The Hon David Bradbury MP
FEDERAL MEMBER FOR LINDSAY
Parliamentary Secretary to the Treasurer

29 September 2010

CORPORATIONS AMENDMENT (SONS OF GWALIA) BILL 2010

Second Reading

Mr BRADBURY (Lindsay) (Parliamentary Secretary to the Treasurer) (11:23 AM)

I move: That this bill be now read a second time.

Today I reintroduce a bill which will amend the Corporations Act to reform the treatment of shareholder claims against companies that become insolvent.

This bill gives effect to the government's decision to reverse the outcome of the High Court's decision in the Sons of Gwalia v Margaretic case. The bill also introduces reforms relating to notices to creditors and shareholder voting, and clarifies the position of shareholders bringing claims for damages against companies.

To the ultimate benefit of both shareholders and creditors, this bill will remove an area of uncertainty that currently results in higher finance costs for business. It will also reduce the costs and complexity associated with running insolvency administrations.

The bill contains three primary measures.

Firstly, the bill amends section 563A of the Corporations Act to provide that all claims in relation to the buying, selling, holding or otherwise dealing with shares are to be ranked equally—and after all other creditors' claims.

In January 2010, the government announced its decision to introduce legislation to reverse the effect of the High Court's decision in Sons of Gwalia v Margaretic. In Sons of Gwalia, the High Court determined that section 563A, as it is currently worded, did not subordinate certain compensation claims by shareholders below the claims of other creditors.

Prior to Sons of Gwalia, the common understanding was that all shareholder claims against a company in external administration that related to a shareholding were made in the 'capacity as a member of the company' and were postponed by operation of section 563A of the Corporations Act.

Investors make a conscious decision to invest money in a company in the hope of sharing in the company's profits. In doing so, they are entitled to expect proper disclosure from the company. But they must accept that they are taking a risk in making that investment.

In contrast, creditors are not hoping to increase their wealth by gambling on the future profitability of a company. They are often small businesses or trade creditors who are simply owed money for work they have already done, or for materials they have supplied.

Investors who have been misled into making that investment should rightly be able to claim redress. However, they should not be able to do so to the detriment of creditors when a company is insolvent.

The provision, as currently interpreted, has the effect of undermining the traditional distinction between debt and equity.

The decision in Sons of Gwalia has had the effect of shifting the losses suffered by shareholders (due to a company's misleading conduct or nondisclosure) to the company's unsecured creditors.

By reducing the likely return to unsecured lenders in an insolvency, the Sons of Gwalia decision has had the effect of increasing the cost of unsecured debt and of reducing the availability of credit, particularly for less well-established companies.

Secondly, the bill streamlines the treatment of shareholder claimants in an external administration. Persons bringing claims regarding shareholdings will not vote as creditors in a voluntary administration or a winding up unless they receive permission from the court. They will also not receive reports to creditors unless they first make a request for such to the external administrator.

Thirdly, the bill eliminates certain residual common law restrictions on the capacity of a shareholder to recover damages against a company.

The 1880 House of Lords decision in Houldsworth v City of Glasgow Bank determined that a person who has subscribed for shares in a company may not, while they retain those shares, recover damages against the company on the ground that they were induced by the company to subscribe for those shares by fraud or misrepresentation.

Although case law in Australia has subsequently limited the reach of this decision, there are still situations where a shareholder may unfairly be prevented from suing for damages. The application of the old rule is limited, uncertain and difficult for stakeholders to comprehend. I note that in the United Kingdom, the rule was excluded in all cases by the Companies Act 2006 (UK).

The global financial crisis highlighted the importance of addressing any impediments to companies accessing reasonably priced credit.

These reforms restore the order of priority for distributions of assets in corporate insolvencies to the position that was understood to exist prior to the Sons of Gwalia judgment.

In doing so, they improve access by companies to credit, ensuring continued employment, entrepreneurialism and economic growth. I commend the bill to the House.