH EDWARD JEPPESEN, PHIL COUGHLAN, RIMMELZWAAN SUPERANNUATION FUND, RICHANA PTY LTD, GRAEME DAVID & LOCHA MAKIE RIXON, NEWTOWN PTY LTD, LANGENAUER SUPERANNUATION FUND, KEITH BURSTON, BRENT OLLIVER, GLENN ALFRED & ROSLYN BREADSELL, TOM LOVATT, JOHN McKAY, TODD OLLIVER and WAYNE OLLIVER** (applicants) **v** **REDEMPTION INVESTMENTS LIMITED (ACN 086 525 466)** (respondent)
FILE NO:	S6135 of 2002
DIVISION:	Trial Division
DELIVERED ON:	18 October 2002
DELIVERED AT:	Brisbane
HEARING DATE:	11 September 2002
JUDGE:	Mackenzie J
ORDER:	**Application dismissed with costs to be assessed**
CATCHWORDS:	CORPORATIONS – INTERNAL DISPUTES – GENERAL PRINCIPLES – application for leave to bring proceedings – where application of s 237 - whether requirements of s 237 satisfied *Corporations Act* 2001 (Cth), s 236, s 237, s 237(2)(a), s 237(2)(b), s 237(2)(c), s 237(2)(d), s 242 *Corporate Law Economic Reform Program Bill* 1998 (Cth) *Dowling v Colonial Mutual Life Assurance Society Ltd* (1915) 20 CLR 509, considered *Goozee v Graphic World Group Holdings Pty Ltd* [2002] NSW SC 640, applied *IOC Australia Pty Ltd v Mobil Oil Australia Ltd* (1975) 11 ALR 417,considered *Jeans v Deangrove Pty Ltd* (2001) NSW SC 84, applied *Metyor Inc* (*formerly Talisman Technologies Inc*) *v Queensland Electronic Switching Pty Ltd* [2002] QCA 269,

considered
RTP Holdings Pty Ltd v Roberts (2000) 36 ACSR 170, applied
Swansson v Pratt [2002] NSWSC 583, considered

COUNSEL: M D Martin for the applicants
R N Taves for the repsondent

SOLICITORS: North Coast Law for the applicants
McMahon Clarke Legal for the respondent

[1] **MACKENZIE J:** This is an application under ss 236 and 237 of the *Corporations Act* 2001 (Cth) for leave to bring proceeding in the name of Redemption Investments Limited ("RIL") against Graham Eric Scott, Andrew Clark Miller, Ian Sydney Cotton and Alan Bruce Cowan. Messrs Scott, Cotton and Cowan were directors of the company at the time of the critical events and Mr Miller was secretary. He has from the 30 June 2000 been a director.

[2] Section 236 provides as follows:

> "(1) A person may bring proceedings on behalf of a company … if:
>
> (a) the person is:
>
> (i) a member, former member, or person entitled to be registered as a member, of the company or of a related body corporate; or
>
> (ii) an officer or former officer of the company; and
>
> (b) the person is acting with leave granted under section 237.
>
> (2) Proceedings brought on behalf of a company must be brought in the company's name.
>
> (3) The right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished."

[3] Relevantly, s 237 provides as follows:

> "(1) A person referred to in paragraph 236(1)(a) may apply to the Court for leave to bring, or to intervene in, proceedings.
>
> (2) The Court must grant the application if it is satisfied that:
>
> (a) it is probable that the company will not itself bring the proceedings or properly take responsibility for them, or for the steps in them; and
>
> (b) the applicant is acting in good faith; and
>
> (c) it is in the best interests of the company that the applicant leave; and
>
> (d) if the applicant is applying for leave to bring proceedings - there is a serious question to be tried; and
>
> (e) either:

(i) at last 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or

(ii) it is appropriate to grant leave even though subparagraph (i) is not satisfied.

… ."

The proposed action

[4] The draft statement of claim in the proposed action discloses that action is proposed against the four officers of RIL referred to above for negligence or breach of fiduciary duty. It is pleaded that by a prospectus and two supplementary prospectuses the company's business was limited to "approved investments" as described in the prospectus.

[5] Subsequent to June 1999 the prospective defendants caused the company to invest moneys with Tamsdale Ltd, a company the sole director of which was William Dohan, who, in 1998, was under investigation by the United States Securities and Exchange Commission and was subsequently indicted for breach of United States securities legislation. A number of particulars are given revolving around the failure to properly investigate Tamsdale, its director and employees or their expertise, and failure to have regard to Dohan's character as known to the prospective defendants from a private investigator's report obtained by them.

Respondent's criticism of proposed claim

[6] The respondent argues that the proposed claim is inadequate to establish a serious question to be tried. It is submitted that the focus in it on what is described as investment of moneys with Tamsdale involves a misconception, since money was paid to Tamsdale only for transfer to another company Linnco, a licensed dealer. The placement of moneys with Linnco was an "approved investment".

[7] It was also submitted that there was no pleading that the negligence alleged was causative of the loss; that the risks associated with a speculative scheme, as this was according to the prospectus, had been fully explained; that the "business judgment" principle and the powers and duties of the directors had been ignored or misunderstood; and that there was no apparent evidentiary basis to assert that there was necessarily a breach of duty by reason of the matters particularised in the claim.

History

[8] The prospectus was issued on 22 April 1999, the supplementary prospectus on 18 June 1999 and the second supplementary prospectus on 26 October 1999. In the last mentioned document, the term "approved investment" was amended by including a new paragraph:

> "(k) Cash held by, in the account of or on deposit with a Licensed Securities Dealer in Australia or an equivalent person licensed or registered under the relevant law regulating dealing in securities in any of the USA, Canada, the countries of the European Union, New Zealand and Singapore".

[9] Most of the moneys transferred from the company's account with Clydesdale Bank to Tamsdale's account at Lloyds Bank were transferred prior to this amendment of the definition of "approved investment", but it was not until some months later that it became apparent that money was at risk. Prior to that the only provision relating to cash was:

> "(a) cash at bank or on deposit at financial institutions rated "A" or better."

Other forms of investment were also defined and were available throughout the relevant period to be used as "approved investments".

[10] An affidavit from Mr Miller explains that RIL was incorporated to raise funds from the public to invest in high risk, leveraged trading and arbitrage products in Australia and abroad. Distillation of this affidavit and other affidavits discloses that the directors obtained a comprehensive report in September 1998 from a private investigator concerning several persons including Dohan. On 20 May 1999 an agreement was made between RIL and Tamsdale under which RIL agreed to make available funds to enable Tamsdale to arrange projects using the funds as collateral security. In June 1999 RIL set up accounts at the Clydesdale Bank in London and Mr Miller and Mr Cotton met Dohan who "was considering establishing an agency/dealer agreement to take advantage of a foreign currency trading system which had been earning reasonable returns". Mr Miller deposes that Mr Dohan was well connected in London and was in a position to seek out the arbitrage projects in which RIL was interested in investing.

[11] On 2 July 1999 an amendment was made to the agreement between RIL and Tamsdale requiring Tamsdale to designate funds held by Tamsdale as being held on behalf of RIL in trust for it. It was also provided that RIL's moneys were not to be commingled with other funds or assets held by Tamsdale and that they would only be held in accounts with "A" rated banks or with (UK) Securities and Futures Authority dealers. (It has become apparent that neither Dohan nor Tamsdale were authorised dealers. A company Linnco Europe Limited with which it was believed Dohan dealt was, it appears, an authorised dealer, but had been subjected to an order by the Securities and Futures Authority in the U.K. to cease carrying on investment from close of business on 18 July 2001 because of a substantial deficiency in its investment capital.)

[12] From shortly after the time when the amendment was executed moneys were transferred on several occasions from RIL to Tamsdale in the belief that they were being paid on to Linnco for the purpose of trading. In February 2000, Dohan told Miller that RIL was facing possible exposure against collateralised capital of $1.2m. Miller went to London in April 2000 and on returning to Brisbane reported to the

directors that a strategic withdrawal should be made from dealers used by Dohan and invested in other options.

[13] On 3 June 2000, Dohan informed Miller that a call on 95% of RIL's collateralised capital had been made. The company's insurers were advised but at the time of the present proceedings, no claim had been made. In Miller's second affidavit the earlier statement that "the policy covers loss through fraud or theft" is revised to "RIL is in the process of obtaining legal advice in respect of that issue and until that advice is available, I will not be certain that the policy covers loss suffered by the company through fraud or theft".

[14] A recovery programme was instituted through August 2000. Dohan was to investigate whether Linnco and a trader had colluded contrary to RIL's interests. In September 2000, Dohan told Murray that he had been charged by the United States authorities in relation to securities dealings. Nonetheless, Dohan continued to manage the recovery programme until February 2001 when what was left of RIL's capital was repatriated to Australia. It had been believed that the association with Dohan should be continued because he was ideally placed to advise about the activities of the dealer, which seemed to be the most likely cause of the loss, and to provide RIL with trade sheets from which it could be analysed how the loss occurred. It is deposed that that had proved unsuccessful because Dohan had not provided any information regarding to the trader's activities or the trade sheets. Directors' minutes relating to the investigations are exhibited to Miller's affidavit.

Best interests of the company - Miller's contentions

[15] Miller's affidavit addresses this issue at length. He deposes that once the funds had been returned to Australia and the balance accounted for, RIL started to put pressure on Dohan for action in relation to the clearing houses and the trader and in particular, to determine if there was any fraud involved. However, communication with him deteriorated after the funds were repatriated. In February 2002, Miller contacted the Director of Enforcement of the Financial Services Authority in the UK. He was advised to write to that officer which he did in February 2002.

[16] Exhibited is a reply from the FSA Enforcement Division to the effect that the FSA was still in the process of attempting to find Dohan without success. Several lines of inquiry were being pursued. They had been in touch with law enforcement agencies in the UK and understood that the Metropolitan Police were processing a request for assistance from United States Customs. The letter continued:

> "You will appreciate that the concern of the FSA in this matter is limited to whether Mr Dohan was conducting a regulated activity in the UK without the requisite permission and that we do not investigate other criminal conduct. You should be advised that if you suspect that Mr Dohan may have been responsible for any criminal conduct … you should consider reporting these suspicious to the relevant UK police force (in this case to the Metropolitan Police in London)."

[17] Murray asserts that the directors of RIL have acted reasonably in attempting to recover the funds lost by asking the FSA to investigate the matter, keeping ASIC informed and keeping the shareholders informed. He also deposes that unless an ATO refund to the company of about $105,000 has not been paid in error, the only assets of RIL amount to about $21,000. He also states that the directors have not claimed any fees from RIL since incorporation. The directors are continuing to carry out the administration of RIL and investigate the circumstances surrounding the loss of funds and look for new business, at no charge to RIL.

[18] It is asserted that if the application is granted and RIL is given leave to commence proceedings against the directors, RIL will have to pay for those services to be provided by someone else with no knowledge of the company. He also said that RIL would also have the expense of funding the litigation against the directors. He also deposed that the directors have formed the view that RIL would be better off if it could actively pursue new opportunities with its remaining assets.

[19] Miller deposes that the directors have considered all of the options available to RIL to recover its funds. He says that at this stage there is not sufficient information available to determine how the funds were lost and whether a good cause of action lies against any company or individual in the UK as a result of the loss. The directors have been and are still reluctant to instruct solicitors in the UK to advise about the prospects of successfully bringing a civil action to recover the funds because it is likely that all of RIL's current resources would be used up simply in getting the lawyers to investigate the matter and provide preliminary advice. The directors have therefore pursued a strategy of trying to find out more about the circumstances of the loss originally through Dohan and now through the FSA, on the basis that the FSA enquiries are not costing RIL any money.

[20] Once the result of those enquiries is known the directors will then decide what action to take, which might involve a civil action in the UK or a claim on RIL's insurance. It is deposed that either way it is likely that RIL will need all of its current assets to pursue the matter further. The directors are reluctant to incur the expense without being able to advise shareholders realistically about the prospects of successfully recovering money from any action they may take.

[21] None of this evidence has been tested. However, leaving that aside, the prospects of actually recovering moneys in civil actions in the United Kingdom must be questionable especially if Dohan and Tamsdale or anyone they dealt with were fraudulent, unless the loss is covered by the insurance policy. It is not clear that steps taken to pursue the claim on the insurance policy will be fruitful. More than 2 years on, it is not even clear, according to the latest affidavit, whether the policy covers theft or fraud. There seems to have been little demonstrated urgency in the way the matter has progressed to date. On present indications, the FSA is unlikely to achieve anything in the United Kingdom that will materially advance a civil claim. Further, there is no evidence suggesting that the invitation to refer any allegations of fraud to the police has been taken up. With regard to the desire to follow up new opportunities with the remaining assets, one wonders what prospect there would be of materially retrieving the situation by that strategy, given the limited extent of the company's finances.

Serious question to be tried - Miller's contentions

[22] It is deposed by Miller that the investment of the funds through Dohan and Tamsdale was an authorised investment in terms of the prospectus. Whether that was correct at the time of the investment of the bulk of the funds, or at all, may be uncertain. Further, the evidence is sparse as to the nature of the transactions entered into using the money. Miller deposes that at each stage of events the directors made decisions based on a proper consideration of the material available to them and the initial decision to invest RIL's funds through Dohan and Tamsdale was made after extensive due diligence processes had been undertaken. Reference has already been made to the private investigator's report which raised a number of issues concerning Dohan's previous activities. After the funds were lost the directors put in place a conservative strategy to recover as much of them as possible and explore avenues to take action for recovery of the loss.

Good faith - Miller's contentions

[23] Miller's affidavit refers to a letter circulated in March 2002 by the solicitors for the applicants with particular reference to a person James Eglitis, who had conducted investigations into the loss of the money and inviting investors to contribute towards the cost of litigation. Miller deposes that he had been introduced to Eglitis in January 2002 by "one of the shareholders". He deposes that Eglitis said that he had been imprisoned in the USA for securities fraud and that RIL should "set a thief to catch a thief". He made a proposition about the way in which his services might be utilised.

[24] The proposition was put to the board of RIL and a decision was made to refuse the approach on the basis of Eglitis' record. Further inquiries reveal that he was an undischarged bankrupt in Australia at that time and that he had been banned by ASIC from dealing in securities and futures. Miller deposes that Eglitis continued to contact him until 9 February 2002, when a phone call with threatening overtones was made. A letter dated 27 February 2002 warning shareholders about dealing with Eglitis had been sent on behalf of Redemption Investments. As previously mentioned, the circular letter dated 12 March 2002 was then sent to shareholders by the applicant's solicitors.

Conclusions as to whether the application has been made out

[25] The sections relied on are a departure from previous law, as explained in *Metyor Inc* (formerly *Talisman Technologies Inc*) *v Queensland Electronic Switching Pty Ltd* [2002] QCA 269 by McPherson JA, and in the Explanatory Memorandum to the *Corporate Law Economic Reform Program Bill* 1998. There has been limited consideration of the provisions since it has been in force and it will presumably be the case that the appropriate principles will be developed incrementally, as more individual cases are considered. It is necessary for the applicants to satisfy each of

the requirements under s 237. If not, leave cannot be given (*RTP Holdings Pty Ltd v Roberts* (2000) 36 ACSR 170; *Jeans v Deangrove Pty Ltd* (2001) NSW SC 84; *Goozee v Graphic World Group Holdings Pty Ltd* [2002] NSW SC 640).

Section 237(2)(a)

[26] There is no reason to doubt that the company will not itself bring the proceedings while it remains under the control of those whose actions are impugned by the applicants. This is reinforced by the inference from the affidavit of Miller that the directors defend their actions.

Section 237(2)(b)

[27] With regard to good faith, in *Goozee*, Barratt J referred, with apparent approval, to the observations of Palmer J in *Swansson v Pratt* [2002] NSWSC 583 where Palmer J said that there are at least two interrelated factors to which the courts will always have regard in determining whether the good faith requirement of s 237(2)(b) is satisfied. The first is whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. The second is whether the applicant is seeking to bring the derivative suit for such a collateral purpose as would amount to an abuse of process. He went on to say that those two factors will in most but not all cases overlap entirely. If the court is not satisfied that the applicant actually holds the requisite belief, that fact alone would be sufficient to lead to the conclusion that the application must be made for a collateral purpose, so as to be an abuse of process. The applicant may however believe that the company has a good cause of action with a reasonable prospect of success but nevertheless may be intent on bringing the derivative action not to prosecute it to a conclusion, but to use it as a means of obtaining some advantage for which the action was not designed or for some collateral advantage beyond what the law offers. If that is shown the application and the derivatives suit itself would be an abuse of the courts process.

[28] In the present case none of the potential plaintiffs has deposed to a belief in the viability of the cause of action. There is an affidavit from the solicitor having carriage of the action in which he deposes that the applicants believe that they can show a *prima facie* case against the directors for negligence in investment the funds or alternatively transferring funds to an unlicensed and unregistered securities dealer. While the affidavit is expressed in quite general terms, it is not necessary to finally resolve whether it is sufficient for the solicitor to depose in those terms on behalf of the applicants generally since this element is not the only one upon which the application would fail if the affidavit were insufficient for the purpose.

[29] I note also in the context of this ground the remarks of Palmer J in *Swansson* to the effect that a derivative action sought to be instituted by a current shareholder for the purpose of restoring value to his or her shares in the company would not be an abuse of process even if the applicant is spurred on by intense personal animosity, even malice against the defendant. He states that it is not the law that only a plaintiff who feels goodwill towards a defendant is entitled to sue, on the basis of

cases such as *Dowling v Colonial Mutual Life Assurance Society Ltd* (1915) 20 CLR 509, 521-522; *IOC Australia Pty Ltd v Mobil Oil Australia Ltd* (1975) 11 ALR 417, 426-427. He went on to say that, on the other hand, an action sought to be instituted by a former shareholder with a history of grievances against the current majority of shareholders or the current board may be easier to characterise as brought for the purpose of satisfying nothing more than a private vendetta and not brought in good faith.

[30] The proposed plaintiffs are shareholders or persons allegedly entitled to be registered as shareholders who have lost considerable value of their investment. They are directly affected by what has happened. I do not consider that there is any evidence of bad faith in bringing the action, if leave is allowed. It is also necessary to comment on the contents of the affidavit of Miller concerning Eglitis and the reliance apparently placed on him by the solicitors for the proposed plaintiffs. Whether or not it is wise to place reliance on him given his background is not the important circumstance in determining whether the applicants are acting in good faith. I do not consider that the matters referred to by Miller are proved to impact upon the good faith of the applicants.

Section 237(2)(c) and s 237(2)(d)

[31] While the issues of whether there is a serious question to be tried and whether it is in the best interests of the company that the applicants have leave are separate, it is convenient in this case to make some observations about the existing state of affairs concerning steps to recover the moneys lost and the state of the evidence upon which the applicants base the proposed application.

[32] There are indications in the CLERP Explanatory Memorandum that a pragmatic and practical approach ought to be taken in deciding whether leave should be given (see for example paras 6.33 and 6.38-6.39). There are unsatisfactory features in the slow pace at which the company's predicament has been addressed by the directors, and also in the applicants' case. The problem is that it is one thing to propose how a cause of action might be framed if evidence were available, but another to satisfy the statutory test that it is in the best interests of the company that leave be given to bring the action. As previously mentioned, there has not been a great sense of urgency on the part of the directors about making inquiries with a view to recovering any moneys that may be recoverable from Tamsdale, Dohan or Linnco. It is also of concern that the position with respect to insurance cover in the event that theft or fraud has been involved in the loss of the money is still unresolved. It is understandable that the applicants may feel aggrieved. However the minutes exhibited to Miller's affidavit indicate that the subject has not been entirely ignored, and the company is in a desperate financial situation and has at all material times had a limited capacity to pursue the matter effectively. If the taxation refund is a legitimate entitlement that may provide some alleviation but, realistically, it will probably be insufficient to pursue an effective action in the United Kingdom through to completion.

[33] The application is designed to provide a means of restoring to the company losses allegedly incurred as a result of the negligence or breach of fiduciary duty of the officers of the company. The criticisms of the proposed pleadings by the respondent have been referred to above. Revision of them might meet some aspects of the objections. But there is an underlying concern that a fundamental premise is that the fact that moneys were passed to Tamsdale is causative of the loss. That may or may not prove to be the case. There is at least some evidence that the moneys went to a licensed dealer and were subsequently lost. It is purely speculative that the mere fact that the moneys passed through Tamsdale's account to Linnco, if that is what happened, contributed in any material way to the loss.

[34] In the absence of any evidence that it did, it would seem difficult for the proposed action to succeed. The concern is that giving leave at this point, on the evidence apparently available and bearing in mind what is not obviously available, would be premature. If leave were given, disclosure would, no doubt, shed some further light on what was done by and known to the proposed respondents at material times.

[35] But there is a real risk that if the facts establishing causation have to be established otherwise, as seems to be the case if the information placed before me is reflective of the true position, it is likely that there will be a need to conduct investigations, which are likely to be difficult, in the United Kingdom at least. Some limited assistance may be available at lesser cost if the regulatory authorities in the United Kingdom are successful in locating Dohan and/or locating any relevant records. However, it is speculative whether that will occur.

[36] The proposed applicants represent about one-sixth of the shareholding of the company. At the moment there is no evidence that a greater proportion of the shareholders have any interest in joining the proceedings. The respondent argues that an equivalent outcome in respect of the individual applicants could be achieved under the *Corporations Act* by recovering losses sustained in the event that breaches of the *Corporations Act* by the directors are proved. Assuming, without exploring the issue further, that that is correct it seems to me to be somewhat beside the point that individual shareholders may have a right of recovery against the directors. The issue to be resolved under the criteria in section 237 is whether bringing an action against the directors in the company's name is in the company's best interests, not whether individual shareholders might achieve redress against the same parties.

[37] It is also submitted that the inability of the company to pay for the action against the directors, or to pay the directors' costs if the action fails indicate that it is not in the company's best interests to have the action brought in its name. No submissions were made concerning orders under s 242, but the assumption inherent in the submission seems to be that an order that the company be responsible for the costs of the action would be made. As the CLERP Explanatory Memorandum states, lack of access to company funds by shareholders to finance the proceedings where a shareholder sought to enforce a right on behalf of the company was one of the difficulties associated with the pre-existing common law action. That led to a disinclination on the part of prospective litigants to risk having costs awarded against them in a case which would ultimately benefit the company as a whole, not just individual shareholders (para 6.15). If the taxation refund is not a legitimate

entitlement of the company, the financial state of the company is precarious. If the $105,000 refund is a legitimate entitlement its position will be somewhat alleviated, but given the nature of the action proposed the capacity of the company to fund the action itself would probably be marginal, given the inherently expensive inquiries that would probably have to be made.

[38] In an application of this kind, it is necessary for an applicant to establish a greater assurance that the action, in the form proposed, will be viable than has been established on the evidence. Where the degree of speculation is as high as it is in this case, and the means of establishing a greater degree of assurance involves the matters referred to above, it would be wrong to find that it is in the company's best interests that leave be given or to find that there is a serious question to be tried.

[39] As the matter stands at the present time, I am not persuaded positively that the applicants have discharged the onus on them under s 237 to enable leave to be given take action in the company's name against the directors. The application is therefore dismissed with costs to be assessed.