Corporations Amendment (Sons of Gwalia) Bill 2010

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Law and Bills Digest Section

Contents

Purpose ................................................................................................................................. 2
Background ......................................................................................................................... 2
  Decision in Sons of Gwalia ............................................................................................ 2
  Recent corporate insolvency law reform proposals ..................................................... 3
  Proposed section 563A of the Corporations Act ....................................................... 4
  Committee consideration ............................................................................................ 5
Financial implications ........................................................................................................ 5
Main provisions ................................................................................................................ 5
Corporations Amendment (Sons of Gwalia) Bill 2010

Date introduced: 2 June 2010
House: House of Representatives
Portfolio: Financial Services, Superannuation and Corporate Law

Commencement: The formal provisions commence on Royal Assent. Schedule 1 commences the day after Royal Assent.¹

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bills page, which is at http://www.aph.gov.au/bills/. When Bills have been passed they can be found at ComLaw, which is at http://www.comlaw.gov.au/.

Purpose

The main purpose of the Bill is to amend the Corporations Act 2001 (the Corporations Act) to reverse the effects of the decision of the High Court of Australia in Sons of Gwalia Ltd v Margaretic [2007] HCA 1; (2007) 231 CLR 160; (2007) 232 ALR 232; (2007) 81 ALJR 525 (Sons of Gwalia).²

Background

Decision in Sons of Gwalia

In Sons of Gwalia, the High Court determined that section 563A of the Corporations Act, as currently worded, did not subordinate certain compensation claims by shareholders below the claims of other creditors in the external administration of a company. More particularly, it determined that shareholders who had suffered loss or damage as a result of purchasing shares in a company on the basis of false or misleading information contained in the company’s financial statements should rank equally with unsecured creditors in the distribution of the company’s assets in a winding-up. In so deciding, the High Court affirmed the decision of the House of Lords in Houldsworth v City of Glasgow Bank (1880) 5 AC 317, which established that a person’s capacity to bring a claim for damages can be affected by how the person acquired the shares and whether the person still holds them.

¹ Clause 2 of the Bill. Note, however, that the Explanatory Memorandum claims that the Bill commences on a single day ‘fixed by proclamation’. See Explanatory Memorandum, Corporations Amendment (Sons of Gwalia) Bill 2010, pp. 3 and 8.

While the Australian Securities and Investments Commission (ASIC) (among others) supported the High Court’s decision, the banking industry and ‘many insolvency practitioners’ opposed the outcome.3

**Recent corporate insolvency law reform proposals**

On 19 January 2010, Chris Bowen MP (Minister for Financial Services, Superannuation and Corporate Law) announced a package of reforms to Australia’s corporate insolvency laws.4 According to the Minister’s media release, the package contains ‘a range of reforms directed at reducing the costs and complexity of insolvency administrations; improving communications with creditors (such as through the use of e-mail); and reducing the potential for abuse of corporate insolvency law’.5 The reforms ‘substantially’ adopt the recommendations made in December 2008 by the Corporations and Markets Advisory Committee (CAMAC) following its review of shareholder claims against insolvent companies in the wake of the High Court’s decision.6

As part of the package of insolvent trading reforms, the Minister released a discussion paper setting out possible options for providing a safe harbour for reorganisation attempts outside of external administration (commonly known as ‘informal workouts’). Submissions closed on 2 March 2010. Treasury received 22 submissions (of which all 22 were made public),7 and the Government is now working on an exposure draft of a Bill containing proposed amendments of the Corporations Act.8

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5. Ibid.


8. This step was revealed to some lawyers and industry experts at a private briefing on 18 January 2010. See D Crowe and J Eyers, ‘Directors win in insolvency law shake-up’, op. cit.
Also on 19 January 2010, the Minister announced that the Government proposed to introduce legislation designed to reverse the effects of the decision of the High Court in *Sons of Gwalia*.\(^9\) In so doing, the Rudd Government signalled its rejection of CAMAC’s recommendation to allow the effect of the decision to stand—although it is noted that the recommendation was not supported by all members of CAMAC’s Advisory Committee.\(^{10}\) The issue is a vexed one, as CAMAC noted in its report:

This is an area where certainty is required. The decision of the High Court—while it may have surprised some and given rise to legitimate concerns—has provided a useful measure of certainty about the legal position. While recognising a tension in underlying policy considerations, the Court held as a matter of statutory construction that claims by aggrieved shareholders for damages were not claims ‘in their capacity as a member’ that should be postponed. It follows that they should be treated on a par with the claims of ordinary unsecured creditors. Shareholders and those who extend credit to companies now know the position that will apply in the event of aggrieved shareholder claims in an external administration.

The question is whether the legal position as laid out by the High Court is appropriate as a matter of policy or whether it has adverse consequences that call for legislative intervention. The views of interested parties on this policy question are polarised. Strong arguments have been put forward for maintaining the current position on the one hand or postponing or limiting the claims of aggrieved shareholders in an external administration on the other.\(^{11}\)

**Proposed section 563A of the Corporations Act**

Under **proposed section 563A** (as repealed and substituted by item 2 of Schedule 1 to the Bill), any claim brought by a person (and not just a shareholder) against a company that arose from the buying, selling, holding or otherwise dealing with a shareholding is to be postponed in an external administration until after all other claims have been paid. One academic commentator suggests that the proposed reform (which really just reinstates the commonly held view about the meaning of section 563A before the High Court’s decision) ‘will create a rich and warm feeling with business’.\(^{12}\) Particularly, this is because the

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11. Ibid.

reversal of the effect of the High Court’s decision is thought to end long-standing uncertainty over the relative rights of creditors and shareholders, thus encouraging lenders to offer finance to companies by once more giving priority to debt over equity in the winding-up of a company.\(^\text{13}\)

**Committee consideration**

On 13 May 2010, the Senate resolved to refer the provisions of ‘time-critical Bills’ to various legislative and general purpose standing committees for inquiry and report by 15 June 2010.\(^\text{14}\) On 3 June 2010, the Senate Economics Legislation Committee reported that there are no substantive matters that require examination in the current Bill.\(^\text{15}\)

**Financial implications**

The Bill has ‘no significant financial impact on Commonwealth expenditure or revenue’.\(^\text{16}\)

**Main provisions**

**Item 1** of **Schedule 1** inserts **proposed Part 2F.4** into the Corporations Act, which deals with proceedings against a company by members and others. It currently comprises only one provision: **proposed section 247E**, which states that a person is not prevented from obtaining damages or other compensation from a company simply because the person:

- holds, or has held shares in the company
- has subscribed for shares in the company, or
- has a right to be included in the register that the company maintains under section 169 of the Corporations Act.\(^\text{17}\)

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\(^{13}\) D Crowe and J Eyers, ‘Directors win in insolvency law shake-up’, op. cit.


\(^{16}\) Explanatory Memorandum, op. cit., p. 3.

\(^{17}\) Section 169 of the Corporations Act sets out the general requirements of a register of company members (or members of a registered scheme). The text of section 169 is available electronically at
The provision abrogates (or cancels) the effect of the decision of the House of Lords in *Houldsworth v City of Glasgow Bank* (see above). As a result, there will be no restriction on a shareholder’s ability to recover damages against a company based on how he or she acquired the shares or whether he or she still holds them.

**Item 2** repeals existing section 563A and substitutes proposed section 563A in its place. It provides that the payment of a subordinate claim made against a company is to be postponed until all other claims against the company are satisfied. The term ‘subordinate claim’ is defined in proposed subsection 563A(2) to mean:

(a) a claim for a debt owed by the company to a person in the person’s capacity as a member of the company (whether by way of dividends, profits or otherwise); or

(b) any other claim that arises from a person buying, holding, selling or otherwise dealing in shares in the company.

**Proposed section 563A** (as repealed and substituted by **item 2**) applies to any claim that arises after Schedule 1 commences (being the day after Royal Assent).

**Item 3** inserts proposed section 600H into the Corporations Act, which sets out the rights of a person whose claim against a company is postponed under section 563A.

Under proposed paragraph 600H(a), the person is entitled to receive a copy of any notice, report or statement to creditors, but only if the person asks the company’s administrator or liquidator, in writing, for a copy of the document.

Under proposed paragraph 600H(b), the person is entitled to vote in his or her capacity as a creditor of the company during the external administration of the company, but only if the Court so orders. The Explanatory Memorandum suggests that in determining whether to make such an order, the Court ‘might be expected to have regard to whether the person might reasonably be considered to possess a real financial interest in the external administration’.

However, the Bill contains no indication of the sorts of matters to which the Court must, or may, have regard in determining whether to make the order.

**Proposed section 600H** applies to any claim made against a company if the external administration of the company commences after Schedule 1 to the Bill commences (being the day after Royal Assent).

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18. Subitem 4(1) of Schedule 1 to the Bill.
20. Subitem 4(2) of Schedule 1 to the Bill.

**Warning:**

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