

Liability of Unsecured Creditors for Shareholder Compensation

by Sheree Angove, Associate

In 2007, the High Court of Australia in *Sons of Gwalia Ltd (admin apt) v Magaretic* (2007) 232 ALR 232 determined that a shareholder claiming compensation was entitled to rank equally in the liquidation of a company with other creditors. This effectively meant that an unsecured creditor would be responsible for compensating a shareholder who claimed to have suffered loss as the result of the misconduct of a company.

Prior to this decision, it was believed that such a claim would, by operation of the *Corporations Act 2001*, be subordinated and therefore ranked below and postponed until claims of other unsecured creditors were satisfied from the external administration of the company.

The decision had numerous adverse effects, particularly in respect of collapsed publicly listed companies, such as:

1. the reduction of dividends being paid to unsecured creditors;
2. a decrease in the availability of unsecured corporate loans due to the perceived difficulty for lenders in monitoring debt risk;
3. a marked increase in premiums of unsecured corporate loans and an overall reduction in the provision of available credit to corporate entities;
4. increased difficulty in identification by liquidators of possible creditors;
5. increased cost and delay in the external administration of companies; and
6. peripheral effect on director liability for misconduct with such claims being satisfied out of company funds rather than placing the liability on the director.

In April 2010, the Federal Government introduced the *Corporations Amendment (Sons of Gwalia) Bill 2010* ("The Bill"). The Bill

sought (among other things) to reinstate the former state of the law by ensuring that such shareholder claims had subordinated status. In practical terms, once passed, the Bill will ensure that any claim by a shareholder for compensation for loss suffered as the result of corporate misconduct will rank below claims of company creditors in the event of liquidation.

The Bill has been referred by the Senate for inquiry and report. The reporting date is 24 August 2010, after the Federal election date of 21 August 2010. As such the Bill may lapse without becoming law. It is therefore unknown whether unsecured creditors will continue to be liable to compensate shareholders who claim loss for corporate misconduct.

If you have any questions, please contact Sheree Angove, David Watt or Harry Nicolaidis (dispute resolution) or Robert Cunningham (corporate and commercial).



Sheree Angove
Associate

07 3233 1239 or
sheree.angove@flowerandhart.com.au



Robert Cunningham
Managing Partner

07 3233 1214 or
robert.cunningham@flowerandhart.com.au



David Watt
Partner

07 3233 1205 or
dwatt@flowerandhart.com.au



Harry Nicolaidis
Partner

07 3233 1268 or
harry.nicolaidis@flowerandhart.com.au



Legal Best
Practice
LAW 9000
SAI GLOBAL

Quality

Service

Honesty and Integrity

Balance

Level 16 Central Plaza Two, 66 Eagle St Brisbane Q Australia
GPO Box 219 Brisbane Q 4001 DX144
T 07 3233 1233 I F 07 3233 0900 I www.flowerandhart.com.au

FlowerandHart

LAWYERS