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AUSTRALIA

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Burying *Sons of Gwalia* clears the way for greater investment

Restoring the traditional right of creditors over shareholders in the winding up of a company is not only practical and equitable, it also clears the way for greater investment at a time when the country needs it most, claims the leading independent body for governance and risk management.

Welcoming the move to reverse the effect of the High Court's decision in *Sons of Gwalia v Margaretic*, Chartered Secretaries Australia's (CSA) chief executive Mr Tim Sheehy said, "the federal government is to be applauded for rejecting the High Court's legalistic approach in favour of what is clearly in the nation's best interests.

"Capital market investors can finally take comfort that the time-honoured and well-understood distinction between the rights and risks of debt and equity investment will again prevail," said Mr Sheehy.

CSA had long argued that the High Court decision flew in the face of the traditional principle that shareholders assume greater risk for the chance of greater reward while creditors accept limited returns for lower risk. CSA's view was that *Sons of Gwalia* distorted the capital markets by forcing creditors to compete with shareholders in a winding-up and effectively underwrite shareholders' speculative risks with no compensating benefits.

Moreover, CSA argued that the decision was bad for governance by inadvertently creating a privileged class of shareholder when, in principle, all ordinary shareholders should have identical rights. That is, *Sons of Gwalia* gave only those shareholders who purchased their shares at the time of a company's misleading conduct equal standing with creditors, but excluded those who had bought their shares at an earlier time.

"The government has now delivered the right result by confirming that shareholders must continue to absorb the risk of insolvency as part of the broad range of risks they assume in acquiring shares and which properly include the risks of corporate fraud, misconduct and the non-disclosure of price-sensitive information," said Mr Sheehy.

"The government's decision promotes regulatory certainty and greater equity — both of which are good for governance," he added.

MEDIA RELEASE

In *Sons of Gwalia*, a shareholder alleged that he had been induced to buy shares in an ASX-listed company as a result of the company's misleading conduct. The High Court held that the shareholder had the same rights as an unsecured creditor in the subsequent winding up of the company to lodge a claim against the company's assets for the shares' loss in value. In this case, the company's alleged misconduct arose from a breach of its continuous disclosure obligations in failing to advise the ASX of changes in its operations that meant it could no longer operate as a going concern.

The Corporations and Markets Advisory Committee (CAMAC) had recommended in March 2009 that, while the controversial decision had significant implications for providers of corporate debt finance as well as the conduct of external administrations, the government should not take action to overturn its effect.

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About Chartered Secretaries Australia

Chartered Secretaries Australia (CSA) is the independent leader in governance, risk and compliance. As the peak professional body delivering accredited education and the most practical and authoritative training and information in the field, we are focused on improving organisational performance and transparency.

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