



## Corporations Amendment (Sons of Gwalia) Bill 2010

This is a later edition of a Bills Digest previously prepared for the 42<sup>nd</sup> Parliament

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## Corporations Amendment (Sons of Gwalia) Bill 2010

**Date introduced:** 29 September 2010

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The formal provisions commence on Royal Assent. Schedule 1 commences the day after Royal Assent.<sup>1</sup>

**Links:** The links to the [Bill, its Explanatory Memorandum and second reading speech](#) can be found on the Bills home page, or through <http://www.aph.gov.au/bills/>. When bills have been passed they can be found at the ComLaw website, which is at <http://www.comlaw.gov.au/>.

**This Bill lapsed on the proroguing of Parliament in July 2010. It has been re-introduced without any significant changes.**

### 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*).<sup>2</sup>

### 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

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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.
  2. An electronic copy of the High Court's decision is available at <http://www.austlii.edu.au/au/cases/cth/HCA/2007/1.html> (viewed 11 October 2010)

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damages can be affected by how the person acquired the shares and whether the person still holds them.

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.<sup>3</sup>

## 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.<sup>4</sup> 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'.<sup>5</sup> 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.<sup>6</sup>

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),<sup>7</sup> and the Government is now working on an exposure draft of a Bill containing proposed amendments of the Corporations Act.<sup>8</sup>

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*.<sup>9</sup> In so doing, the Rudd Government signalled its rejection of CAMAC's recommendation to allow the effect

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3. D Crowe and J Eyers, 'Directors win in insolvency law shake-up', *Australian Financial Review*, 19 January 2010, p. 1, viewed 11 October 2010, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2FJ7OV6%22>
  4. C Bowen MP (Minister for Financial Services, Superannuation and Corporate Law), *Corporate insolvency law reform package*, media release, no. 004, 19 January 2010, viewed 11 October 2010, <http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressrel%2F5OYV6%22>
  5. *Ibid.*
  6. CAMAC was established in 1989 'to provide a source of independent advice to the Australian Government on issues that arise in corporations and financial markets law and practice'. See CAMAC, *Welcome to CAMAC*, CAMAC website, viewed 11 October 2010, <http://www.camac.gov.au/camac/camac.nsf>
  7. Treasury, *Submissions: Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration*, Treasury website, 8 March 2010, viewed 11 October 2010, <http://www.treasury.gov.au/contentitem.asp?ContentID=1748&NavID=037>
  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.*
  9. C Bowen MP (Minister for Financial Services, Superannuation and Corporate Law), *Corporate insolvency law reform package*, media release, *op. cit.*

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of the decision to stand—although it is noted that the recommendation was not supported by all members of CAMAC’s Advisory Committee.<sup>10</sup> 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.<sup>11</sup>

## 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’.<sup>12</sup> Particularly, this is because the 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.<sup>13</sup>

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10. CAMAC, *Shareholder claims against insolvent companies: Implications of the Sons of Gwalia decision*, report, CAMAC website, December 2008, p. 63, viewed 11 October 2010,

[http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2009/\\$file/Sons\\_of\\_Gwalia\\_Report.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2009/$file/Sons_of_Gwalia_Report.pdf)

11. *Ibid.*

12. B Baxt (partner at Freehills and professorial associate at the University of Melbourne), ‘Rule revision should give business room to move’, *Australian Financial Review*, 19 January 2010, p. 47, viewed 11 October 2010,

<http://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id%3A%22media%2Fpressclp%2F0BOV6%22>

13. D Crowe and J Eyers, ‘Directors win in insolvency law shake-up’, *op. cit.*

## 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.<sup>14</sup> On 3 June 2010, the Senate Economics Legislation Committee reported that there are no substantive matters that require examination in the current Bill.<sup>15</sup> On 23 June 2010 the Senate referred the following matter to the Legal and Constitutional Affairs Committee for inquiry and report. Due to the prorogation of the 42nd Parliament and the dissolution of the House of Representatives on 19 July 2010, the Committee determined not to continue this inquiry.

On 30 September 2010 the Senate referred the Corporations Amendment (Sons of Gwalia) Bill 2010 for inquiry and report by 18 November 2010. Details of the inquiry are at the inquiry [webpage](#).

## Financial implications

The Bill has 'no significant financial impact on Commonwealth expenditure or revenue'.<sup>16</sup>

## Key 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.<sup>17</sup>

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.

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14. Senator P Wong, 'References to committees', Senate, *Debates*, 13 May 2010, p. 2839, viewed 11 October 2010, <http://www.aph.gov.au/hansard/senate/dailys/ds130510.pdf>. Here the phrase 'time-critical Bills' refers to all Bills introduced into the House of Representatives after 13 May 2010 and before 3 June 2010 that contain provisions commencing on or before 1 July 2010.

15. Senate Economics Legislation Committee, 'Consideration of time critical Bills', *Report No. 2*, 3 June 2010, viewed 11 October 2010, [http://www.aph.gov.au/Senate/committee/economics\\_ctte/timecritical\\_bills/report/report02.pdf](http://www.aph.gov.au/Senate/committee/economics_ctte/timecritical_bills/report/report02.pdf)

16. Explanatory Memorandum, op. cit., p. 3.

**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).<sup>18</sup>

**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’.<sup>19</sup> 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).<sup>20</sup>

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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 [http://www.austlii.edu.au/au/legis/cth/consol\\_act/ca2001172/s169.html](http://www.austlii.edu.au/au/legis/cth/consol_act/ca2001172/s169.html) (viewed 11 October 2010).

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

19. Explanatory Memorandum, op. cit., p. 7.

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

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