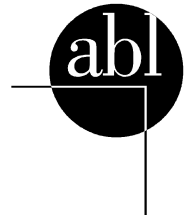


SUBMISSION TO GOVERNANCE AND INSOLVENCY UNIT CORPORATIONS AND FINANCIAL SERVICES DIVISION THE TREASURY

EXPOSURE DRAFT - CORPORATIONS AMENDMENT (No. 2) BILL 2010

Arnold Bloch Leibler per Leon Zwier and Sue Kee*



MELBOURNE
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1 Introduction

- 1.1 This submission is in response to the release on 23 April 2010, under the authority of the Hon Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, of the Exposure Draft - Corporations Amendment (No. 2) Bill 2010 and Explanatory Memorandum and the invitation for comments on the exposure draft material to be submitted to the Treasury by 18 May 2010.
- 1.2 Arnold Bloch Leibler strongly commends the government's decision to reverse the effect of the High Court's decision in *Sons of Gwalia & Anor v Margaretic* (2007) 60 ACSR 292 (**Sons of Gwalia**) as announced by the Minister in a media release dated 19 January 2010. The reversing of the effect of the Sons of Gwalia decision will enhance the prospects of distressed companies trading out of difficulties, will preserve employment and will avoid a proliferation of legal and insolvency practitioner costs in dealing with the quantum of claims now to be subordinated.
- 1.3 Arnold Bloch Leibler supports the intention of subordination of shareholder claims¹ in an insolvency administration contained in Schedule 1, item 2 of the Bill by way of repeal and replacement of section 563A of the *Corporations Act 2001 (Act)* and the Bill's provision in Schedule 1, item 1 to insert new section 247E into the Act to give statutory clarification that the rule in *Houldsworth v City of Glasgow Bank* (1880) 5 App Cas 317 will not have effect of disentitling shareholders bringing claims for damages based on the manner in which a shareholder has acquired shares or whether they still hold the shares.

* Arnold Bloch Leibler acted for ING Investment Management LLC in the *Sons of Gwalia* litigation.

¹ The expression "shareholder claims" used in this submission has the meaning given by Hayne J in *Sons of Gwalia Ltd & Anor v Margaretic* (2007) 60 ACSR 292, 328: "A person who buys, or subscribes for, shares in a company, relying upon misleading or deceptive information from the company, or misled as to the company's worth by its failure to make disclosures required by law, may have a claim for damages against the company. That claim may be framed in the tort of deceit but, more probably than not, will now be framed as a claim under consumer protection provisions of the Trade Practices Act 1974 (Cth) or investor protection provisions of the Corporations Act 2001 (Cth) (the 2001 Act) or the Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act)."

- 1.4 As stated in our submission to CAMAC, we appreciate that the proposed solution of an arbitrary subordination of consumer rights in an insolvency administration is just that. This in our submission represents the correct balance. Solvent companies that mislead the shareholders will face all the current civil, quasi criminal and criminal consequences of doing so. However, only in circumstances where the company is insolvent will the civil claims be subordinated to those of other creditors and then only in circumstances where shareholder claimants will remain as creditors with all the current protections concerning the reconstruction process. But corporations are man made. The legislature can draw and re-draw the boundaries as and when it regards it as necessary and appropriate to do so. This proposed subordination is a measured and necessary response.²
- 1.5 It has been suggested that aggrieved shareholders should be in no worse position in an external administration than holders of options or convertible notes who have been similarly deceived into acquiring their securities at the same time by means of the same faulty disclosure or non disclosure as. As referred to at paragraph 2.27 of the Explanatory Memorandum, options and note holders have never been considered to be postponed as creditors under section 563A. We submit that there is no rationale for change to the status quo and note that the proposed reforms have no impact on the status quo.³

2 The need for certainty in voting rights of postponed shareholders

- 2.1 The purpose of this submission is to recommend that further legislative amendment be made to give effect to the purpose of streamlining external administrations insofar as the Bill is directed to rationalise shareholder voting in external administration.
- 2.2 Schedule 1, item 3 of the Bill provides for the insertion of new section 600H into the Act. While paragraph (a) of proposed new section 600H appears appropriately directed to achieve the purpose of streamlining external administrations by limiting the obligation of administrators and liquidators to give any notice, report or statement to only those shareholders who have made a written request for such notice, report or statement, it is not at all clear that paragraph (b) of the proposed section will achieve that purpose.
- 2.3 This submission is based on the premise that the problems arising out of the *Sons of Gwalia* decision may, contrary to the underlying rationale of corporate reconstruction, have the affect of forcing large publicly listed companies into a formal insolvency administration⁴ (with all the

² As an insolvency practitioner my view is that all shareholder claims should be subordinated to creditors. However this submission advocates a more balanced approach.

³ This statement is based on the understanding that the phrase "*otherwise dealing in shares of the company*" in proposed section 563A(2)(b) does not extend the reach of the proposed section to include options and note holders.

⁴ This is because the class of shareholders most apparently within the ambit of the *Sons of Gwalia* decision are the shareholders in disclosing entities that rely on the company for accurate information affected the value of the investment.

concomitant loss of employment, disruption to and loss of confidence in the market, as well as costs and expenses) when, but for the decision, it could have been avoided. We note that paragraph 2.10 of the Explanatory Memorandum suggests that it is also the Government's view that it is the event of the collapse of listed public companies that drives the need for this legislative reform to negate the effect of the common law.

- 2.4 In this context, where the potential number of "aggrieved shareholders"⁵ is of some not insignificant magnitude, Arnold Bloch Leibler recommends that the appropriate balance between responsible insolvent corporate re-organisation, maintenance of good corporate governance standards and consumer protection requires the Government to reconsider the effect on insolvency administration if a class of shareholders' were to succeed in obtaining a Court order under proposed new section 600H entitling them to vote as creditors of a company. Although the statutory imposition of a hurdle of a Court order is a positive measure, it is possible that once that threshold has been met the difficulties identified in the December 2008 Corporations and Markets Advisory Committee Report "Shareholder Claims against insolvent companies Implications of the *Sons of Gwalia* decision" will be revived.

3 Achieving the objects of the proposed reforms

- 3.1 It is to be emphasised that two of the objectives of the reforms, as set out in paragraph 2.12 of the Explanatory Memorandum are to

"reduce the costs for insolvency practitioners to carry out external administrations; both costs that they ultimately bear themselves and those that they are able to pass onto creditors claiming in the administration (through reduced distributions); and

improve the efficacy of external administration, both in terms of reallocation of capital to productive uses and the promotion of business rehabilitation."

- 3.2 The question arises as to whether these objective of the reforms are achievable by a legislative amendment in terms of proposed section 600H(b) in its current form. Where an aggrieved shareholder is entitled to vote as a creditor by a Court order to that effect under proposed section 600H(b), Arnold Bloch Leibler recommends that the shareholder's claim be limited to a nominal amount of one dollar. This measure would overcome the concerns about the possibility of aggrieved shareholders dominating the voting in creditors' meetings.
- 3.3 As noted at paragraph 2.44 of the Explanatory Memorandum this new class of creditors are characterised by claims that are inherently difficult to determine. Accordingly, the attribution of nominal value to their claims for the purposes of voting in their capacity as creditor would have the effect of regularising the rights of this class of creditors in the absence of

⁵ This term is used in the sense referred to in paragraph 2.16 of the Explanatory Memorandum, "to refer to current or former shareholders making claims against companies for loss due to misleading conduct and non-disclosure".

an efficient mechanism for determining the claims. While the current scheme enables an administrator to admit a shareholder to vote at the creditors' meeting for the full amount of claim in the shareholder's proof of debt or for a nominal value this discretion is in our view sufficient to overcome the risk that once admitted as a creditor the aggrieved shareholders' voting rights by number could dominate the voting in creditors' meetings.

4 Conclusion

- 4.1 Arnold Bloch Leibler's submission to CAMAC submitted that the difficulties presented by the SOG Decision could be solved by a simple amendment to section 563A of the Act along the lines suggested by Kirby J in his judgment in the SOG Decision.⁶
- 4.2 We submitted to CAMAC that such an amendment ought to specifically subordinate shareholder claims to the claims of non-shareholder, ordinary unsecured creditors and are pleased that this is the Government's proposed course. However, we also submitted to CAMAC that the legislative amendment should provide that shareholder claimants be admitted to proof in a formal insolvency procedure for the notional sum of one dollar. This would afford shareholder claimants with creditors' statutory rights including voting rights and the right to apply to terminate a deed of company arrangement under section 445D of the Act while at the same time providing the commercial certainty as to the value and status of the claims thereby enhancing the prospects of a successful reconstruction.
- 4.3 We submit that legislative amendment subordinating aggrieved shareholder claims while not also effecting legislative amendment to rationalise the value and status of those claims by providing that the shareholder claimants be admitted to proof in a formal insolvency procedure for the nominal sum of one dollar will not give distressed companies a more realistic opportunity of rehabilitation. This is in not in the interests of all stakeholders of distressed corporations (including members).
- 4.4 For the foregoing reasons, we recommend an amendment to proposed section 600H of the Act as follows:

600H Rights if claim against the company postponed

- (1) A person whose claim against a company is postponed under section 563A is entitled:
- (a) to receive a copy of any notice, report or statement to creditors only if the person asks the administrator or liquidator of the company, in writing, for a copy of the notice, report or statement; and
 - (b) to vote in their capacity as a creditor of the company, during the external administration of the company, only if the Court so orders.

⁶ (2007) 60 ACSR 292 at 327

(2) Where a Court has made orders of the kind referred to in paragraph (1)(b), for the purpose of voting in the capacity of creditor the person shall be admitted to proof in the external administration of the company for the nominal sum of one dollar or such other amount as provided for by the Regulations.