

THE TREATMENT OF SECURITIES RELATED CLAIMS IN INSOLVENCY²

Abstract

The generally accepted rule in insolvency is that equity holders come last when distributing the assets of the debtor. During the life of the company, shareholders can assume numerous roles that don't have to be necessarily connected with their status as members. One of the situations that have emerged as fairly controversial concerns shareholders as a damaged party (especially in the domain of securities fraud). In this case, the controversy revolves around the question whether shareholders that suffered damage should be treated as tort claimants and ranked equally with other unsecured creditors, or should their claims be subordinated. These cases have shown the existence of the conflict between the rules of insolvency law and set of laws aimed at investor protection.

Keywords: *insolvency, shareholders, securities fraud, subordination, investor protection.*

1. Introductory remarks

The protection of creditors is seen as one of the most important issues in business law. Hence, the legal science and practice have developed many instruments in order to obtain this goal. The protection is necessary during the entire lifespan of the company and becomes especially important when financial difficulties emerge and the insolvency procedure is opened. In fact, the protection of creditors is recognised as the main goal of insolvency procedure. The entire procedure is developed in order to prevent the race for the debtor's assets.³ Therefore, the legislators

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³ D. Henry, "Subordinating Subordination: Worldcom and the Effect of Sarbanes-Oxley's Fair Funds Provision on Distributions in Bankruptcy", *Emory Bankruptcy Development Journal*, Vol. 21, 2004, 263.

established systems of classification of creditors in certain priority orders. This means that some creditors (those of higher rank) will receive a larger portion of assets than those of the lower rank who will receive less, or even nothing. Since this means a certain degree of discrimination and inequality among creditors, it is necessary to find a compelling policy reason for this legislative solution.⁴

Ladder of priorities mostly comprises of several groups of creditors – super-priority creditors, priority creditors, *pari passu* creditors, subordinated creditors and expropriated creditors.⁵ The group of subordinated creditors includes various claims – equity claims, creditors subordinated for misconduct (equitable subordination), post-insolvency interest, consensually subordinated creditors etc.⁶ The subordinated creditors are somewhat neglected in the legal literature, but in practice, their treatment has shown to be of great importance. This is especially true for the shareholders who are accorded special treatment in insolvency on the grounds that they are insiders who have more information on business and finances of the debtor than other creditors and can use this information in order to secure an advantage over outside creditors.⁷

The general principle is that equity comes after the credit, but the practice has opened new perspectives on shareholder position in insolvency. The place of these claims in the ladder of priorities is important for shareholders because it determines which part (or whether any part) of debtor's assets will belong to them. Also, in some countries subordinated shareholders can be devoid of their voting rights in reorganization procedure.

This paper is focused on the question whether shareholders who acquired shares as a result of misleading conduct of the company should participate in insolvency proceedings as unsecured creditors for claims that arise out of that conduct, or their claims should be treated as any other equity-related claim and thus subordinated.

2. The new developments in insolvency priorities

For a long period of time banks, the bondholders and the trade had had the key claims against the debtor. However, today the structure of debt has changed and the debtors are faced with new types of claims - shareholder class action lawsuits, fraud claims and claims by securities regulators, indemnity claims by third-party co-defendants, and other

⁴ P. Wood, *Principles of International Insolvency*, Sweet & Maxwell, London 2007², 238.

⁵ *Ibid.*

⁶ *Ibid.*, 267-271.

⁷ A. Cahn, „Equitable Subordination of Shareholder Loans?“, *European Business Organization Law Review* 1/2006, 296, 298.

forms of equity-related claims.⁸ This is a consequence of an enactment of a set of laws aimed at investors' protection that require the company to disclose information relevant for the value of the investment or that might influence the decisions of investors to buy, sell or retain their securities.⁹

In the light of the new developments, a tension was noted between remedies under securities law and insolvency law in respect of the treatment of these claims.¹⁰ Namely, securities laws grant investors certain remedies that give rise to the question where should claims of investors be placed in the ladder of priorities in insolvency. In the ordinary course of events, on insolvency, creditors rank ahead of equity investors. However, a dilemma has emerged whether investor's claim for fraud damages should be subordinated on the grounds that the damages are related to an equity interest, or the claim should rank with unsecured creditors because the damages don't relate to the nature of the equity investment but rather to fraudulent conduct.¹¹ The new approach brought the idea of extending the concept of rateable (*pari passu*) distribution within the class of ordinary unsecured creditors to accommodate the interests of defrauded shareholders.¹² The problem is that the debtor's estate consists of a limited pool of assets and if the shareholders share *pro rata* with other creditors, the amount received by creditors would be reduced (zero-sum game—the more one claimant receives from the bankruptcy estate, the less the other claimants will receive).¹³ On the other hand, shareholders which were misled into buying securities by defective market disclosure need the protection the most during company's insolvency.¹⁴

The financial crisis has shown that shareholders sue not only the company but also third parties such as auditors, underwriters and directors or officers, who then in return try to recover their losses by activating indemnification clauses. It was debated whether these claimants should rank *pari passu* with unsecured creditors, or they should be subordinated

⁸ INSOL, "Update on Shareholder and Equity - Related Claims in Insolvency Proceedings", *Technical Series*, Issue No. 28, 2013, 1.

⁹ J. Sarra, "From Subordination to Parity: An International Comparison of Equity Securities Law Claims in Insolvency Proceedings", *INSOL International Insolvency Review*, Vol. 16, 2007, 187.

¹⁰ *Ibid.*, 186.

¹¹ *Ibid.*, 182.

¹² B. Mamutse, "Compensating defrauded shareholders in insolvency: is parity the answer?", *Northern Ireland Legal Quarterly*, Vol. 62, 1/2011, 75.

¹³ Z. Christensen, "The Fair Funds for Investors Provision of Sarbanes-Oxley: Is It Unfair to the Creditors of a Bankrupt Debtor?", *University of Illinois Law Review*, 1/2005, 371; W. Wahler, A. Maza, D. Eshew, M. Wiles, "At the Crossroads: The Intersection of the Federal Securities Laws and the Bankruptcy Code", *The Business Lawyer*, Vol. 63, 2007, 138.

¹⁴ A. Hargovan, J. Harris, "The Shifting Balance of Shareholders' Interests in Insolvency: Evolution or Revolution?", *Melbourne University Law Review*, Vol. 31, 2007, 593.

and bear all the cost of shareholders' claims.¹⁵ The subordination of these claims is considered to be a positive development because the risks associated with securities law violations shift from the general creditors to those in the best position to assess the risks and prevent misrepresentations.¹⁶ Subordinating gatekeepers' claims ensures that they will be diligent when providing their services and put an effort in reducing the risk of unlawful conduct and financial collapse of the company.¹⁷

3. Subordination of securities-related claims – *pro et contra*

These new occurrences have raised the question whether the subordination of these claims is justified. The justifications of subordination can broadly be categorised as being based on contract, creditor reliance and equity.¹⁸ Justifications based on contract are related to the capital maintenance doctrine and stem from the fact that shareholder undertakes the obligation to contribute to the assets of the debtor.¹⁹ Reliance rationale considers the subordination necessary in order to protect the creditor's expectations that his claim will have the seniority over shareholders' claims.²⁰ From the perspective of achieving equity, subordination prevents that creditors bear the economic burden of shareholder fraud remedies.²¹

From a practical point of view, one of the major problems is that without the subordination an enhanced risk of class action suits would exist.²² Also, there are concerns that the removal of the subordination rule will dilute the returns to unsecured creditors, which in return would increase the cost of lending to reflect the higher risk of non-return that creditors face.²³ This flood of claims would complicate the insolvency procedure, as their adjudication is time- and cost-consuming.²⁴ Those in favour of subordinating the claims also focus on the specific position of shareholders. Namely, shareholders have the most to gain from company's

¹⁵ R. Baulke, L. Nicholson, *The Treatment of Third Party Indemnity Claims in Canadian Restructurings*, https://www.insolvency.ca/en/resourcesGeneral/IIC_LawStudentAward-2013-1ThirdPartyIndemnityClaimsInCanadianRestructurings_Nicholson_Baulke.pdf, 3.

¹⁶ *Ibid.*, 4.

¹⁷ *Ibid.*, 13.

¹⁸ B. Mamutse, 76.

¹⁹ *Ibid.*

²⁰ K. B. Davis, "The status of defrauded securityholders in corporate bankruptcy", *Duke Law Journal*, 1/1983, 19.

²¹ B. Mamutse, 76.

²² K. B. Davis, 22.

²³ K. B. Davis, 25; R. Gengatharen, "Sons of Gwalia: defrauded shareholders claims in insolvency", *International Insolvency Review*, Vol. 17, 1/2008, 6-7.

²⁴ R. Gengatharen, 8.

success, unlike the creditors that have claims limited to the amount of their debt.²⁵ Also, shareholders have the right to receive information from the company, attend and vote at company meetings, vote for or against directors, and take action under a statutory derivative action.²⁶

However, some point out that the circumstances of creditors and shareholders in current times have changed, which has to be reflected in the legal solutions, or otherwise, the realities of the commerce would be completely ignored.²⁷ This new standing point is based on the fact that the position of modern shareholders can be compared to that of unsecured creditors – they are mostly outsiders with limited knowledge regarding business activities of the company.²⁸ This is especially true for shareholders in public companies who are dispersed and without any real power and influence on the business of the company.²⁹ They mostly receive the information through reports presented on shareholders meetings or through the financial reports disclosed to the public. On the other hand, growing number of creditors are large financial institutions who can contract right to demand additional information.³⁰

4. State of the affairs in selected countries

Study of the subject has shown that the most distinguished common law countries faced great challenges in developing an adequate legislative policy on how to allocate the risks between creditors and shareholders in insolvency. Even though they share similar cultural and legal background, their approaches towards the subject differ to a certain extent. It was determined that, on the one hand, Australia and the UK and, on the other hand, the US and Canada were harbouring similar approach to the matter.³¹

4.1.1. Canada

Until the last decade, Canadian insolvency law didn't contain any specific norms about the position of shareholders' securities claims in insolvency, but the general rule that shareholder claims come last in the ladder of priorities was applied. The main problem was the ever-changing nature of the securities which gradually received the hybrid forms,

²⁵ INSOL, 6. Similar J. Sarra, 188.

²⁶ A. Hargovan, J. Harris (2007a), 606.

²⁷ B. Mamutse, 86-87.

²⁸ *Ibid.*, 97.

²⁹ K. B. Davis, 28, 44; J. Sarra, 222.

³⁰ K. B. Davis, 67. Opposite R. Gengatharen, 10.

³¹ R. Gengatharen, 6.

combining both elements of debt and equity.³² Recognizing the problem, Supreme Court of Canada instructed courts to look to the substance of the particular transaction and decide on the nature of the claim by determining the intention of the parties.³³ Nevertheless, even with this guiding principle, results were not consistent.³⁴

Before the legislative reform in 2009, there were several suggestions on how to solve this issue – grant only the new shareholders (purchasers) the equal footing with unsecured creditors, grant securities regulator enhanced powers (i.e. disgorgement funds), rank all shareholders' claims with unsecured creditors or subordinate all equity-related claims.³⁵ However, after the amendments, a clear intent to subordinate shareholders' claims was shown through a broad definition of equity interests and equity claims and statutory prohibitions on voting and distributions for these claimants unless all non-equity claims had been satisfied in full.³⁶

Amendments expanded the definition of equity claim to envelop the indemnity claims of third parties (directors, officers, auditors, underwriters) on the grounds that equity claims are underlying in these types of claims and that they in fact represent “a shareholder claim for loss of investment”.³⁷ Before the amendments the courts allowed third-party indemnities to rank *pari passu* with creditors, focusing only on the contractual nature of the relationship between these parties and the debtor.³⁸ *National Bank of Canada v Merit Energy* is the only case prior to the 2009 amendments that directly addressed this question. The court held that indemnity claims of directors, officers, auditors and underwriters arising from a shareholder lawsuit were unsecured claims, because the indemnity was contractual and distinct from a claim for a return on equity. The decision in *Re Sino-Forest* was the first to apply the amended provisions and the court established that third-party indemnity claims should be treated as equity claims and subordinated where the underlying primary claim is an equity claim.

This new approach concerning the treatment of securities-related claims is seen as overly rigid and it was stated it undermines investor

³² S. Ben-Ishai, “Debt or Equity? A Puzzle for Canadian Bankruptcy Law”, *Canadian Business Law Journal*, Vol. 53, 3/2013, 417. Prominent examples of hybrid investments include redeemable preferred shares, convertible debentures, debentures which have their interest rate tied to the performance of one or more equities, income securities, and debentures with attached warrants, among many other variations.

³³ S. Ben-Ishai, 420.

³⁴ *INSOL*, 6; S. Ben-Ishai, 422-423.

³⁵ J. Sarra, 222-224.

³⁶ *INSOL*, 8.

³⁷ *Ibid.*, 10. In *Re Sino-Forest*, the Court of Appeal subordinated a \$9.2 billion indemnification claim advanced by auditors and underwriters.

³⁸ R. Baulke, L. Nicholson, 4.

protection regime by passing the entire risk of securities law violation to shareholders.³⁹ This strict regime can incentivise the debtors to forum shop and argue that the centre of main interests of a Canadian company is elsewhere when cross-border issues arise.⁴⁰

4.1.2. The USA

A fundamental rule governing the distribution of a bankruptcy estate in the US is so-called absolute priority rule. Section 510(b) of the United States Bankruptcy Code⁴¹ expressly provides for the mandatory subordination of a broad array of claims that arise from equity interests.⁴² This legislative solution is mostly based on the argumentation expressed in a seminal article from professors Slain and Kripke who advocated the subordination of shareholders' claims.⁴³ This article influenced a great deal the reform of the bankruptcy system in 1978 because the Congress strongly relied on its rationales for giving priority to creditors over shareholders – dissimilar risk and return expectations and the reliance of creditors on equity cushion/pool. Until the enactment of Bankruptcy Code in 1978, the courts followed the path established in *Oppenheimer* case – there was no subordination of claims of defrauded shareholders.⁴⁴

This legislative policy of blanket subordination was severely criticized on the grounds that it would likely jeopardize consumer and investors' protection. It was considered it would “hinder the preventive and compensatory role of disclosure law”, and would “make companies judgement-proof in respect of securities claims and would increase the risk of moral hazard”.⁴⁵ On the other side, parity of shareholders with creditors would give them the best of both worlds – gains if company prospers and the participation with creditors if it fails.⁴⁶

³⁹ A. Harnes, Standing up for shareholders: treatment of shareholders and equity claims in Canadian corporate insolvency proceedings, <https://www.insolvency.ca/en/whatwedo/resources/StandingUpforShareholders-TreatmentofShareholdersandEquityClaimsinCanadianCorporateInsolvencyProceedings.pdf>, 1, 11, last visited November, 14, 2017.

⁴⁰ J. Sarra, 209.

⁴¹ 11 U.S.C. § 101 et seq.

⁴² Section 510(b) applies to three distinct categories of claims: (1) a claim arising from rescission of a purchase or sale of a security of the debtor; (2) a claim for damages arising from the purchase or sale of a security of the debtor; and (3) a claim for reimbursement or contribution on account of either of the first two.

⁴³ J. Slain, H. Kripke, “The Interface between Securities Regulation and Bankruptcy-Allocating the Risk of Illegal Securities Issuance between Securityholders and the Issuer’s Creditors, *N.Y.U. L. Rev.*, Vol. 48, 1973, 261-300.

⁴⁴ D. Henry, 274.

⁴⁵ A. Hargovan, J. Harris (2007a), 615 – 616.

⁴⁶ A. Hargovan, J. Harris (2007a), 616.

During its existence, the rule from section 510 (b) faced two great challenges. The first one was determining the scope of the subordination, i.e. how to interpret the notion “arising from purchase or sale of securities”. Namely, the question was whether this only relates to buying the securities or it envelops the situations in which the shareholder was induced to retain them.⁴⁷ A narrow interpretation of article 510 (b) would relate only to the misconduct at the time of purchase or sale of the shares, whereas the claims arising from misconduct after the issuance of shares would be subordinated only if the wider interpretation is applied.⁴⁸ It was noticed that the earlier case law was in favour of the narrow interpretation of the norm, but that eventually a trend of a broader interpretation of section 510 (b) prevailed.⁴⁹

The court in case *In re Mid-American Waste Systems* expressed the view that Congress intended to subordinate the claims of other parties (officers, directors and underwriters) who played a role in the purchase and sale transactions which give rise to the securities law claims. This was based on the fact that these people are in a better position to evaluate the risk of the issuance of securities – even if they do not hold the securities themselves – and they cannot shift the risk to the company’s creditors.⁵⁰ The decision to include indemnity claims in the scope of the norm of Section 510 (b) took a long time to be reached but now it has the widest possible interpretation.⁵¹ It was concluded that the aim of the provision was not only to prevent recovery of shareholders before creditors but also to shift the risk of securities law claims to the parties most informed about the claims.⁵²

The debate on securities claims in insolvency has intensified with the enactment of Sarbanes-Oxley Act (SOX) in 2002 and the cases of *Worldcom* and *Adelphia*.⁵³ Since then, the latent conflict between the article 510(b) of Bankruptcy Act and section 308(a) of SOX (Fair funds for investors) has been noted, which proved to be the second great challenge the institute of subordination faced. The enactment of SOX called into question the traditional theories of the creditor and shareholder relationship in bankruptcy.⁵⁴ The source

⁴⁷ D. Henry, 279.

⁴⁸ Z. Christensen, 361.

⁴⁹ A. Hargovan, J. Harris, “Sons of Gwalia and Statutory Debt Subordination: An Appraisal of the North American Experience”, <http://ssrn.com/abstract=1001567>, 18-19, last visited October 4, 2017. The authors see the cases of *Telegroup* and *Geneva Steele* as turning point in the judicial reasoning. Also, Christensen cited as an example of narrow interpretation case *In Re Montgomery Ward Holding Corp* and as examples of broader interpretation cases *In Re Geneva Steel Co.* and *In Re Granite Partners, L.P.* See Z. Christensen, 364

⁵⁰ INSOL, 16.

⁵¹ R. Baulke, L. Nicholson, 8.

⁵² *Ibid.*, 7.

⁵³ *SEC v Worldcom, Inc*, 273 F. Supp. 2d 431, 431 (S.D.N.Y. 2003) and *In Re Adelphia Communications Corp.*, 327 B.R. 143 (Bankr. S.D.N.Y. 2005).

⁵⁴ D. Henry, 260.

of the conflict is the fact that § 510(b) subordinates the claims of defrauded shareholders granting them payment only after unsecured creditors were paid in full, while the SOX provisions allow them to have the same priority as unsecured creditors. SOX allows the Securities Exchange Commission (SEC) to return funds recovered from civil penalties to investors affected by the violation of securities law, treating them equivalently to tort victims and granting them a greater priority than it would have otherwise been the case.⁵⁵ This is because monetary damages obtained by the SEC in a civil action for a securities law violation are in a superior position to monetary damages obtained by a shareholder in a private action on the same grounds.⁵⁶ In this way shareholders can recover as unsecured creditors indirectly through the SEC's actions, bypassing the absolute priority rule.⁵⁷ The problem is that the Congress didn't explicitly state the intention to grant shareholders greater priority in insolvency, i.e. to bypass the absolute priority rule.⁵⁸ Some authors see these new legislative solutions as an appropriate response to the evolving financial markets and current situation.⁵⁹ For some, this new development is defensible on the grounds that it does not interfere with the equal treatment of creditors *per se*, as the disbursements are not being made from funds that they would otherwise be entitled to.⁶⁰ Also, it is stated that solution from section 308 (a) of SOX, relates only to a limited segment of claims, i.e. only those brought by SEC and should not be equated with shareholder-creditor parity in insolvency.⁶¹

4.1.3. Australia

Australian law has had a long-standing norm that shareholder claims in a corporate liquidation are subordinated to those of creditors, but the rationale behind the article 563A was not sought for a very long time.⁶² Unlike the clear rules in the US law, Australian law under the view of the judiciary didn't contain clear legislative policy on securities-related claims in its norm in section 563A of Corporations Act.⁶³

⁵⁵ K. B. Davis, 299.

⁵⁶ Z. Christensen, 353.

⁵⁷ Z. Christensen, 342; B. Mamutse, 79; J. Sarra, 192-193; W. Wahler *et al.*, 132.

⁵⁸ Z. Christensen, 370; B. Mamutse, 81.

⁵⁹ D. Henry, 262.

⁶⁰ B. Mamutse, 89.

⁶¹ A. Hargovan, J. Harris (2007b), 29.

⁶² Hargovan and Harris recognize this tendency in the first modern corporate law statute from 1862. A. Hargovan, J. Harris (2007a), 613.

⁶³ Payment of a debt owed by a company to a person in the person's capacity as a member of the company, whether by way of dividends, profits or otherwise, is to be postponed until all debts owed to, or claims made by, persons otherwise than as members of the company have been satisfied.

High Court's decision in case *Sons of Gwalia v Margaretic*⁶⁴ shook the Australian legal circles to the core and raised many controversies regarding the status of shareholders' claims in insolvency. The case concerned Mr Margaretic who bought the shares of a mining company Sons of Gwalia, but shortly after the company suffered a financial collapse. Mr Margaretic claimed the company didn't honour its disclosure obligations. The main question was whether the shareholder's claim in this case was in his capacity as a member or in some other capacity. The High Court found in favour of the claimant, finding that this claim was not raised in his capacity as a member, because the claim stemmed from a consumer protection laws and isn't related to the membership in the company. The main criterion the court applied was the nature of the debt, rather than the identity of a claimant.⁶⁵ Up until this decision, most of the shareholder-related cases relied on the ruling in case *Houldsworth* which prevents a shareholder from claiming damages for misrepresentation inducing the purchase of shares in the company whilst the shareholder remains on the share register.

After the ruling was made, a serious debate over the implications of the decision was started. It was pointed to the adverse impact it could have on the efficiency of the procedure – possible floodgate of shareholder claims and practical difficulties for the insolvency administrators in adjudicating the shareholders' claims.⁶⁶ It was also recognized that successful shareholder claims could dilute the assets available to non-shareholder creditors.⁶⁷ The fact that this new-found status of shareholders can affect the process of corporate rehabilitation was seen as a potentially large problem. Namely, the shareholders would have the right to vote along with other creditors on the future of the company and could significantly influence the outcome of the process. The problem might arise if they had diverging interests from other creditors, as well as, among themselves.⁶⁸ Also, worries were expressed that the apparent change in priorities in corporate liquidations would act as a barrier to Australian companies obtaining loans, particularly from the

⁶⁴ *Sons of Gwalia Ltd v Margaretic; ING Investment Management LLC v Margaretic* [2007] HCA 1.

⁶⁵ B. Mamutse, 84.

⁶⁶ A. Hargovan, J. Harris (2007b), 12. However, it was stated that this new-found solution has a limited range. Firstly, because a great deal of insolvencies occurs because of business misfortune that is not related to deceptive practices. Secondly, the decision was based on the application of disclosure obligations that relate only to public companies, which are rarely subjects of insolvency procedures. A. Hargovan, J. Harris (2007a), 611.

⁶⁷ A. Hargovan, J. Harris (2007b), 12.

⁶⁸ A. Hargovan, "Aggrieved Shareholders as Creditors: An Unmapped Coordinate in the Cartography of Australian Insolvency Law", in: *International Insolvency Law: Reforms and Challenges* (ed. P. J. Omar), Routledge, New York 2016, 154; J. Sarra, 218.

United States.⁶⁹ However, it was pointed out that this decision might not be relevant to a lot of companies, because many insolvencies are unrelated to unfair business practices and because the disclosure obligations apply only to public companies.⁷⁰

The case indicated the need to draw the line between shareholders' and creditors' interests in insolvency. A question was posed which model is the most viable for the position of these types of claims in insolvency. One of the proposed solutions was to adopt a model similar to the US law, subordinating all shareholder claims.⁷¹ There were also efforts to develop a model that would recognize legitimate rights of creditors, but also accommodate the shareholder protection rights (limited subordination rule).⁷² This proposal was based on the idea that existing shareholders have an informational advantage over creditors and potential investors and therefore their claims for misrepresentation should be subordinated, unlike the claims of new shareholders.⁷³ This model was criticized on the grounds that it creates an unnecessary divide between the shareholders, especially having in mind that existing shareholders also have limited power over the management.⁷⁴ In the end, the legislative reform overturned the decision in *Sons Gwalia*. In 2010, the section 536A of Corporations Act was amended and established that claims in relation to the buying, selling, holding or otherwise dealing in shares are to be paid after satisfaction of all creditors' claims.

4.1.4. The UK

English law derives its expression of the principle of shareholder subordination from the section 74(2)(f) of the Insolvency Act 1986.⁷⁵ However, section 655 of the Companies Act 2006 provides that a shareholder's claim against the company for damages or other compensation is not barred by the mere fact of ownership of (or entitlement to) shares in the company. The principle is not that 'members come last',

⁶⁹ K. Kendall, "Subordination of Shareholder Claims in Australia: A Comparison with the United Kingdom post-Sons of Gwalia", *Legal studies working paper series paper*, number 2009/2, 2. The reason for the fear was the fact that US law subordinates all securities related shareholder claims.

⁷⁰ A. Hargovan, J. Harris (2007a), 611.

⁷¹ R. Gengatharen, 12.

⁷² A. Hargovan, J. Harris (2007b), 32.

⁷³ *Ibid.*, 34.

⁷⁴ R. Gengatharen, 12.

⁷⁵ "A sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves."

but rather that the ‘rights of members as members come last’ - rights founded on the statutory contract are, as the price of limited liability, subordinated to the rights of creditors.⁷⁶

For the treatment of shareholders’ claims in insolvency in the UK law, the most relevant case is considered to be *Soden*.⁷⁷ In this case, the parent company claimed damages for negligent misrepresentation on the grounds that it was induced by its subsidiary to purchase the shares of the said entity. House of Lords was asked to decide whether the claim belonged to the parent company in its ‘character of a member’. The court found that the claims were not claims of a member since they were not based on a statutory contract, but on an independent contract for transfer of shares. The case made a clear distinction between claims deriving from a shareholding and those with their origins in a member’s separate, parallel relationship with the company.⁷⁸ Also a rule was established that only the claims of transferee shareholders (i.e. those who bought the securities on the market) are not to be subordinated, unlike those of subscribing shareholders (i.e. those who bought the securities directly from the company).⁷⁹

5. Concluding remarks

The recent events in the financial market have shown the existence of the conflict between the underlying values of two important sets of laws. On the one hand, there are securities laws aimed at market discipline, prescribing sanctions for those who breach the rules and on the other hand, insolvency law aimed at providing certainty in respect of ranking of creditors’ claims in case of insolvency, which directly affects the availability and price of the credit.

In this context, an especially significant question is the position of shareholders who were induced by the fraudulent conduct of company to buy or retain their securities. A certain dichotomy in the approach regarding the position of defrauded shareholders is observed. Jurisdictions are, on the one hand, enhancing the remedies available to securities holders for corporate misconduct and on the other hand, the claims arising from those types of situations are completely subordinated to other interests in the firm.⁸⁰

The analysis of several legal systems has shown that despite the initial willingness to grant favourable treatment to defrauded shareholders,

⁷⁶ J. Sarra, 215.

⁷⁷ *Soden v British & Commonwealth Holdings Plc* [1998] A.C. 298.

⁷⁸ B. Mamutse, 76.

⁷⁹ J. Sarra, 215; A. Hargovan, J. Harris (2007b), 7.

⁸⁰ J. Sarra, 224.

there is a gradual expansion of the scope of subordination norm in order to envelop all shareholders' claims regardless of their origin. This development can be seen as an emanation of principle that unsecured non-member creditors are the focal point of the protection.

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**PRAVNI TRETMAN POTRAŽIVANJA VEZANIH ZA HARTIJE
OD VREDNOSTI U STEČAJU****Rezime**

Opšteprihvaćeno pravilo u stečaju je da se potraživanja vlasnika kapitala nalaze na poslednjem mestu prilikom deobe imovine stečajnog dužnika. Tokom postojanja kompanije, akcionari se mogu naći u mnogim ulogama koje ne moraju nužno da budu povezane sa njihovim članskim statusom. Jedan od tih slučajeva, koji se pokazao kao relativno sporan, odnosi se na položaj akcionara kao oštećenih od strane kompanije (posebno u kontekstu prevara u vezi sa hartijama od vrednosti). U ovom slučaj sporno je da li oštećeni akcionari treba da se tretiraju kao bilo koje drugo oštećeno lice i rangiraju se sa neobezbeđenim poveriocima ili njihova potraživanja treba da budu subordinirana potraživanjima ostalih poverilaca. Ovi slučajevi ukazuju na postojanje konflikta između pravila stečajnog prava i seta zakona koji su usmereni ka zaštiti investitora.

Ključne reči: stečaj, akcionari, prevare u vezi sa hartijama od vrednosti, subordinacija, zaštita investitora.