**COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE**

SHARES OF NO PAR VALUE AND PARTLY-PAID SHARES

REPORT NO. 11

November 1990

REPORT OF THE COMPANIES AND SECURITIES LAW REVIEW COMMITTEE ON SHARES OF NO PAR VALUE AND PARTLY-PAID SHARES

TO: The Ministerial Council for Companies and Securities

The CSIRC presents to the Ministerial Council its Report on Shares of No Par Value and Partly-paid Shares. This is the Eleventh Report of the Committee, the others being:

* Report on the Takeover Threshold (November 1984)

* Report On partial Takeover Bids (August 1985)

* Report on Forms of Legal Organisation for Small Business Enterprises (September 1985)

* Report on the Civil Liability of Company Auditors (September 1986)

Report on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums (September 1986)

* Report on a Company's Purchase of its own Shares (September 1987)

* Report on Prescribed Interests (May 1988)

* Report on Nominee Directors and Alternate Directors (March 1989)

* Report on Director's Statutory Duty to Disclose Interest and Loans to Directors (November 1989)

* Report on Indemnification, Relief and Insurance in relation to Directors and Officers (May 1990)

Terms of Reference

The Ministerial Council for Companies and Securities referred to the Committee "for inquiry and review the question of the use of the corporate form".

The Ministerial Council decided that "[i]n making its inquiry and review, the Committee will have regard to the following:

(a) the provisions in Part IV, Division 3 of the Companies Act, 1981, including:

....

(iii) the authorization of companies to issue ordinary shares without attributing to them a fixed par value and to issue preference shares of no par value;

....

(g) any related totters."

In March 1990 the Committee published Discussion Paper No. 10: Shares of no par value and partly-paid shares. It attracted a considerable number of substantial responses. The Committee derived much assistance from the responses and is grateful for the time and effort put into their preparation.

A list of respondents to the Discussion Paper is in an appendix to this report.

OVERVIEW OF THE REPORT

This report is about companies that are incorporated under the Companies Act 1981 (Cw1th) (and the correspond Companies Codes of the States and the Northern Territory) or under earlier legislation that issue shares.[1]

A share, described in commercial terms, is a fraction of the total claim of all proprietors on the corporate enterprise. Leaving aside valuation by reference to securities markets and questions of priority as between classes of shares, a share I s value is a fraction of the total net North of the enterprise. A share is allotted to a shareholder as consideration for a contribution (or promised contribution) towards the company's capital. The monetary equivalent of that contribution is referred to in this report as the "issue price" of the share. As the company's fortunes wax or wane after the allotment, the value of the share will increase or diminish away from the issue price.

In many cases the issue price will be of only historical interest. But where the issue price is not fully paid or where there are preference shares, the issue price can remain significant. For partly-paid shares the issue price will measure the limit of liability of a member or past member of a limited company to contribute towards payment of the company's debts in a winding up and for preference shares it may be an element in the preference shareholder's entitlements to dividend return Of capital and participation in any surplus in a winding up.

This report is concerned With provisions in the Companies Act 1981 (Cwlth) which require a company which proposes to allot shares to ascribe a nominal value to each share which it proposes to allot. That nominal value is not necessarily the same as the issue price of a share since it is open to a company to allot shares in consideration of an issue price which includes a premium over nominal value and, in certain circumstances, to allot shares at a discount.

The main thrust of this report is to recommend that the legislative requirement that all shares be given a nominal value should be relaxed so that if a company proposes to issue shares it may, on the one band, elect to ascribe a nominal value to all of its ordinary shares or all of its, preference shares or, on the other band, to allot all of its ordinary shares or all of its Preference shares as shares without nominal value. In commercial circles "nominal value" is sometimes referred to as "par value". The two expressions mean the same thing. Shares that do not have a nominal value ascribed to them are referred to as "no par value shares".

1. It is also relevant to e provisions in the corporations Act 1989 (Cw1th) relating to company shares. At the time, of writing, those provisions are not yet in force.

SUMMARY OF RECOMMENDATIONS

Recommendation	Para	Page
The Committee recommends that the Companies Act 1981 (Cwlth) be amended so as to allow any company to issue no par value shares.	[31]	19
The Committee recommends that the Companies Act 1981 (Cwlth) be amended so as to give all companies the option to issue shares having a nominal value or shares of no par value.	[36]	20
The Committee recommends legislation along the lines of section 74 of the South African Act.	[39]	20
The Committee recommends that the amount received on account of the issue price of no par value shares should be required to be carried to a capital account to be called the "contributed capital account", that no part of the contributed capital should be returnable except in the circumstances that paid-up capital is now returnable and that any liability to pay any mistake put of the issue price for no par value shares should be extinguishable or reducible only in the circumstances in which a liability to pay the nominal value of ashore can now, be or reduced.	[52]	22
The Committee recommends that preliminary expenses should not be capable of being written off against contributed capital.	[55]	23
The Committee recommends that section 119(2) be amended so that it will no longer authorise the application of a share premium account in writing off the preliminary expenses of the company.	[57]	23
The Committee recommends that the legislation should allow no par value shares to be issued as partly-paid shares.	[73]	26
The Committee recommends that the legislation should not require a company to state the maximum number of no par value shares that it can issue.	[77]	27
The Committee recommends that if the Act is amended to authorise the issue of no par value shares that power should extend to the issue of no par value preference shares.	[81]	27

The committee recommends that the legislation should authorise the issue of no par value redeemable preference shares. It should be a condition of redemption that the shares are fully paid-up. They should be redeemable only out of profits otherwise available for dividends or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. [90] 30

	Para	Page
If they are redeemed out of profits the company should be required to transfer a like amount of profits to the contributed capital account.	[90]	30
The Committee further recommends that any premium payable on redemption of shares of no par value should be provided only out of a fresh issue of shares made for the purpose or from profits available for distribution as dividend and that in the litter case there should, as in the case of capital paid out on redemption, be a transfer from profits to the contributed capital account.		
The Committee recommends that a company, if so authorised by its articles, should have power by ordinary resolution to convert its fully-paid up shares having a nominal value to no par value shares and vice versa but subject to the protection of any existing class rights attached to issued shares.	[98]	32
The provisions of Sections 75 and 78 of the South African Act 1973 provide useful models on the matter of conversion		
There could be instruments or arrangements which refer to nominal value. A provision is needed so that any reference to nominal value of a share in any such instrument or arrangement will after conversion be a reference to the nominal value of the share immediately before conversion, in the absence of a contrary intention in the instrument or arrangement or the resolution authorising conversion.		
The Committee recommends that until the legislation is amended to require that payable on the redemption of redeemable preference shares may be provided for only out of profits otherwise available for dividends or out of the proceeds of a new issue of shares made for the purpose of redemption there should be no facility for converting redeemable preference shares having a nominal value into no par value redeemable preference shares or vice versa where the shares are redeemable at a premium and were issued before the amendment takes effect.	[102]	33
The Committee recommends	[109]	35

(a) that the legislation should provide that a company having a share capital, if so authorised by its articles, my increase its share capital constituted by shares of no par value by transferring reserves or profits to the contributed capital with or without an issue of shares (compare South Africa : Companies Act 1973 section 75(1)(b)); and

	Para	Page
(b) that the legislation should provide that a company having a share capital, if so authorised by its articles, by ordinary resolution passed in general meeting may increase the number of its fully-paid issued no par value shares without an increase of its contributed capital (compare South Africa : Companies Act 1973 section 75(1)(d)).	[100]	35
The Committee recommends that the legislation should provide that a company having a share capital, if so authorised by its articles, may by resolution passed in general meeting consolidate and reduce the number of its issued no par value shares. Compare South Africa : Companies Act 1973 section 75(1) (c).[112]	36	
The Committee recommends that the ability to convert shares into stock should not be extended to no par value shares.	[115]	36
The Committee recommends that any proposed new legislation on no par value shares should be exposed for public discussion for a relatively long period. [120] 38		
The Committee recommends that any legislation to allow the issue of no par value shares should not come into operation until after a period in which other legislation can be reviewed.	[123]	39

THE EXISTING POSITION

Current legislation requiring a nominal value to be attached to a share.

[1] The Companies Act 1981 (Cwlth) requires that a nominal value of a share be stated. Section 37 (1) (c) provides that the memorandum of association of a company, other than an unlimited company, shall state "the amount of share capital (if any) with which the company proposes to be registered and the division of that share capital into shares of a fixed amount;". Section 74(5) provides that in the case of an unlimited company that has a share capital, the articles of association shall state "the amount of share capital with which the company proposes to be registered and the division of that share capital into shares of a fixed amount." A company limited by guarantee my convert under section 69 to a company limited both by shares and guarantee. Under section 69(2) and (4) the company would have to lodge (among other things) a printed copy of a special resolution "making such alterations to the memorandum of the company as are necessary to bring the memorandum into conformity with the requirements of the Act relating to the memorandum of a company of the status sought." That provision would attract the requirements in section 37 (1) (c) that the amount of share capital be stated and that the division of that share capital into shares of a fixed amount also be stated.

[2] Protection of creditors as the original reason for the requirement that a nominal value be attached to a share. Legislators in nineteenth-century England thought that the amount of a company's issued share capital would be a major consideration in the minds of persons who contemplated giving credit to the company. The main significance of the nominal value attached to a share was that it indicated the minimum amount for which a subscriber for a share, or a successor, mist become liable as a shareholder to contribute to the company. In stating the nominal value of shares the company inhibited itself from, agreeing with a subscriber to allot a share for less than the nominal value such an issue at a discount to nominal value can be made by a limited company but only with the approval of the relevant Supreme Court under section 118. A no liability company is free to issue shares at a discount to nominal value without having to obtain court approval. But that is because share-holders in a no liability company are under no statutory liability to pay any outstanding part of the nominal value.

[3] Protection of other shareholders as a reason for the requirement that a nominal value be attached to a share. The requirement of a nominal value and the prohibition on a company limited by shares allotting shares at a discount to nominal value

provides some protection to existing shareholders against a form of stock-watering.

ARGUMENTS FOR AND AGAINST CHANGE

Arguments for abolition of the concept of nominal value.

[4] Nominal value is misleading. It obscures the reality that a share is no more than a proportionate interest in the net worth of a business.

[5] Nominal value is an unnecessary barrier to understanding company investment. The existence of a nominal value of a share different from, its market value can cause confusion for individuals who are newcomers to investment in shares. A stated morainal value can be misleading to creditors as well as shareholders. Developments in the law of dividends have meant that contributed capital can be lost in the ordinary course of carrying on the company's business and dividends can be distributed even though the nominal capital has not been made good.[2]

[6] Nominal value can add to the complexity of a company's financial statements. If there were no requirement of a nominal value, there would be no need for the concept of a share premium account.

[7] Nominal value can lead to complexity in a company's share capital structure. It became established that a limited company is not free to issue shares at a discount to morainal value. A limited company whose shares have a market value below their morainal value can issue shares of the same class if it follows the procedure in section 118. That requires an application to the Supreme Court which involves expense and delay and there is scope for mis-understanding. The company my not wish to be seen to be forced to issue shares at a discount : it may prefer to create an (new class of shares. If the requirement of morainal value had been renewed and the company had issued no par value shares, it would be able without any application to the Court to issue shares of the same class at their market price. True, a well-informed market would realise that the new issue is on more advantageous term than the original issue, but it would be only the market price that is relevant.

[8] Nominal value creates unnecessary work for share registries - Nominal value requires that when profits are capitalised the company has to make an issue of shares. The shares that are issued are commonly called "bonus shares". The shareholder to whom they are issued obtains no added value beyond that which is referable to added marketability.[3] If shares have no morainal value, a decision to capitalise profits does not need to entail an issue of shares. The usual work of share registries would be simplified.

[9] creditors do not rely on nominal value for protection. The original justification for a statement of morainal value as a protection for creditors has not been borne out. Creditors of limited companies are influenced more by the company's business reputation, its net worth and its cash flow than by the amount contributed by its shareholders or the amount of their statutory liability to contribute. In many cases the capital raised by the allotment of shares has little relationship to the resources

employed by the company. A company with an issued capital of $2 may be quite sound in term

2. D Harding and J O'Halloran. Discussion Paper attached to submission of law Council of Australia - Companies Committee, Business Law Section.

3. under the current income tax regime companies are able to issue bonus shares out of share premium reserve to shareholders who forgo their right to dividend. This facility is particularly beneficial to the shareholder where the holding attracting the issue was acquired before 20 September 1985.

of net worth or cash flow.[4] If a limited company were to have shares of no nominal value creditors could still have the benefit of the principle that contributions of capital are not to be returned to members before liquidation except in an approved reduction of capital or a permitted buy-back. That principle can be implemented by requiring the consideration for the issue of a share to be carried to a contributed capital account, restricting distribution of the amount in that account and restricting the ability of the company to release the shareholder from liability to pay any outstanding amount of the issue price : see para. [52].

[10] Nominal value does not wholly prevent stock-watering. The concept of nominal value and the restrictions on the issue of shares at a discount to nominal value provide only partial projection for shareholders against stock-watering. If shares have a market value above their nominal value, stock-watering can occur through a placement at less than market value. The fundamental problem is one of ensuring that directors do not allot shares except for adequate consideration. In its Report to the Ministerial Council on the Issue of Shares for Non-Cash Consideration Treatment of Share Premiums (September 1986) this Committee recommended amendments to the Companies Act 1981 so as to state the duties of directors in connection with an issue of shares for a non-cash consideration or for a consideration containing a non-cash element.[5] So far as shareholders in listed public companies are concerned, some protection against stock-watering is provided by ASX Listing Rule 3E (6).

[11] Nominal value shares, unlike no par value shares, do not focus on the issue price. Shares issued at no par value may focus attention on the issue price, which is more a than the nominal value.[6]

[12] Nominal value can require the creation of a share premium account. Where the issue price is at a premium to nominal value the distinction in the legislation between what a company can do with the nominal value and what it can do with the amount received as share premium contributes to highly artificial transactions.

In an earlier report[7] the Committee recommends changes to the Companies Act which would reduce the artificiality and bring the treatment of share premium closer to share capital.

4. In an earlier report the Committee has pointed to the impracticability of introducing a requirement of minimum paid-up capital : Report on Form of Legal Organisation for Small Business Enterprises (September 1985), paras. [147] to [149].

5. See para. 12 of the report.

6. Joint submission of Australian society of Accountants and The Institute of Chartered Accountants in Australia.

7. Report to the Ministerial Council on the Issue of Shares for Non-Cash Consideration and treatment of Share Premiums (September 1986).

The Committee recommends amendments:

(a) to sections 119 and 120 to make it no longer possible for the share premium account to be applied in providing redemption premiums on redemption of redeemable preference shares;[8]

(b) to section 119 to prohibit the application of the share premium account in writing off expenses and commissions paid and discounts allowed on any issues of debentures and in providing for any premiums payable on the redemption of debentures;[9] and

(c) so as to assimilate an unpaid premium for an allotment of shares to unpaid share capital so that there would be a statutory obligation to pay unpaid premium just as there is a statutory obligation to pay unpaid share capital.[10]

Since the issue of no par value shares cannot involve anything in the nature of a premium a company's capital accounts and the legislation about them can be relatively straight-forward.

Arguments in rebuttal of criticisms of nominal value.

[13] Nominal value is not misleading. Business people are not generally misled in assessing the value of shares by the existence of nominal value.[11]

[14] Difficulties about issue of shares at a discount can be removed without abolishing nominal value. The prohibition on issue of shares at a discount without Court approval could be overcome in other ways. One would be to enact provisions allowing issue at a discount subject to a procedure for approval by main s and the giving of an opportunity for creditors to object. Something like the procedure provided for by section 129(10) of the Companies Act 1981 (Cwlth), relating to the approving of financial assistance for an acquisition of shares, has been.[12]

[15] Nominal value is needed to measure liability to pay any unpaid amount of the capital subscribed. Nominal value marks the outer limit of a sub-scriber's statutory liability in relation to a contribution to capital. By way of answer the need for a measure of liability in the case of a no par value share can be met by the issue price.

8. Paras. [10] ff.

9. Paras. [24] ff.

10. Paras. [32] ff.

11 .Law Council of Australia - Companies Committee, Business law Section.

12. Law Council of Australia – Companies Committee, Business Law Section.

[16] Introduction of no par value shares entails technical problems. It is said[13] that there would be technical problems to be solved if no par value shares were to be authorized, even if only as an option for companies. Some of the problems are:

(a) the preservation of the differential rights attached to preference shares and redeemable preference shares in relation to ordinary share capital;

(b) the treatment of the concept of partly paid shares, and of the liability to pay any unpaid amount on shares in a no par value system;

(c) amendment of the accounting requirements of the companies legislation and of the taxation legislation to take account of the absence of nominal values; and

(d) the legislative complexity of providing for alternatives of both shares with nominal value and shares of no par value.

[17] These various criticisms relate to matters which are discussed later in this report. None of the criticisms is regarded by the Committee as providing a reason at the outset for deciding against the introduction of no par value shares.

THE POSITION IN OTHER COUNTRIES

[18] In the United States many jurisdictions give companies an option to issue shares of no par value. Such shares were first introduced in the State of New York in 1912. In Canada shares are required to be issued as no par value shares.[14] In South Africa companies have the option to issue shares with a nominal value or as no par value shares. Although in the United Kingdom in 1954 the Gedgee Committee[15] recommended the legalisation of no par value ordinary shares and the Jenkins Committee[16] in 1962 recommended the same change for all types of shares, no change has been legislated. This has been described as regrettable.[17]

Nominal value deemed for limited purposes

[19] An alternative to the complete abolition of nominal value is amplified by the California General Corporation Law section 205 under

13. Law Council of Australia - Companies Committee, Business Law Section.

14. E.g. Canada Business Corporations Act, section 24(1);

Ontario Business Corporations Act, 1982, section 22 (1).

15. Cmd. 9112

16. 1749, paras. 32 - 34.

17. Gower, Modern Company Law (1979 4th Ed.) 238.

which shares, which for all other purposes can only be no par value shares, are d~ to have a nominal value for limited purposes.

Section 205 provides:

"205. Solely for the purpose of any statute or regulation imposing any tax or fee based upon the capitalization of a corporation all authorized shares of a corporation organised under this division shall be deemed to have a nominal or par value of one dollar ($1) per share. If any federal or other statute or regulation applicable to a particular corporation requires that the share of such corporation have a par value, such shares shall have the par value determined by the board in order to satisfy the requirements of such statute or regulation. Leg. H. 1975 ch 682, effective January 1, 1977."

In Australia incorporation fees charged to companies are no longer based on authorised capital.

There my be legislation, either Commonwealth or State, other than companies and securities legislation, which is expressed to operate according to the nominal value of a share. To meet the needs of such legislation there could be merit in assigning a deemed nominal value to no par value shares. But that assignment should be made once and for all.

ACCOUNTING AND RELATED CONSIDERATION WHERE NO PAR VALUE SHARES ARE ALLOTTED

Continuing need for distinction between contributed capital and distributable profits

[20] Relaxation of the requirements about nominal value will not affect the distinction between contributed capital and distributable profits. There will still be a need to protect creditors against an unauthorised return of contributed capital. The distinction between capital which is not to be freely returnable and distributable profits can be maintained by requiring that all amounts paid to the company for the issue of no par value shares and any capitalised accretions be carried to a capital account. In some countries such an account is called the "stated capital account".

[21] The New Zealand Law Commission did not adopt the concept of "stated capital".[18] Instead, it proposed that protection of creditors should rest on a solvency test alone. Its Draft Companies Act section 3(3) contained a definition of the solvency test in the following terms:

"(3) A company satisfies the solvency test if:

(a) it is able to pay its debts as they become due; and

18. New Zealand Law Commission Report No. 9 entitled Company Law Reform and Restart, June 1989, para. 382.

(b) the realisable value of the company's assets is greater than the aggregate of the present value of its liabilities, whether contingent or otherwise."

The New Zealand Law Commission made the following comments on that test:

"330 The Solvency test set out in section 3(3) is pivotal to the scheme of the Act. It applies to all transactions which transfer wealth from the company to the prejudice of creditors and, where some shareholders only receive benefit, to the prejudice of non-participating shareholders. The test is designed to be a substantial constraint in such circumstances because they are those in which limited liability and management power are most open to abuse.

331 The test is a two-pronged one to ensure both "balance sheet" solvency and "cash-flow" solvency. It recognises that measuring current assets against current liabilities my not be sufficient to establish solvency. The test ensures that decisions are based on cash-flow analysis showing that known obligations of the company can reasonably be expected to be satisfied during the time they will fall due.

332 The solvency test is applied in the draft Act to all distributions, including share repurchase as well as dividends. At present, the law relating to dividends is entirely to be found in the cases.

333 The draft Act follows United States precedent in using the concept of "realisable value" in the assets over liabilities limb of the test. The Canadian reliance upon a concept of "stated value" (being the sum of all value received on issue of shares) seems to us simply to reinstate under a different name the concept of nominal capital for the purposes of distributions and is insufficient protection for creditors at risk. We realise that in making a determination whether to make a distribution in marginal cases the directors will not be able to rely upon the historic values of assets in their accounts. We think in those marginal cases it would be wrong to permit the accounts to be sheltered behind to the prejudice of creditors. In those circumstances prudent directors will require reassessment of the value of the company's assets. The test is designed to be a purposive one for the protection of creditors."

[22] The approach of the New Zealand law Commission in not adopting the concept of "stated capital" is an abandonment of a significant control on distributions by companies. Under the New Zealand law Commission's proposal directors who contemplate making a distribution need only feel assured as to the company's liquidity and have an expectation that there will be a surplus on realisation of assets. The Committee doubts whether that is a sufficient safeguard. Directors intent on a distribution my be over-sanguine in their estimates of the company's financial position. An additional requirement that stated capital my not be returned except under arrangements approved by the court or subject to the limitations on permitted buy-backs can provide protection against an ill advised distribution.

[23] The Committee notes that the New Zealand Securities Commission in a report in 1989 disagreed with the New Zealand Law Commission's view. The New Zealand Securities Commission stated its view as follows:

"4.5 contributed Capital

4.5.1 We advise that further provision is necessary in securities law about the treatment of funds contributed to a company in exchange for shares. Some shares my, but others may not, carry "fixed entitlements" within the meaning of the test proposed by the law Commission for the purpose of restricting distributions. (That test is set out in paragraph 3.4 above).

4.5.2. The calculations required under the test would include as assets the funds received by the company in exchange for shares (or assets acquired from the application of such funds) but exclude any provisions for the repayment of such contributions where there are no "fixed entitlements".

4.5.3 Where the company is merely the legal alter ego of one or a few individuals as proprietors, one might favour the flexibility proposed by the law Commission with respect to distributions which go from the comp to those individuals as shareholders. Perhaps in such cases it does not totter that a distribution my be merely a refund of previously contributed funds, so long as the "debts", "liabilities", and "fixed entitlements" are covered by the assets left in the company after the distribution. That appears to us to be the rationale of Law Commission's brief discussion of the topic in LC Report paragraphs 330 to 333 and the rejection, in paragraph 382, of the suggestion (which we supported) that there should be a "stated Capital Account".

4.5.4 But especially where a company issues securities to the public, we have no doubt that it is necessary to draw a sharp

distinction between distributions from contributed funds and distributions from other sources usually referred to as profits.

4.5.5 Most North American jurisdictions require that this distinction be drawn by means of an account known as the "Stated Capital Account". The Ontario Business Corporations Act 1982, s.24 and ss.34 to 40, provides the model we think should be

followed here. We would prefer to designate the account the "Contributed Capital Account", and we will use that term in this report.

4.5.6 The first function of the Contributed Capital Account would be to record the monetary value of the consideration received by a company in exchange for shares in the company. Such an account is a necessary feature of any system of corporate accounting, for the following reasons:

(a) All securities, whether labelled equity, debt or participatory, are in the last analysis, claims upon the company that issues them, ranking in same relationship to all other claims. Where a company issues securities in different classes, especially having different priorities (whether preferred or deferred) and has other obligations, it is necessary to make provision for the recognition and observance of the rankings and various entitlements in the accounting system. The distinction between debt and equity (while it may be "wafer thin" in some cases) is fundamental to securities law, and provides one of the crucial indicators of the strength or weakness of a company. The solvency test proposed by the Law Commission (set out in paragraph 3.4 above) refers only to "debts", "liabilities, whether contingent or otherwise", and "fixed entitlements" as an aggregate in relation to the company's assets. In our opinion, more sophisticated provisions are necessary to reflect the wide range of different classes of securities and obligations. We think a Contributed Capital Account, setting out the contributions received by the company in exchange for shares, is a necessary requirement for that purpose.

(b) In our opinion, it would be quite inadvisable to leave the recognition and enforcement of the rights attached to securities to the ordinary law of contract. Assurances and remedies more powerful than those available under that law are, in our judgment, required to sustain confidence in the corporate structure and the extraordinarily complex sets of relationships that can be created within and outside it. We regard a Contributed Capital Account as a means of providing same of such assurances and remedies.

(c) Where a company purchases shares it, or its holding company, or a subsidiary of its holding company has issued, one effect is to reduce the fund within the company that carries the ultimate risk. The fact of reduction should at least be clearly disclosed in the accounting system and in the company's financial statements. The Law Commission's proposals do not include such entries to be made in the Contributed Capital Account. Whether this be done by the

reduction of capital method or the Treasury Stock Method is a matter that should be dealt with by regulation.

(d) similar considerations arise where a company provides financial assistance for the purchase by someone else of shares issued by the company, its holding company, or a subsidiary of its holding company. The ability of the company to recover that financial assistance depends upon the terms on which it was provided and the solvency of the person assisted. Some extraordinarily ingenious and complicated schemes have been devised for the benefit of the schemers and to the detriment of others interested in the company (**Steen v. Law** [1964] A.C. 267 (P.C.), **Selangor United Rubber Estates Ltd. v. Craddock** [1968] 2 All E.R. 1073 (Ch.D.), **Skelton v. South Auckland Blue Metals Ltd.** [1969] NZLR 955, **Belmont Finance v. Williams Furniture (No. 2)** [1980] 1 All E.R. 393 (C.A.). The Law Commission's proposals - LC Report paragraphs 408 to 431, LC Bill clauses 58 to 61 - do not require disclosure of financial assistance in all cases. We think it is necessary to make a special provision for it, and recommend that the appropriate disclosure should be required in all cases to show the provision of assistance, the company's rights, if any, to recover it, and the identity of the person assisted. Such disclosure should be required i~ a note to the Contributed Capital Account and to the item in the financial starts that refer to the corporate asset.

(e) The Contributed Capital Account could also provide the basis for the contractual restrictions often required by lenders and creditors against depletion of the residual funds during the currency of a loan.

(f) In order to determine whether a company has made an operating profit or incurred an operating loss it is necessary to distinguish funds contributed by shareholders from other receipts. The distinction is important to everyone concerned with companies, including shareholders, creditors, customers and the State revenue collectors. The distinction is conveniently made by requiring funds contributed for shares to be separately recorded and disclosed in a Contributed Capital Account.

(g) Companies usually maintain their financial strength and increase it, by capitalising or retaining profits. That is, in substance, a further contribution from existing shareholders by way of foregoing a distribution. The laws should go further, and provide a convenient means of capitalising

profits, whether or not it is associated with an increase of the number of shares issued. Transfers from profits to the Contributed Capital Account are such a means.

(h) The practice of making distributions to contributors from money contributed by them or other contributors is a known instrument of fraud. A clearly stated and readily enforceable requirement to segregate contributed funds from other receipts, especially where the accounting system is indecently audited, is an important counter-measure against fraud. Such a requirement can conveniently be made by the means of a Contributed Capital Account.

4.5.7 We [the New Zealand Securities Commission] therefore recommend that every company that issues securities to the public (and every subsidiary of such a company) should be required to establish and maintain within its accounting system an account called a "Contributed Capital Account". The consideration received by the company for the issue of its shares, expressed in dollars at the time of issue, should be recorded in that account. If there are shares of different classes, separate entries for each class should be made within the Contributed Capital Account. Transfers from profits to capital should be recorded in the account. Consideration given by the for the acquisition of shares it has previously issued should also be recorded in the account. There would also be need for mechanisms to recognise losses that should be regarded as reducing the contributed Capital and to record distributions by way of reduction of the account. We will refer to reductions of capital in paragraph 4.7. The balance of the account, referred to as the "Contributed Capital" of the company, should be shown in the balance sheet of the company. We will suggest to the Law Commission that further consideration should be given to the question whether the regime we recommend should be applied to other companies."

No need for a share premium account

[24] In their joint submission supporting the introduction of no par value shares the Australian Society of Accountants and The Institute of Chartered Accounts in Australia said:

"The accounting implications of no par value shares involve consideration of the accounting entries required to account for the transaction, including the measurement and the display of such transactions in the financial statements in a manner which is useful to users.

The introduction of shares having no par value should not significantly alter the accounting entries necessary to record the issue of shares. The Authorised Capital need only disclose the

total funds the company my legitimately raise (until authorised to alter), without the need to specify nominal values

attaching to each share comprising the total authorized capital.[19] The proceeds of a share issue for cash, at par or no par value have the effect of reducing the "Unissued Shares" account and increasing the asset, cash. Presently, where the issue price of shares is greater than par value, the difference is required to be credited to "Share Premium" account. No par value shares would as a consequence negate the need for a Share Premium account. This would eliminate the artificial distinction nominal value and share premium which otherwise may purport to be different components of equity. Companies should not be permitted to ascribe any part of the proceeds of an issue as a share premium."

Accumulated profits

[25] It can be added that a company which issued no par value shares and which made profits could still have an accumulated profits account. The amounts in that account would remain distributable by my of cash dividend but the company could decide to capitalize them and thereupon they would be added to contributed capital.

19. Later in this report the Committee recommends that there should be no requirement of any limit on the number or value of no par value shares that a company may allot : see para. [77].

RECOMMENDATIONS

Should the legislation allow the issue of no par value shares?

[26] Among respondents to Discussion Paper No. 10 there was a division of opinion as to whether companies should be allowed to issue shares of no par value. After considering the legislation in other countries and the responses to Discussion Paper No. 10 the Committee believes that an amendment to the Companies Act 1981 (Cwlth) to permit the issue of no par value shares is desirable.

[27] No par value shares have the intrinsic merit of being less complex than shares that have a nominal value. If the added complexity associated with nominal value were compensated for by significant advantages, the Committee would hesitate to recommend introduction of no par value shares. But it seems to the Committee that the original reasons for requiring that for all shares there should be a start of nominal value are no longer valid. For the legislature to open up the possibility of issues of no par value shares would be a move towards making the mechanics of equity investment in Australia less complicated : it would be one step tow greater understanding of company finance in the general community. Whether companies will elect to issue a simpler form of share is up to them. The important thing in the Committee's view is that if there is to be unnecessary complication, it should not be required by legislation.

[28] If, as has happened in other countries, privatisation of public enterprises in Australia is to be accompanied by offers of shares to members of the public who may not previously have invested in shares, those new companies may find it useful to have shares of no par value. Another reason for recommending that there should be power in companies to issue no par value shares lies in the need for Australian company securities to be in conformity with a world market. In our own region, New Zealand has prepared legislation to abolish par value.[20] In the interests of a closer economic relationship between Australia and New Zealand it is desirable that companies in Australia should be able to issue no par value shares.

[29] A specific improvement arising from the introduction of no par value shares would be that overseas companies that have issued such shares would no longer have to convert such shares to par value shares in order to comply with section 88(1)(b) of the Companies Act 1981 (Cwlth) if they wished to transfer their incorporation to Australia.

[30] The power to issue shares of no par value should be available to all types of companies that issue shares. No liability companies should have the power.[21]

[31] The Committee recommends that the Companies Act 1981 (Cwlth) be so as to allow any company to issue no par value shares.

20. Companies Bill 1990 (N.Z.) clause 31.

21. Supported in the joint submission of Australian Society of Accountants and The Institute of Chartered Accountants in Australia and the Discussion Paper by D Harding and J O'Halloran.

Should there be a requirement that existing nominal value shares be converted to no par value shares?

[32] There was some support among respondents for a requirement that from a prescribed date all existing nominal value shares should be converted to no par value shares. The joint submission of the Australian Society of Accountants and The Institute of Chartered Accountants in Australia favoured compulsory conversion. They said that a voluntary system would be complex in itself and would require longer legislation.

[33] However, the Committee favours legislation which gives companies (both those now in existence and those formed in the future) an option to issue no par value shares. The Committee believes that it is better to proceed by first introducing an option. The totter can be reviewed later in the light of experience.

[34] The introduction of compulsory conversion could involve alteration of existing rights. For example, conversion to no par value shares will mean that a share premium account must disappear. Some companies may have given their shareholders special rights in relation to amounts credited to a share premium account. There may be other ramifications unknown to the Committee.

[35] The legislation to provide for the option to issue either nominal value shares or no par value shares does not have to be much longer than existing legislation. South Africa has adopted the optional approach and its legislation in the Companies Act 1973 shows that the additional provisions are not unbearably long.

[36] **The Committee recommends that the Companies Act 1981 (Cwlth) be amended so as to give all companies the option to issue shares having a nominal value or shares of no par value.**

In an optional system to what extent should a company be able to have a mixture of no par value shares and shares having a nominal value?

[37] Great confusion in a company could result from some issues of shares being of shares of no par value and other issues being of shares with a nominal value. It would conduce to simplicity to require that a company's share capital should be constituted either entirely by shares of no par value or entirely by shares having a nominal value.

[38] The solution adopted in South Africa lies in section 74 of the Companies Act 1973 which provides:

"74. The share capital of a company may be divided into shares having a par value or may be constituted by shares having no par value: Provided that all of the ordinary shares or all the preference shares shall consist of either the one or the other."

[39] **The Committee recommends legislation along the lines of section 74 of the South African Act.**

Recording of Contributed Capital

[40] The Committee agrees with the approach of the New Zealand Securities Commission set out in para [23] that the amount received on account of the issue price of shares having no par value should be treated as capital.

[41] There is a question as to whether the capital account should be called "stated capital account" or "contributed capital account". "Contributed capital" may appear to comprehend only the amount contributed as consideration for the issue of shares and to exclude accretions to capital as the result of capitalization of reserves or profits. However, such accretions are in a sense contributed by the members when they lose the right to treat the reserves or profits as being distributable. The expression "stated capital" has the virtue of being internationally recognisable. But "contributed capital" should be readily understood with the aid of a clear definition and seems to be more informative than the label "stated capital". "Stated capital" is ambiguous in that it could be taken to refer to something like authorised capital.

[42] If a company elected to have, say, ordinary shares of no par value, it would have a contributed capital account in respect of those shares. If the same company issued, say, preference shares having a nominal value, it would, as now, have a share capital account and a share premium account if there had been issues at a premium.

[43] The Committee notes that the legislation in South Africa in section 77 of the Companies Act 1973 does not provide a suitable model for what the Committee proposes since in South Africa there is a prohibition on the issue of shares on a partly-paid basis. Later in this report the Committee recommends that it should be allowable to issue no par value shares as partly-paid shares.

[44] Repayment by the company of any part of the issue price that has been paid should be restricted in the same way that repayment of paid-up capital is now restricted.

[45] Any liability of a company (or past company under section 360) to pay any part of the issue price that is outstanding should be capable of being released only in the same circumstances that a liability to pay the unpaid part of a share's nominal value can now be released. There could be a release as part of an authorised reduction of capital under section 123 or as part of a permitted buy-back. Provided the expression "share capital" is used in the Act in a sense wide enough to cover not only the nominal value of issued shares having a nominal value but also the issue price of issued no par value shares, provisions such as section 123 can apply

in respect of both shares having a nominal value and no par value shares. The expression "share capital" as used in section 37(1)(c) in the phrase "the amount of share capital" might be read as excluding shares of no par value. It seems desirable that "share capital" should be defined so as to comprehend both classes of shares in order to avoid the need to alter provisions like section 34(1), section 123, section 241 and section 244.

[46] If that approach is followed, references in the Act to "share capital not paid up" and to "paid-up share capital" can apply also to any unpaid part of the issue price of a no par value share. Similarly references to a share being "fully paid-up" could include a no par value share whose issue price has been fully paid.

[47] Section 123(6) may need amendment. At present it provides:

"123(6) An order made under sub-section (5) shall show:

(a) the amount of the share capital of the company as altered by the order;

(b) the number of shares into which the share capital is to be divided;

(c) the amount of each share; and

(d) the amount (if any) that at the date of the order is deemed to be paid up on each share."

[48] Where part or all of a company's issued share capital consists of no par value shares and a reduction of capital by way of return of capital is to extend to them there will have to be a reduction in the contributed capital account. If the reduction is by way of writing off losses there will also have to be a reduction in the contributed capital account. If the reduction is by way of extinguishing or reducing any outstanding liability to pay the issue price there will be a reduction of the amount shown in the [uncalled and] unpaid share capital account. The order will need to show item (a) the amount of the share capital of the company as altered by the order.

[49] Where there is a reduction of capital so that only some issued shares are cancelled item (b) could be equally significant where the shares cancelled are no par value shares as where the shares have nominal value.

[50] Item (c), the amount of each share, would refer in the case of a no par value share to the issue price of the share. It may be that as part of a reduction by return of capital or extinguishment of liability, there is to be a reduction of the issue price of the share. It seems necessary that item (c) should in the case of a no par refer to any variation of the issue price.

[51] Item (d), the amount (if any) that at the date of the order is deemed to be paid up on each share, would be equally apposite to no par value shares.

[52] **The Committee recommends that the amount received on account of the issue price of no par value snares should be required to be carried to a capital account to be called the "contributed capital account", that no part of the contributed capital should be returnable except in the circumstances that paid-up capital is now returnable and that any liability to pay any outstanding part of the issue price for no par value shares should be extinguishable or reducible only in the circumstances in which a**

liability to pay the nominal value of a share can now be extinguished or reduced.

Writing off of the preliminary expenses and expenses, or commission, on creation or issue of shares

[53] At present a capital account, the share premium account, may under section 119(2) be applied in writing off:

(i) the preliminary expenses of the company; or

(ii) the expenses of, or the payment made in respect of or discount allowed on, any issue of shares in, or debentures of the company

[54] In an earlier report[22] of this Committee it was recommended that section 119 be amended so as to remove the power to apply the share premium account in writing off a discount allowed on any issue of debentures of the company. In their joint submission the Australian Society of Accountants and The Institute of Chartered Accountants in Australia stated that in their view "preliminary expenses more appropriately meet the definition of expenses given that their service potential and economic benefits expire in the accounting period when incurred through the use of assets in that period." The Committee agrees that preliminary expenses should be treated as an expense to be accounted for in the profit and loss account rather than being treated as an asset to be charged against contributed capital.

[55] **The Committee recommends that preliminary expenses should not be capable of being written off against contributed capital.**

[56] The basis of the Committee's recommendation on preliminary expenses applies equally to the existing provision in section 119(2) under which the share premium account my be applied in writing off preliminary expenses.

[57] **The Committee recommends that section 119(2) be amended so that it will no longer authorise the application of a share premium account in writing off the preliminary expenses of the company.**

Partly-paid shares : should they be abolished?

[58] The liability of a member to the company in respect of a par value share allotted to the member is measured against the nominal value of the share and any premium that the member may have agreed to pay. The liability on a no par value share will be to pay the issue price agreed upon at the time of issue.

[59] No par value shares could be provided for by legislation on the basis that they may be issued as partly-paid and subject to call for the remainder of the consideration to be paid therefor. California's General Incorporation Law, which has no general requirement of nominal value, allows no par value shares to be issued on that basis : see section 409(d).

22. Report to the Ministerial Council on the issue of shares for non-cash consideration and treatment of share premiums (September 1986), paras. [24] - [26].

[60] In the United Kingdom the Gedge Committee was of the view that there was no objection to shares of no par value being partly paid. The Gedge Committee said that it is important, however, that where shares are partly paid the fact should be clearly indicated on the share certificate, balance sheet, annual return and appropriate documents.[23]

[61] However, there is a view reflected in the legislation of Canada, Ontario and South Africa and in the draft Companies Act proposed by the New Zealand Law Commission that no shares should be allotted on a partly-paid basis.

[62] The Canada Corporations Act section 25(3) prohibits the issue of partly-paid shares. Under section 187(8) partly-paid shares that have issued by existing companies are deemed to have been issued in accordance with the Act and holders of them are not deprived of any right or relieved of any liability in respect of such shares.

[63] The relevant South African legislation is in Companies Act 1973 (Sth. Af.) section 92 which provides:

"92(1) No company shall allot or issue any shares unless the full issue price of or other consideration for such shares has been paid to and received by the company.

(2) Notwithstanding the provisions of sub-section (1), a company may allot or agree to allot shares not fully paid-up for the purpose of their being offered for sale to the public as fully paid-up shares : Provided that

(a) if such offer is not made within one month from the date of such allotment or agreement, such allotment or agreement shall be void; or

(b) if such offer to the public is made but not accepted in full within two months from the date of such allotment or agreement to allot, the allotment of, or the agreement to allot such shares in respect of which the full issue price is not paid within the said period, shall be void."

[64] The provisions of sub-section (2) refer to the allotment of a block of shares to an underwriter for disposition to the public. This method of making public issues is not usual in Australia. In respect of shares which were not fully paid-up at the commencement of the Companies Act 1973 (Sth. Afr.) section 4(2) preserves the rights and obligations of the company and the members as they were under the 1926 Act.

[65] In its discussion paper this Committee posed the issue as to whether there should be a major change to companies legislation so that shares my be issued only if fully paid up. The question evoked a mixed response. One

23. Report of the Committee on Shares of No Par Value. Cmd. 9112, March 1954, para. 43.

member of the Australian Bankers' Association favoured such an amendment and suggested that shares should be issued only if fully paid up within a limited period such as two months. On the other hand, the Westpac Banking Corporation favoured retention of partly paid shares as an option for future issues of shares, whether shares with nominal value or no par shares.

[66] The Committee's question as to whether it should be possible for no par value shares to be allotted as partly-paid shares prompted some respondents to refer to taxation law. They made the point that taxation law is framed on the assumption that partly-paid shares can be issued. This Committee has no power to make recommendations about taxation law. Members of the Committee see its function as being to make recommendations for the improvement of company law. If an improvement in company law necessitates a change in taxation law, that is a matter for others.

[67] Den of the power to allot any shares before the consideration has been fully executed would mean that the Act and the company's articles would no longer need to contain extensive provisions for calls and forfeiture except in relation to existing partly-paid shares. There would be a reduction in the administrative work in a company. Future shareholders in limited companies who acted in good faith would be assured that there was no outstanding liability on their shares.

[68] The change would remove the hardship perceived by unsophisticated shareholders who may be compelled to contribute to the assets of a company being wound up. The Committee is aware of a view that companies legislation should be written for sophisticated investors. The Committee disagrees with that view and sees a need to simplify companies legislation so that a greater number of Australians will be able to consider intelligently whether they should invest in Australian companies.

[69] An argument that has been put against abolishing the power to allot partly-paid shares is that companies have found it useful to provide incentives for executives by the issue of partly-paid shares. However, in some instances where such issues have been made the fortunes of the company have later failed and the partly-paid shares have been an embarrassment to the allottees. It is not the function of the Committee to ensure that investors will never make unwise decisions but it seems to the Committee that there are other ways of providing incentives for executives and that that purpose does not justify the continued existence of a power to issue partly-paid shares.

[70] Another argument supporting the continuation of the power to issue partly-paid shares is that a company may need a certain amount

of share capital now with the assurance that as it develops it will be able to call up further successive contributions of capital from members who are bound to make those contributions. Could the same result be achieved by the making of a contract with an allottee binding the allottee to take up further issues of shares? That would operate differently from an issue of partly-paid shares under existing law. First, the liability would not be attracted to the shares originally allotted and a transferee of those shares would not be bound by a liability imposed by the Act. Secondly, special provisions would be needed to bring about forfeiture of shares allotted in the event of failure to take up further issues of shares as agreed. Thirdly, the liability being contractual rather than statutory could not, without new legislation, be enforced in a liquidation in the convenient way in which

unpaid capital can be got in under existing legislation.

[71] From a shareholder's viewpoint it will often be preferable not to be bound to make future contributions of share capital and to be free to decide to make a further contribution in the light of the company's performance. Under a regime of fully-paid shares any additional contribution of capital can be made by subscription for new shares. In large public companies it would not be practicable to bind by contract shareholders and their transferees to an obligation to take up new shares. But in a small company and a company operating under a shareholders' agreement contractual obligations to take up new shares could be imposed on shareholders and they could be obliged to see that any transferee from them entered into a similar contract with the company. Another possibility is that the articles might impose an obligation upon shareholders to take up a new issue of shares on certain conditions. It might be undesirable to allow a listed public company to have such an article because it could constitute a hidden hazard for the investing public. But that could be regulated by stock exchange listing rules.

[72] The Committee recognises that the abolition of the power to issue shares as partly-paid shares would lead to simplification of the legislation. However, the Committee sees value in companies having the financing choice involved in being able to issue partly-paid shares. Investors should also continue to have the possibility of acquiring shares on an installment payment plan. It is also noteworthy that the Companies Act 1981 section 152(1) dealing with the qualifications for a "trustee corporation" requires in sub-para (g)(ii) that a holding company should have a prescribed amount of reserve capital that cannot be called up before winding up. On balancing all the considerations, the Committee does not recommend any exclusion of the power to issue partly-paid shares.

[73] **The Committee recommends that the legislation should allow no par value shares to be issued as partly-paid shares.**

Should a company which proposes to issue no par value ~ be required to state in its memorandum or articles the maximum number of no par value shares that it can issue?

[74] At present a company having a share capital is required to state the amount of authorised share capital with which it proposes to be registered. If an analogous requirement were considered necessary in relation to no par value shares, it would take the form of a requirement that the company state the maximum number of no par value of shares it proposes to issue. That is the requirement in South Africa : see Companies Act 1973 section 52(2).

[75] However, it seems to the Committee that there is now no good reason why the legislation should require a start of authorised capital whether in the form of shares having a nominal value or of no par value shares. If members of a company wish to limit the amount of share capital or the number of no par value shares that the company may issue, they can insert in the memorandum of the company an appropriate restriction of the kind contemplated by section 68(1A). Any such restriction could later be altered under section 73 (2).

[76] The Committee did not raise the question of abolishing authorised capital in Discussion Paper No. 10 and does not now make any recommendation about authorised capital consisting of shares having nominal value. The Committee notes that abolition of the requirement of authorised capital could have implications regarding the concept of creation of share capital. According to some decided cases share capital which is authorised but not yet issued is thought of as having been created. Abolition of a need to state authorised capital will mean that the earliest time at which share capital is created will be the time of allotment.

[77] **The Committee recommends that the legislation should not require a company to state the maximum number of no par value shares that it can issue.**

PREFERENCE SHARES

No par value preference shares

[78] There is no reason peculiar to preference shares why they should not be issued as shares of no par value. The essential feature of a preference share is that the holder is to be entitled to a distribution in priority to holders of other types of shares. That can be accommodated in shares having no par value. A preferential dividend right can be expressed as a right to a fixed annual percentage based on the issue price of the share.[24] A right to priority in repayment of capital in a winding up can be stated as a right to priority in repayment of the issue price. A right to share in any surplus after return of contributed capital can likewise be defined without difficulty.

[79] In the United Kingdom the Jenkins Committee said that advantages would accrue from permitting the issue of no par value preference shares.[25] The arguments based on the greater simplicity of the concept of no par value over nominal value apply equally in relation to preference shares.

[80] The provisions about class rights in sections 124 to 128 of the Companies Act 1981 (Cwlth) are apt for application to shares of no par value as well as shares having a nominal value.

[81] **The Committee recommends that if the Act is amended to authorise the issue of no par value shares that power should extend to the issue of no par value preference shares.**

No par value redeemable preference shares

[82] There is no reason peculiar to redeemable preference shares why a company should not be empowered to issue redeemable

preference shares of no par value. The amount to be redeemed can be the amount of capital contributed for which the share was issued. Under existing law a redeemable

24. Cf Henochsberg on The Companies Act 1975. 3rd edn, page 138.

25. Report Of the Company Law Committee, Cmnd. 1749, 1962, para. 33.

preference share cannot be redeemed unless it is fully-paid up. A no par value redeemable preference share could likewise be redeemable only if the full amount agreed on its issue as the amount to be paid has been contributed.

[83] Where the share was issued on terms that on redemption a premium would be paid existing law requires that that premium be provided for cut of profits or out of the share premium account. If under a regime allowing the issue of no par value shares a company were to issue only no par value shares and no class of shares having nominal value, there would be no share premium account.

[84] The Companies Act 1973 (Sth. Aft.) section 98 provides for the redemption of no par value redeemable preference shares. Section 98 does not refer to the need for the shares to be fully-paid but that is because the South African Act does not allow for the issue of partly-paid shares generally. Section 98(1)(c) requires that any premium payable on redemption be provided for out of profits or out of the share premium account. To the extent that that applies to no par value redeemable preference shares it can only be applicable where the company has previously issued shares having a nominal value in circumstances giving rise to the creation of a share premium account.

Section 98 of the Companies Act 1973 (Sth. Afr.) provides as follows:

"98(1) Subject to the provisions of this section, a having a share capital, if so authorized by its articles, may issue preference shares which are, or at the option of the company are liable, to be redeemed : Provided that:

(a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividends or out of the proceeds of a fresh issue of shares made for the purposes of the redempt on;

(b) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall, out of profits which would otherwise have available for dividends, be transferred to a reserve fund, to be called the "capital redemption reserve fund", a sum equal to the nominal amount of the shares redeemed, or if shares of no par value, to the book value of the shares redeemed, and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve fund were share capital of the company;

(c) no such shares shall be redeemed unless and until the premium, if any, payable on redemption, has been provided for out of the profits of the company or out of the company's share premium account;

(d) the redemption of such shares shall be effected on such terms and in such manner as shall be provided by the articles of the company.

(2) Where in pursuance of this section a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares (including, if the company so decides by special resolution, shares other than redeemable preference shares) up to the nominal amount of the shares redeemed or to be redeemed or in the case of preference shares of no par value, up to the book value of the shares redeemed or to be redeemed, as if those shares had never been issued, and the share capital of the company or the number of shares of no par value shall not for the purposes of s.75(3) be deemed to be increased by the issue of shares in pursuance of this sub-section: Provided that, where new shares are issued before the redemption of the old shares, the new shares shall not for the purpose of any law relating to stamp duty, be deemed to have been issued in pursuance of this sub-section, unless the old shares are redeemed within thirty days after the issue of the new shares.

(3) The redemption of redeemable preference shares shall not be deemed to constitute a reduction of a company's authorized share capital.

(4) The capital redemption reserve fund may, notwithstanding anything in this section contained, be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid-up capitalization shares.

(5) (a) If a company has redeemed any redeemable preference shares, it shall within one month thereafter give notice thereof in the prescribed form to the Registrar specifying the shares so redeemed.

(b) If default is made in complying with the provisions of paragraph (a), the company shall be guilty of an offence.

(6) For the purposes of subs, (1) and (2) "book value" in respect of preference shares of no par value, means that part of the stated capital contributed by the preference shares redeemed or to be redeemed."

Source of funds for redemption

[85] There is no reason why panes should not be empowered to issue no par value redeemable preference shares which are to be redeemable out of profits that would otherwise be available for dividends or out of a fresh issue of shares made for the purposes of the redemption, as now.

[86] The south African provision in section 98(1)(b) requires a transfer to capital redemption reserve even when the shares redeemed are no par value shares. Such a transfer on the redemption of par value shares can be a

half-way house to the issue of bonus shares. But if the shares redeemed have been no par value shares the transfer from profits should be straight to contributed capital.

Premium payable on redemption

[87] Is it to be permitted that a premium on redemption may be paid out of the contributed capital account? If the company has issued only shares of no par value, it will not be possible to isolate any part of the contributed capital account as representing the equivalent of a share premium account. In such a case the premium on redemption should be incapable of provided from anything other than a fresh issue of shares made for the purpose, or from profits.

[88] Under section 98(1)(c) of the South African Act any share premium account that the company may have (as where, presumably, there has been an issue of ordinary shares with ~ value at a premium) can provide the premium on redemption of redeemable preference shares whether or not they have a par value.

[89] In an earlier report on treatment of share premiums[26] this Committee recommended that redemption premiums should be paid only when there is a fresh issue of shares made for the purpose or a transfer to the capital redemption reserve of distributable profits : the overall capital account should be preserved intact whether redemption was at par or at a premium. In the context of no par value shares a similar recommendation is appropriate.

[90] **The Committee recommends that the legislation should authorise the issue of no par value redeemable preference shares. It should be a condition of redemption that the shat are fully paid-up. They should be tenable only out of profits otherwise available for dividends or out of the proceeds of a fresh issue of shares made for the purposes of the redemption.**

If they are redeemed out of profits the company should be required to transfer a like amount of profits to the contributed capital account.

The Committee further recommends that any premium payable on redemption of shares of no par value should be provided only out of a fresh issue of shares made for the purpose or from profits available for distribution as dividend and that in the latter case there should, as in the case of capital paid out on redemption, be a transfer from profits to the contributed capital account.

26. Report to the Ministerial Council on the issue of shares for non-cash consideration and treatment of share premiums 1986 paras. [18] - [23].

Conversion of share capital consisting of shares having a nominal value into contributed capital divided into shares of no par value and vice versa.

[91] If companies are to be permitted to be formed with shares of no par value, there is a question whether a company which has issued, or makes issues in the future, of shares with a nominal value should have power to convert those shares of nominal value into shares of no par value.

[92] If the company has only one class of shares on issue conversion of all those shares would not pose much difficulty. The amount to be carried to contributed capital account would be the amount in the company's paid-up share capital account, its share premium account and a capital redemption reserve (if any). For the sake of simplicity there should be no power to convert part only of the issued shares. For a similar reason there should be no power to convert unless the shares are fully paid both as to capital and premium (if any). To effect conversion it would be enough for the company to pass a special resolution altering the capital clause in its memorandum of association (or, in the case of an unlimited company, its articles) and to lodge a copy of the resolution with the Commission.

[93] If the company has issued shares of different classes, conversion will not be so straight-forward. There would be a need to ensure that the differing class rights are not disturbed.

[94] One problem relates to treatment of any existing share premium account. It may be that some shareholders would not wish to see it merged into the general contributed capital account.

[95] Another problem arises as to the amount to be recorded in the contributed capital account where the company has made issues of shares with varying premiums. If those issues have been of shares of one class all with the same nominal value, the variation in premiums would not impede the merging of share capital and share premium accounts. But if there have ~n issues of different classes of shares, there may be special class rights to claim premium amounts in a winding up. Those special rights would need to be preserved unless there was an agreement to the contrary or unless the rights were varied. One possibility is that the rights might be varied in the manner provided by section 125, with provision for an application to the Court by holders of not less in the aggregate than 10 per cent of the issued shares in the class : see section 125(4).

[96] Since the Committee's object is to recommend legislative changes in this area which create the widest practicable freedom

of choice for companies the Committee favours allowing companies to convert shares having nominal value to shares of no par value and vice versa. The Committee notes that there could be conversion and re-conversion on more than one occasion.

[97] The Committee has considered whether it should be possible to convert partly-paid shares and has come to the view that the complications involved would outweigh any benefit to be derived. The power to convert should be confined to fully-paid shares. The Committee is also of the view that conversion should require the sanction of an ordinary resolution rather than a special resolution. However, the power to convert should be capable of being exercised only so long as existing rights of shareholders are not prejudiced.

[98] **The Corn tree recommends that a company, if so authorised by its articles, should have power by ordinary resolution to convert its fully-paid up shares having a nominal value to no par value shares and vice versa but subject to the protection of any existing class rights attached to issued shares.**

The provisions of sections 75 and 78 of the South African Companies Act 1973 provide useful models on the matter of conversion.

There could be instruments or arrangements which refer to nominal value. A provision is needed so that any reference to nominal value of a share in any such instrument or arrangement will after conversion be a reference to the nominal value of the share immediately before conversion, in the absence of a contrary intention in the instrument or arrangement or the resolution authorising conversion.

[99] In South Africa the Companies Act 1973 section 75 provides:

"75(1) Subject to the provisions of section 56 [which requires variation of class rights to be effected in the manner prescribed in the memorandum] a company having a share capital, if so authorized by its articles, may by special resolution:

(f) convert all of its ordinary or preference share capital consisting of shares having a par value into stated capital constituted by shares of no par value, subject to the provisions of this Act; provided that an existing may not so convert any share capital which is not fully paid up; [future companies could not issue partly-paid shares]

(g) convert its stated capital constituted by ordinary or preference shares of no par value into share capital consisting of shares having a par value, subject to the provisions of this Act; .... "

The way in which the conversion is to be reflected in the company's books of account is laid down in section 78(1) and (3). Section 78 provides:

"78(1) Where a company converts all its ordinary or preference shares having a par value, or both such ordinary and such preference shares, into shares without par value, there shall be transferred to the stated capital account of the company:

(a) the whole of the ordinary or preference share capital, as the case may be; and

(b) the whole of the share premium account or that part thereof contributed to it by the shares so converted.

(2) Where a company converts all its ordinary or preference shares of no par value or both such ordinary and such preference shares into shares having a par value, there shall be transferred to the share capital account of the company the whole of the stated capital account or that part thereof contributed to it by the shares so converted.

(3) Fractions, fractional surpluses or amounts arising in respect of the nominal share capital or the stated capital may be rounded off but material reductions shall be placed to non-distributable reserves."

Conversion of redeemable preference shares

[100] In general, the option to convert shares having a nominal value to shares of no par value and vice versa should extend to redeemable preference shares. Since conversion of shares having a nominal value to no par value shares would entail the disappearance of any relevant share premium account, it might be thought that some provision would be needed to allow the continued operation of section 119(2)(f) under which the share premium account may be applied in providing for the premium payable on redemption of redeemable preference shares. However, this Committee in its Report to the Ministerial Council on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums[27] recommended that section 119 be amended to provide that premiums payable on the redemption of redeemable preference shares issued after the amendment comes into force my be provided for only out of profits otherwise available for dividends, or subject to certain conditions, out of the proceeds of a new issue of shares made for the purpose of the redemption.

[101] That amendment would not affect redeemable preference shares issued before the amendment. The Committee is of the view that until such time as that amendment operates there should not be a facility for converting redeemable preference shares having a nominal value into no par value redeem le preference shares or vice versa where the shares are redeemable at a premium and were issued before the amendment takes effect.

[102] **The Committee recommends that until the legislation is amended to require that premiums payable on the redemption of redeemable preference shares my be provided for only out of profits otherwise available for dividends or out of the proceeds of a new issue of shares made for the purpose of redemption there should be no facility for converting redeemable preference shares having a nominal value into no par value redeemable preference shares or vice versa where the shares are redeemable at a premium and were issued before the amendment takes effect.**

27 (1986) para. [23].

Increasing the number of issued no par value shares by splitting shares or by capitalising reserves or profits

[103] At present a company has the facility if it wants to, for any reason, to subdivide its issued shares without any change in the total amount of the company's issued share capital. In that subdivision it is the nominal amount of the share that is divided. In the case of shares of no par value there can be no process 'identical with subdivision since there is no nominal amount to be divided but an otherwise similar result can be achieved by increasing the number of no par value shares. In either case the shareholder's aliquot share in the equity is exactly the same as before.

[104] Another process now available to a company is the issue of so-called "bonus shares". This can be done where the company transfers reserves or profits to share capital account and issues new shares against the reserves of profits that are being capitalised. It can also be done by applying a share premium account. The name "bonus shares" is thought by some to be misleading because in the usual case of an issue pro rata to existing holders of ordinary shares there is no bonus element as between the company and each shareholder insofar as the shareholder's aliquot share in the equity is the same as before. A less misleading name might be "capitalisation shares". However, the Committee notes that the expression "bonus shares" is used in the Companies Act 1981 (see section 119) and in the Income Tax Assessment Act.

[105] Under a system of no par value shares a ~y my, if it wishes, increase its contributed capital by the process of transferring part of its reserves or profits to contributed capital. But unlike the position where capital must be represented by shares having nominal value it is not essential that the company should issue any new shares. The decision in a cure as to whether there should be a transfer to contributed capital from reserves or profits is one for the appropriate organ of the company in accordance with its articles and there is no need for any special legislation about the making of that decision. The Committee takes the view that the legislation should not require a transfer to contributed capital out of reserves or profits to be accepted by a new issue and that the legislation should refer to the option which the company has. That is done in the South African Companies Act 1973 section 75(1)(b).

[106] Where it is intended that there be an increase in the number of issued shares it seems desirable under a system of no par value shares that the same process should be followed whether the increase arises from capitalisation of reserves or profits or from something akin to subdivision without any accretion to contributed

capital. On the basis that at present subdivision requires authority in the articles and the passing of an ordinary resolution, similar requirements should apply to an increase in the number of shares on issue where the company receives no money or property in return.

[107] The process akin to sub-division when used in relation to no par value shares should not be available in respect of shares that are only partly paid. The reason is that the process applied to no par value shares involves the creation of a new share rather than just sub-division. While it may be appropriate to split the outstanding liability attached to a share having nominal value, it seems inappropriate to attach liability to a new no par value share.

[108] Turning from subdivision, on the matter of which shareholders should be the allottees of a capitalisation issue and whether it should be made **pro rata** to existing holdings, the company's articles, and in appropriate cases the stock exchange listing rules, should govern as at present and there is no need for the Committee to recommend legislation on the matter as part of a report on the introduction of no par value shares.

[109] **The Committee recommends:**

(a) that the legislation should ~ that a company having a share capital, if so authorised by its articles, may increase its share capital constituted by shares of no par value by transferring reserves or profits to the contributed capital with or without an issue of shares (co spare South Africa : Companies Act 1973 section 75(1)(b)); and

(b) that the legislation should provide that a company having a share capital, if so authorised by its articles, by ordinary resolution passed in general meeting may increase the number of its fully-paid issued no par value shares without an increase of its contributed capital (compare South Africa : Companies Act 1973 section 75(1)(d)).

Reducing the number of issued no par value shares by consolidation

[110] A company may for a variety of reasons wish to reduce the number of issued no par value shares by consolidation. This would not involve any change in the contributed capital account. At present under section 121 the process of consolidation involves not only consolidation in terms of the reduction of the number of issued shares but also division of the company's share capital into shares of larger nominal amount. Consolidation of no par value shares will involve only reduction of the number of issued shares.

[111] This could equally well be done by cancelling some issued shares on a pro-rata basis. However, it would be better to reserve the term 'cancel' for what can happen to issued shares in a Court-approved reduction of capital or on a permitted buy-back. In other words, cancellation is sometimes identified with return of capital. It would seem best to use the term 'consolidate'.

[112] **The Committee recommends that the legislation should provide that a company hawing a share capital, if so authorised by its articles, may by resolution passed in general meeting consolidate and reduce the number of its issued no par value shares. Compare South Africa : Companies Act 1973 section 75(1)(c).**

Conversion of paid-up shares into stock and re-conversion

[113] Fully paid shares having a nominal value can be converted into stock under section 121(1)(c). Stock is the holding of the stockholder expressed in dollars or cents instead of so many shares of so much each[28] The expression of a holding in terms of dollars or cents seems inappropriate to no par value shares which are, in substance, no more than fractions of the company's net worth.

[114] Elsewhere in this report the committee recommends that companies should be able to convert no par value shares to shares of nominal value. A company with no par value shares which wished to issue stock could do so after converting the shares to shares having a nominal value.

[115] **The committee recommends that the ability to convert shares into stock should not be extended to no par value shares.**

Protection of holders of shares against dilution

[116] The existing prohibition on a company issuing shares at a discount to nominal value provides shareholders with partial protection against stock-watering : see para. [10]. The problem of stock-watering is present whether shares have nominal value or not. In its Report to the Ministerial Council on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums (September 1986][29] the Committee recommend amendments to the Companies Act 1981 (Cwlth) designed to prevent issues for inadequate non-cash consideration. The Committee reiterates these recommendations.

Information to potential investors

[117] Empowering companies to issue no par value shares could require changes in the information to be provided in a prospectus. The Committee has considered whether there is a need for any new legislative prescription that prices of past issues of no par value shares should be disclosed. The Committee notes that there has been a shift in legislative policy away from prescribing disclosure of particular types of information: persons concerned with the issue of a prospectus are to be required to state all material information. In view of that, the Committee does not recommend any legislation specifically prescribing disclosure of past issues.

Consequential amendments in companies legislation made necessary by abolition of requirement of nominal value for a share

[118] There are various provisions in the Companies Act 1981 (Cwlth) which depend upon shares having nominal value. They include the following provisions:

28. Gore-Browne on Companies para. 15.6.

29. Para. [112].

Section 73(8) allows an application for cancellation of an alteration of the memorandum of association to be made by "the holders of not less, in the aggregate, than 10% in nominal value of the company's issued share capital or any class of that capital or, if the company is not limited by shares, not less than 10% of the company's members".

In the absence of nominal value, a suitable provision would refer to "the holders of not less, in the aggregate, than 10% of the company's issued shares or any class of shares or, if the company is not limited by shares, not less than 10% of the company's members". Compare section 125(4) and 126(4).

Section 133JA allows a public company to buy back ordinary shares selectively provided (inter alia) the buy-back agreement is "approved by a special resolution of the company passed, at a meeting, by a majority consisting of:

(i) at least 75% in number of; and

(ii) members who together hold at least 75% in nominal value of the shares that entitle their holders to attend and vote at the meeting and are held by;

such members of the company as, being entitled to do so, vote in person or, where proxies are allowed, by proxy, at the meeting;"

In the absence of nominal value a suitable provision in sub-clause (ii) could be:

"(ii) a member who is entitled, or members who are together entitled, to not less than 75% of the total voting rights of all the members having a right to attend and vote at the meeting."

Compare Companies Act 1981 (Cwlth) section 241(1), (3); Foreign Acquisitions and Takeovers Act 1975 (Cwlth) sections 9 and 14.

Section 242(3), providing for approval of short notice of meeting, will need to be amended.

Section 315(4) provides for a compose or arrangement with members, or a class of members, being approved

"by a majority in number of the members, or of the members included in that class of members, present and voting, either in person or by proxy, being in the case of a company having a share capital, a majority whose shares have nominal values that amount, in the aggregate, to not less than 75% of the total of the nominal values of all the shares of the members present and voting in person or

by proxy, or of the members included in that class present and voting in person or by proxy, as the case my be;"

To meet the case of members holding no par value shares the comparable provision in South Africa, section 311 of the Companies Act 1973 (Sth. Afr.) provides for agreement to a compromise or arrangement by:

"(b) a majority representing three-fourths of the votes exercisable by the members or class of members ..."

In South Africa companies have the option to issue shares having nominal value or no par value shares. The provision quoted serves in respect of both types of shares.

A provision similar to the South African provision seems appropriate for section 315.

The Committee has earlier recommended to the Ministerial Council an addition to section 315(4)(a) of a provision whereby a compose or arrangement with option-holders could be approved by a majority of option holders "being a majority where options carry the right to be allotted shares having nominal values, that amount, in the aggregate, to not less than 75% of the total of the nominal value of all shares that could be allotted under the options by virtue of which the holders present and voting are entitled to attend and vote;"

If the options could be over no par value shares, a suitable provision could be:

"being a majority whose options carry the right to be allotted shares that would entitle the holders, in the aggregate, to not less than 75% of the total voting rights attached to the shares that could be allotted under the options by virtue of which the holders present and voting are entitled to attend and vote;"

Exposure of draft legislation for public discussion prior to enactment

[119] An unusually high proportion of the responses to Discussion Paper No. 10 referred to the need for any proposed new legislation to be exposed for public discussion over a relatively long period. The Committee is of the same view.

[120] **The Committee recommends that any proposed new legislation on no par value shares should be exposed for public discussion for a relatively long period.**

Delayed operation to allow time for consequential amendments to other legislation

[121] If legislation to allow the issue of no par value shares is enacted, there should be some delay before it operates.

[122] The introduction of a power in companies to issue no par value shares could require other legislation to be reviewed and amended.

In particular, the implications for income tax legislation will require a thorough review.

[123] **The Committee recommends that any legislation to allow the issue of no par value shares should not come into operation until after a period in which other legislation can be reviewed.**

H A J FORD (Chairman)
G W CHARLTON
D A CRAWFORD
D R MAGAREY

7 November 1990

Z-0055HF.REP

APPENDIX

LIST OF RESPONDENTS

Australian Bankers' Association
Australian Society of Accountants
Australian Stock Exchange Limited
C R A Limited
Federal Commissioner of Taxation
Dr K Fletcher
Mr. Ho Yew Kee
Institute of Corporate Managers, Secretaries and Administrators Ltd.
Insurance and Superannuation Commission
Law Council of Australia, Companies Committee, Business Law Section
N E Renton & Associates
The Institute of Chartered Accountants in Australia
The Law Society of South Australia, Commercial Law Committee
The Law Society of Western Australia
Mr. C Warrell
Westpac Banking Corporation