

CORPORATIONS LAW
SIMPLIFICATION PROGRAM

SHARE BUY-BACKS

PROPOSAL FOR SIMPLIFICATION

TASK FORCE

MARCH 1994

Simplification Task Force
Attorney-General's Department
BARTON ACT 2600

SHARE BUY-BACKS – PROPOSAL FOR SIMPLIFICATION

This proposal simplifies the rules concerning share buy-backs.

The existing provisions

The Corporations Law currently recognises 5 types of buy-back:

- buy-back schemes – where an identical and proportional offer is made to every shareholder
- on-market purchases – purchases by listed companies of their own shares in the ordinary course of trading on the stock exchange
- employee-share purchases – purchases of shares held by or for the benefit of current or former employees of a company, including salaried directors, according to the terms of an employee share scheme
- odd-lot purchases – purchases by listed companies of small parcels of shares which are not marketable on the stock exchange
- selective buy-backs – a buy-back that does not fall within any of the other categories, such as the purchase of a particular member's shares.

The share buy-back provisions are sections 206AA-206VF in Division 4B of Part 2.4 of the Corporations Law. The Australian Stock Exchange Listing Rule 3V also applies to buy-backs undertaken by listed companies.

Current criticisms

The following criticisms have been made of the current provisions in the Law:

- they are too long, comprising 89 sections and 48 pages
- they are complex and difficult to understand
- they impose heavy compliance costs
- each of the 5 types of buy-backs is subject to its own set of rules
- the rules apply differently to public and proprietary companies
- they include unnecessary safeguards against potential abuse (eg to stop market manipulation, buy-backs are prohibited 3 months before or after a share placement or rights issue – this prevents a public company which operates a dividend reinvestment plan undertaking a buy-back).

Concerns

There are a number of general concerns about share buy-backs:

- increasing the risk of corporate failure – due to the distribution of the company's assets to its shareholders, with a resulting increase in the financial risk to the company's creditors and remaining shareholders
- internal inequities – where favoured shareholders are bought out at a substantial premium, or where a company acquires shares at a marked undervalue, to the detriment of vendor shareholders
- market price manipulation – unilaterally raising the share price to encourage others to 'jump on the band-wagon' and purchase the shares
- improper attempts to secure or consolidate corporate control

- greenmail – acquiring the shares of a particular shareholder at a premium to the market price, often in response to a threat by that shareholder to make a takeover bid or disrupt the company's affairs
- insider trading – by the company and its officers in the company's shares.

Proposal

The policy underlying the proposal is to allow a company to buy back its shares, subject to safeguards intended mainly to protect the interests of its creditors and remaining shareholders against inappropriate actions by directors and other insiders.

The proposal concentrates on:

- solvency
- disclosure
- shareholder approval.

Benefits of proposal

The proposed rules:

- are shorter and easier to understand
- eliminate unnecessary procedural requirements
- reduce compliance costs
- are largely uniform for all types of buy-backs
- are the same for all companies.

The proposal and capital maintenance

The capital maintenance doctrine forms the background to the buy-back provisions. A number of issues have been raised about other aspects of the doctrine.

The Task Force anticipates issuing a paper on the capital maintenance doctrine shortly.

THE PROPOSAL

Proposal	Issues for consideration
<p><u>Power</u></p> <p>1. A company may buy back its shares, except its redeemable preference shares. <i>Because they are redeemable, a separate mechanism for buying back the shares is inappropriate.</i></p> <p><u>Directors' liability</u></p> <p>2. Directors are personally liable where a buy-back leads to insolvency.</p> <p><u>Solvency</u></p> <p>3. Before a company buys back its shares, the directors must sign a written declaration that in their opinion the company will be solvent immediately after the company buys back its shares.</p>	<p>Should this power be limited to ordinary shares?</p> <p>Should it extend to partly paid shares?</p> <p>Should it be limited to an overall percentage of the company's shares?</p> <p>Is it sufficient protection merely to have the right to include in a company's constitution provisions restricting the exercise of the statutory power?</p> <p>Should there be a requirement that buy-backs be authorised by the articles (as under the present law)?</p> <p>Should simplification of the provisions concerning unacceptable self-acquisition be addressed in light of the simplification of the buy-back rules?</p> <p>What should be the basis for directors' personal liability?</p> <p>Should all of the company's directors be required to agree to a solvency declaration/</p> <p>Should a solvency declaration cease to be in force at the end of a period specified in the Law (as under the present law)?</p> <p>If so, what should that period be?</p> <p>Should a solvency declaration cease to be in force when a director who agreed to the declaration gives notice that the director considers that the declaration is no longer correct?</p> <p>If so, what form should the notice take, and to whom should it be given?</p> <p>Should an auditor's report be required (as under the present law)? If so, what form should it take?</p>

Proposal	Issues for consideration
<p><u>Member approval</u></p> <p>4.(i) <u>Buy-backs, other than employee schemes and odd-lots</u></p> <p>If a buy-back involves an identical and proportional offer to all members or takes place on the stockcar, an ordinary resolution is required only if immediately after the buy-back the company would have bought back more than 10% of its ordinary shares in the previous 12 months.</p> <p>(ii) <u>Buy-back as part of an employee share scheme</u></p> <p>A buy-back requires an ordinary resolution only if immediately after the buy-back the company would have bought back more than 10% of its ordinary shares in the previous 12 months.</p> <p>(iii) <u>Buy-back of odd lots</u></p> <p>A resolution is not required.</p> <p>If a members' resolution is required, the company must include with the notice of the meeting a statement setting out all information which the company ought reasonably provide to enable a person to decide whether or not to vote in favour of the resolution.</p> <p><u>ASC power to modify</u></p> <p>5. The ASC can modify the restriction on particular persons voting in a particular case.</p> <p><u>Buy-back offer</u></p> <p>6. The buy-back offer must also be accompanied by a statement setting out any other information known to the company that is material to a person deciding whether to accept the offer.</p>	<p>Should there be an absolute percentage limit on the number of shares that shareholders can approve for buy-back in any 12 month period (say 20%)?</p> <p>Should there be a percentage limit on the number of shares which may be bought back in any 12 month period under an identical and proportional offer to members (say 2%) below which no restrictions would apply?</p> <p>Given the exclusion of interested parties, would an ordinary resolution be appropriate for selective buy-backs?</p> <p>Should the disclosure test also refer specifically to other matters, such as those referred to in section 206KK (the disclosure of directors' interests) and section 206KL (effect on control of company)?</p> <p>Are there any other provisions which the ASC should be able to identify?</p> <p>Is this disclosure requirement necessary, given common law disclosure obligations?</p> <p>Would it help to spell out what is meant by 'material'?</p> <p>Should the disclosure test specifically require disclosure of any takeover proposal or directors' interest?</p>

Proposal	Issues for consideration
<p><u>Notification to the ASC</u></p> <p>7. Before the buy-back is made, the company must lodge a copy of the following with the ASC:</p> <ul style="list-style-type: none"> • the directors' solvency declaration • the buy-back offer (except where the buy-back takes place on the stock market) • any document provided by the company to its members in connection with the buy-back. <p><u>Suspension of rights</u></p> <p>8. The rights attached to a share are suspended once the buy-back offer is accepted. In particular, the share may not be transferred by the company to a third party.</p> <p><u>Cancellation</u></p> <p>9. Any shares bought back are cancelled immediately after the transfer is registered by the company. Once the bought back shares are cancelled, the company must lodge with the ASC details of the cancelled shares.</p> <p><u>Takeover provisions</u></p> <p>10. Part 6.7 (notification of substantial shareholdings) should apply, but only after completion of the buy-back. Listed companies will be required to notify members after the buy-back. Part 6.9 (reference to Panel about unacceptable conduct) will apply. The rest of Chapter 6 (takeovers) will not apply.</p> <p><u>Setting aside buy-backs</u></p> <p>11. Vendor shareholders are liable to have improper transactions set aside.</p>	<p>In the case of an odd-lot buy-back, should any lodgement be required?</p> <p>In the case of an on-market buy-back, should the company be required to lodge with the ASC information concerning the offer price and the number of shares proposed to be bought back?</p> <p>Should the disclosure test specifically require a statement about any take-over proposal that is known to any director?</p> <p>Do the rules in paragraphs 4, 6 and 10 provide sufficient protection against unacceptable takeover activity – by the target company in resisting or facilitating a takeover bid? Should an expert's report be required in particular cases?</p> <p>Should the ASC be able to relieve companies of the obligation to notify members of odd-lot buy-backs?</p> <p>What powers might the court be given to deal with this situation, especially in relation to partly-paid shares?</p> <p>Should this provisions also allow a vendor shareholder to seek reinstatement?</p>

HOW THE PROPOSAL WILL WORK

Selective buy-back by a company	Current law	Task Force proposal
Can a public company carry out the buy-back if the buy-back would exceed 10% in 12 months?	No	Yes
Must the company have a current buy-back authorisation in its articles?	Yes	No
Must the company be solvent to carry out a buy-back?	Yes	Yes
Do the directors have to sign a solvency declaration?	Yes	Yes
Is an auditors' report required?	Yes ¹	No
Is disinterested member approval required by special resolution?	Yes ²	Yes
Is the ASC prevented from giving relief on voting requirements?	Yes	No
Are there other special voting requirements?	Yes	No
Must there be full disclosure to shareholders?	Yes	Yes
Is an expert's report required?	Yes ³	No
Does the company have to advertise the buy-back, and then wait 21 days?	Yes	No
Must buy-back documents be lodged with the ASC?	Yes	Yes
Do the documents have to be available for inspection at the company's registered office?	Yes	No
Must a company keep a buy-backs register?	Yes	No
Will there be a compliance certificate	Yes	No
Are there restrictions on the source of funds for the buy-back?	Yes	No
Are there restrictions on the timing of new issues (eg under dividend reinvestment plans) as a result of the buy-back?	Yes	No
Must rights be suspended and shares cancelled following a buy-back?	Yes	Yes

¹ Only for buy-backs by public companies and those buy-backs by proprietary companies which lead to the company buying back more than 10% of its shares in 12 months.

² Only for selective buy-backs by public companies and those selective buy-backs by proprietary companies that lead to the company buying back more than 10% of its shares in 12 months.

³ Only for buy-backs by public companies.