

## BOOST TO SHAREHOLDER'S RIGHTS

A recent decision of the Federal Court has provided shareholders with the right to claim a larger share of the pie in the event of a corporate collapse.

In the matter *Sons of Gwalia Limited (Administrator Appointed) v Margaretic* [2005] FCA1305, the Federal Court decided that a shareholder in a failed company could stand alongside and be treated as a creditor in respect of a claim for damages.

This case, delivered on 15 September 2005, provides an exception to sec 563A of the Corporations Act (Act) which postpones the rights of shareholders until after all other debts and claims of creditors have been settled.

Underpinning sec 563A of the Act is the assumption that shareholders accept risks associated with the purchase of shares. Those risks traditionally include losses to share value and the prior satisfaction of creditor's claims when companies fail.

Sons of Gwalia has blurred the operation of sec 563A of the Act and the long established distinction between creditors and shareholders

and their respective entitlements against failed companies.

### BRIEF FACTS OF THE SONS OF GWALIA CASE

The case related to an application by the administrators of Sons of Gwalia for a declaration that a claim by a shareholder was not a provable debt under a proposed Deed of Company Arrangement.

The shareholder had purchased shares in the company on 18 August 2004, but on 29 August 2005, Sons of Gwalia was placed into administration.

The shareholder alleged that Sons of Gwalia had engaged in misleading and deceptive conduct by failing to disclose information.

The Court held that the shareholder was a creditor for the purposes of the proposed Deed of Company Arrangement.

### IMPLICATIONS OF THE CASE

The decision has a number of implications for insolvency practitioners, shareholders and unsecured creditors.

For insolvency practitioners, the decision will result in significant delays and additional costs to the administration process.

Insolvency laws are already complex and this will no doubt contribute to the complexity of the insolvency practitioner's role in assessing and determining proofs of debt by shareholders. Delays in the distribution of dividends to creditors are also likely.

For shareholders, the ability to make claims for loss of value of shares in the case of failed companies is no longer constrained by sec 563A of the Act.

The decision sets a precedent for shareholders to share in the pool of funds that were reserved for unsecured creditors.

The likely outcome of the decision will be the opening of the flood gates of similar claims

by other shareholders, likely to be financed by litigation funders.

Shareholders will still have to base their claim on an allegation that the company's conduct resulted in the shareholder's loss.

For unsecured creditors, the admission of proofs of debt lodged by shareholders could significantly reduce the funds available for distribution to unsecured creditors.

Unsecured creditors will have to share the company's capital with shareholders diminishing the dividends that unsecured creditors would have otherwise been entitled to receive.

#### APPEAL

The administrators of Sons of Gwalia have appealed against the decision. Until the appeal has been determined, shareholders, unsecured creditors, unsecured debt financiers, litigation funders and insolvency practitioners will have to work through the ramifications of the decision on their respective interests.

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