Appendix B

COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

DISCUSSION PAPER NO. 5
A COMPANY'S PURCHASE OF ITS OWN SHARES

JUNE. 1986

Appendix B

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Chapter 1: Current Australian Law

ORIGIN AND RATIONALE OF THE PROHIBITION

[101] The prohibition on a company acquiring its own shares (hereinafter referred to as "the self-purchase power") was authoritatively laid down by the House of Lords in Trevor v Whitworth [1886-1890] All ER 46. The House of Lords enunciated that a company cannot purchase its own shares or reduce its capital except in accordance with the statutory procedures, or return directly or indirectly the capital subscribed, other than in the course of liquidation or pursuant to statutory authority. The Court identified three interlinked policy bases behind this prohibition:

(a) Structure of the Legislation

[102] The relevant legislation required the Memorandum to stipulate nominal capital (see Companies Code s37(1) (c)) and laid down a formal procedure for reduction of capital (see Companies Code s121; 123). These provisions were interpreted in Trevor v Whitworth as manifesting a clear legislative intention that capital be maintained, subject to a statutory reduction, and this policy would be violated if companies were empowered to purchase their own shares. Companies could not unilaterally reduce their issued or paid-up capital by such means as a declaration of dividend out of capital or unauthorised reduction of capital, but:

"The stringent precautions to prevent the reduction of the capital of a limited company without due notice and judicial sanction would be idle if the company might purchase its own shares wholesale and so effect the desired result" (at 50)

(b) Ranking of Shareholders

[103] Shareholders in a limited liability company acquire

exemption from personal liability for the debts of the company. In exchange for that immunity shareholders are ranked behind creditors on the list of persons entitled to claim on the assets of a company in liquidation. A self-purchase power would place the vendor shareholders in advance of, or at least on par with, company creditors. This problem arises where a company is unable to honour its debts as and when they fall due, and focuses on the relative rights of creditors and former shareholders in the event of a company insolvency.

(c) Creditor Protection Through Capital Maintenance

[104] The maintenance of the company's capital in the interests of creditors was advanced as a principal rationale behind the self-purchase prohibition. This rested on the theory that creditors provide funds on the basis of an express or implied representation that the capital shall be applied only for the purposes of the business and that it not be returned to shareholders. Creditors have a right to look to the capital subscribed as one source for the discharge of the company's liabilities to them.

[105] It is by no means self-evident that the principle of capital maintenance is of much utility to creditors. A number of shortcomings have been referred to, namely:

* Lack of any statutory requirement for a minimum paid-up capital. The company's capital may be inadequate from the outset. Also there is no requirement for any part of the share capital to be kept in reserve for the benefit of creditors.

* The capacity of companies to issue shares for non-cash consideration where the valuations assigned to these considerations are not normally independently verified.

* Lack of any provision to protect capital, once raised, from dissipation "in the ordinary course of business". This means that the company’s capital may diminish through its trading operations, changes in economic conditions, or pursuant to dividend distributions out of capital "profits" despite a decline in the company's business and the increased risk exposure of creditors.

[106] Creditors may be better protected through such mechanisms as borrowing limits in the company's trust deed; provision of adequate security; or independent assessment of the company's credit-worthiness.

[107] Despite the shortcomings in the traditional basis for the prohibition on company self-purchases, it is by no means self-evident that the granting of this power is in the interests of the company, its shareholders, creditors or the public. It does not suffice merely to point to inadequacies in the capital maintenance principle as a protective device to justify granting a self-purchase power. It is also necessary to establish that such a power may fulfil useful functions and these are not outweighed by potential problems and manipulative practices that may result.

THE STATUTORY PROHIBITION

[108] The Companies Code prohibits a company acquiring or lending money for the purchase of its shares or those of its holding company. Three categories of transaction are involved:

* a company acquiring its own shares or units of shares: s129(1) (b) (i);

* a purported acquisition by a subsidiary of shares or units of shares in its holding company: s129(1) (b) (ii); s36(2); and

* a company lending money on the security of its shares or units of shares in itself or its holding company: s129(1) (c).

Section 129(1)(b)(i)

[109] This sub-section is drafted in very wide terms. It applies whenever a company "acquires" its own shares "whether directly or indirectly in any way". The term "acquires" is expressly defined in s129(16) to cover "any acquisition or proposed acquisition whether by way of purchase, subscription or otherwise". Moreover s129(1) (b) catches not only the acquisition of "shares" as such but also the acquisition of "units" of shares, defined under s5(1) as "any right or interest, whether legal or equitable in the share ... by whatever term called and includes any such right or interest in the share".

[110] The reference to direct or indirect acquisition is designed to overcome the otherwise obvious loophole of a corporation acquiring its shares through a nominee or agent. However there are limits on the concept of an indirect acquisition as seen in the decision of August Investments Pty. Limited v Poseidon and Samin Limited: see [131]-[142].

Section 129(1)(b)(ii)

[111] Although a holding company and its subsidiary are separate legal entities, the commercial independence of the subsidiary is often minimal. In many cases therefore, the purchase by a subsidiary of shares of its holding company would have much the same effect as the purchase by the holding company of its own shares. Accordingly the sub-section prohibits the subsidiary from "purporting" to acquire shares or units of shares in its holding company. (The term "purport" is used in view of s36 of the Companies Code which prohibits the subsidiary from being a member of its holding company.)

Section 129(1)(c)

[112] A company is prohibited from lending money on the security of its shares or those of its holding company. This is designed to prevent circumvention of the self-purchase prohibition by an arrangement whereby a company lends money on the security of its shares, a legitimate or engineered default in repayment occurs, and the company exercises its right to enforce the security, thereby effectively acquiring its own shares.

[113] The "validation" procedure set out in s129(10)-(15) of the Companies Code has no application to transactions falling within s129(1) (b) or (c). This procedure applies only to the provision of financial assistance by a company to enable another party to acquire shares in the company or its holding company.

Effect of Breach

[114] Entry into a transaction in breach of s129(1) (b) or (c), which does not fall within any of the recognised exceptions or shelters, (see [119]-[143]) has criminal and civil consequences for the parties involved, and as well affects the validity and enforceability of the transaction.

Criminal Consequences

[115] Defaulting officers are liable for criminal penalties of up to two years imprisonment and/or $10,000: s129(5); s572, as are any other persons knowingly concerned in or party to the commission of the offence: Companies and Securities (Interpretation and Miscellaneous Provisions) Act s38(1). Proceedings for an offence under s129 may be instituted within the period of five years after the act alleged to constitute the breach, or with the consent of the Ministerial Council, at any later time: Companies and Securities (Interpretation and Miscellaneous Provisions) Act s34.

[116] A company itself is immune from criminal liability, on the basis that any penalty would act to the detriment of innocent shareholders and creditors.

Civil Consequences

[117] Where a person is convicted of an offence under s129, the Criminal Court may, in addition to imposing a criminal penalty, order the convicted person to pay compensation to the company or any other person of such amount as the Court specifies: s129(6). The Court may make such an order where it is satisfied that the company or some other person has suffered loss or damage as a result of the contravention.

The Validity and Enforceability of Affected Transactions

[118] Section 130(1) provides that the validity of a contract or transaction is not affected by a contravention of s129(1) (b) or (c) unless the contract or transaction effects the acquisition or loan that constitutes the contravention. This means, for instance, that a contract of purchase by a company of its own shares is void but collateral contracts are preserved. Such collateral contracts are voidable at the option of the company: s130(2). Where a contract or transacticn is void ab initio or avoided, application for relief may be made to the court by any person who has, or is likely to suffer, loss or damage as a consequence: s130 (4) (5).

EXCEPTIONS TO THE SELF-PURCHASE PROHIBITION

Section 129(1): Acquisitions expressly provided by the Companies Code

[119] Section 129 exempts from its prohibition corporate self-purchases allowed for elsewhere in the Code. The principal statutory exceptions are s120: redemption of

redeemable preference shares: see [126] - [128]; s123: reduction of capital: see [129] - [130]; s123 (12): self-purchases by unlimited liability companies: and s320: oppression orders:

Section 129(8)(e): Acquisition of Fully Paid Shares for No Consideration

[120] This section merely formalises the common law position which allowed such transactions, on the reasoning that there has been no reduction in the company's capital. To preserve this policy base, the sub-section requires that no consideration be provided by the company or by any corporation that is related to the company.

Section 129(8)(b): Reduction of Capital

[121] The prohibition does not apply to a payment made by a corporation pursuant to a reduction of capital under s123.

Section 129(8)(f): Purchase Pursuant to a Court Order

[122] One instance where such an order may be made is where the court is satisfied that a company's affairs are being conducted in an oppressive manner: s320. The court may order a self-purchase to allow for the retirement of one or more members.

Section 129(8)(e): Creation or Acquisition of a Lien

[123] This allows a company to take a lien on partly paid shares for any amount payable to the company. To safeguard against abuse of this exception, the lien must have been created or acquired both in good faith and in the ordinary course of commercial dealing.

Section 129(9)(a): Money lending Transactions

[124] The prohibition on a company lending money on the security of its shares does not apply to securities given by a money-lending company in the ordinary course of its lending operations.

Section 129(9)(b): Employee Share Benefit Schemes

[125] A Company may provide financial assistance for the acquisition of its fully paid shares to be held by or on behalf of employees. These shares may be held by the company in a trust capacity or a separate trust fund may be established.

Redemption of Redeemable Preference Shares: s120

[126] A company may, if so authorised by its Articles, issue preference shares which are, or at the option of the company are, liable to be redeemed. To protect the interests of creditors such shares shall not be redeemed except:

* on such terms and in such manner as are provided by the Articles;

* out of profits that would otherwise be available for dividends or out of the proceeds of a fresh issue of shares made for the purposes of the redemption; and

* where they are fully paid up.

[127] If the redemption is paid out of profits, the capital so redeemed must be replaced by a reserve fund called a "capital redemption reserve" to which must be transferred a sum equal to the nominal amount of the shares redeemed.

[128] The Companies Legislation contains no definition of preference shares but the term would appear to cover any shares which afford the holder a preference as regards dividend, capital or otherwise. This gives companies a degree of flexibility in deciding what shares might be issued as redeemable preference shares.

Reduction of Capital: s123

[129] A company may, by complying with the procedures set out in s123, reduce its share capital by, inter alia, acquiring and cancelling its shares. The statutory procedures, involving the passing of a special resolution,

settling a list of creditors entitled to object to the reduction, and court confirmation, are designed to, protect the interests of creditors, shareholders and the public.

[130] There are a number of disincentives in employing s123 to effect a corporate self-purchase. The relatively complicated legal process can be both costly and time-consuming. For instance a 1979 study (Coombes R; Tress R: Return of Capital: A Legal or a Market Process? Australian Journal of Management Vol. 4 No 2 1979, p89) indicated that of 27 capital reductions examined, the average time span from announcement to final share purchase was 168 days. The time period of any particular reduction will be greatly affected by whether any objection to the reduction is raised in court. A further problem is that there is a prima facie presumption against the validity of a reduction of capital otherwise than in accordance with the priorities on winding-up. This principle is designed to ensure equitable and uniform treatment of shareholders, but it does introduce a degree of inflexibility compared, say, with a peri passu or on-market self-purchase offer by a company. In the latter case shareholders would have the choice between a cash receipt by selling, or an increased share of ownership by retaining their shares.

Acquisition of Shares in a Company which it self holds shares in the acquiring company.

[131] A company is entitled to acquire an interest in another company which holds its shares. This principle emerges from the decision of the Full Court of the South Australian Supreme Court in August Investments Pty. Ltd. v Poseidon and Samin Limited [1971] 2 SASR 71. In that case Poseidon Limited sought to make a takeover bid for Samin Limited, the latter company holding some 200,000 Poseidon shares. It was argued that Poseidon was in effect proposing to purchase its own shares, in breach of the forerunner to s129.

[132] The Full Court ruled unanimously that the prohibition on self-purchase did not extend to a company acquiring an interest in one of its corporate shareholders. Poseidon was not purchasing either a direct or indirect beneficial interest in itself, nor becoming in law a member of itself. Samin did not hold the Poseidon shares on trust for Poseidon, nor had it agreed to do so in future. The transaction was not a direct or indirect acquisition in breach of the old equivalent of s129.

[133] The majority of the Court dismissed motive as irrelevant and ruled that nothing turned on establishing that the acquired company subsequently became a subsidiary of the acquiring company. Mitchell J dissented on this point and was prepared to hold that the prohibition on self-purchase may be violated if the acquired company had been set up for the purpose of acquiring shares in the (eventual) holding company. Likewise:

"If the sole asset of the intended subsidiary company were a parcel of shares in the proposed holding company it seems to me that the court might be entitled, in looking at the realities of the situation, to say that the proposal by the latter company was to purchase its own snares, notwithstanding the fact that nominally it was acquiring shares in the former company".

Implications of August Investments v Poseidon

[134] A company may, in effect, control a proportion of its own shares by acquiring an interest in one or more of its corporate shareholders. However there are a number of constraints on this self-purchase method. A holding company is not entitled to use a subsidiary company to acquire shares in the holding company, as this is in breach of the Companies Code s36. Where the acquired shareholder subsequently becomes a subsidiary of the acquiring company the relevant shares must be treated as non-voting shares, and be disposed

of within 12 months: s36(5). However these disabilities do not arise where the interlocking corporate arrangement falls short of a holding company-subsidiary relationship. In such instances the shares may be held indefinitely.

[135] The principles underlying August Investments v Poseidon allow for the establishment of "mutual support" networks and protective cross-shareholding webs between companies enabling shares to be held in support of existing management. A board of directors under pressure from speculation of an unwelcome takeover bid might employ this mechanism in an attempt to frustrate a prospective offer by soaking up loose shareholdings.

Policy Responses

[136] Given these glosses on the s129 prohibition, a number of possible policy responses may be considered:

* Maintain the current law

[137] Under this approach a company can, in effect, control a proportion of its shares through the use of mutual support networks and associates, subject to the constraints of CASA s11; Companies Code s36 (in the event of a holding company-subsidiary relationship arising) and s129 (restrictions on a company funding the purchase of its own shares). The motives for entering into such relationships would appear not to impinge on their legality, though the actions of directors may be challenged as in breach of their fiduciary duties at common law or pursuant to the Companies Code s229 (e.g. directors seeking to entrench their position rather than acting in the best interests of the company).

* Prohibit the Poseidon Mechanism

[138] This approach would attempt to close the "loophole" by prohibiting a company acquiring shares or other

interests in any of its shareholders. A blanket prohibition of this nature would constitute an unjustifiable restriction on share acquisitions and take-over activity. For example, the holding by a take-over target of even a few shares in the bidder would suffice to thwart the bid.

[139] A compromise approach may be to place a ceiling on the proportion of a company's shares that may be purchased in this manner. A limitation already applies under s11 of CASA which prohibits an acquisition that could increase a person's entitlement to voting shares beyond 20%.

* Review Motive

[140] A further approach may be to regulate this form of self-purchase by focusing on issues of motive, and adopt, if not extend, the principles alluded to by Mitchell J in August Investments v Poseidon. Under this approach a distinction could be drawn between instances where the sole or primary motive for the transaction was to enable the company to exercise some control over its shares, and where this was merely an incidental by-product of a broader transaction. The prohibition in s129 would apply to the former case.

[141] This would be a more flexible policy approach than outright prohibition and would be designed to inhibit use of the Poseidon precedent for purposes of obtaining a degree of corporate self-ownership. The shortcoming of this option is the difficult evidential issues that it raises, particularly in determining matters of motive, and the reliance on litigation to effect its enforcement.

* Reform the General Prohibition by Relaxing the Barriers to Corporate Self-Ownership

[142] This would involve abandoning the general s129 prohibition on company self-purchases. Adoption of this policy would allow companies to acquire their shares directly, without resort to the process of acquiring an interest in their shareholders. However this may not eliminate use of the Poseidon mechanism to protect against unwelcome takeover bids, considering the limitation of the self-purchase power as a takeover defence: see [330].

Other Exceptions to the Self-Purchase Prohibition

[143] These other exceptions are:

* Forfeiture of shares for non-payment of calls, or surrender of shares in circumstances which would entitle the company to enforce forfeiture. The forfeiture or surrender only affects any amount so far unpaid and no return of capital is involved.

* Surrender of shares in exchange for new shares of the same nominal value.

* Purchase by unlimited liability companies of their own shares: s123(12).

AUSTRALIAN COMMITTEES OF INQUIRY

[144] The question of whether companies should be entitled to purchase their own shares has been examined on three occasions in Australia.

Eggleston Committee: Fifth Interim Report(1970)

[145] This report pointed out that while a company cannot hold formal title to its own shares it may be possible for shares to be vested in a trustee to hold them on the company's behalf, at least where the company provided no consideration. The Committee supported a proposal that would maintain such trust arrangements but shares should carry no voting rights while they are so held.

[146] The Committee gave no consideration to the broader policy questions involving corporate self-purchase.

Interstate Corporate Affairs Commission (1977)

[147] This Discussion Paper outlined proposed amendments which would allow a company to acquire its own shares. The following reasons favouring the power were referred to by the Commission:

"The view has been advanced that financial advisers in the United States consider that a judicious purchase by a company of its own shares within reason is a desirable practice because it allows greater financial flexibility. Additionally it is said to enhance the value of the reduced number of shares in terms of increased earning power and market value related to earning power (and hence the value on reassignment) than would be possible by the investment of a company's funds elsewhere.

"It is also suggested that shares purchased by a company may be used by it in a subsequent takeover acquisition where new shares would otherwise be issued so that the shares previously repurchased by the company reduce the diluting effect on the other shareholders' equities."

[148] It was proposed that the approval procedures subsequently adopted in s129(10)-(15) of the Companies Code apply to self-purchases as well as financial assistance transactions. In addition it was proposed to provide that shares held by or for the company would carry no voting rights. It would be left to the company to decide whether the shares were to be held for resale (treasury shares) or cancelled. Disclosure requirements would apply.

[149] These proposals were not adopted, due in large measure to criticisms raised by Professor Harding of the University of NSW.

Campbell Committee(1981)

[150] The Committee considered various submissions for reform of the existing law to permit companies to purchase their own shares. It had been suggested to the Committee that the relaxation of restrictions on self-purchase might:

* permit and facilitate corporate restructuring to meet changing circumstances; e.g. it would allow the early retirement of capital no longer necessary for the operation of a company after the sale of an operating division or subsidiary;

* make it easier for unlisted companies to attract outside shareholders - without the need for public listing - as shareholders wishing to sell their holding could, under certain circumstances, be bought out by the company if other shareholders were unable or unwilling to purchase the available shares; and

* facilitate the development of stock option and like arrangements by enabling a company to purchase an employee's shares upon retirement.

[151] The Committee noted that the rationale for the prohibition was to protect both creditors and shareholders by preventing a company from:

* supporting the market in its shares, e.g. to prevent a takeover;

* assisting an outsider to take over the company; or

* reducing shareholders' funds at the possible expense of creditors.

[152] The Committee did not examine the self-purchase issue in detail, but recommended its further consideration, provided there were appropriate safeguards for shareholders and creditors.

Chapter 2: Overseas Approaches

Introduction

[201] The general trend in overseas common law jurisdictions has been to permit corporate self-purchases. The USA has moved away from the Trevor v Whitworth prohibition, and corporate self-purchase has been seen as an acceptable financial procedure. Proposals to relax the self-purchase prohibition have been put forward and adopted in Canada and the UK (though rejected in New Zealand and South Africa). However there are significant differences in the various jurisdictions as to the rules and procedures governing self-purchases.

CANADA

Lawrence Committee: Ontario (1967)

[202] The Lawrence Committee favoured granting companies the power to acquire their own shares. The Committee put forward two main lines of argument in support of this recommendation:

* the principle of capital maintenance, upon which the prohibition was originally formulated in Trevor v Whitworth (1887), was a poor safeguard for creditors;

* there were legitimate and useful reasons why a company should be entitled to purchase its own shares:

"For example, companies may wish to purchase outstanding common shares in order to provide for incentive, bonus or stock option plans without being required to extend their equity base to provide the required shares. Purchase of outstanding common shares is a feasible method whereby a company could contract its equity base as the financial requirements of the company may dictate. The right to purchase common shares could also facilitate mergers and acquisitions in some cases and certainly provides a much needed flexibility for closely held

companies and their shareholders in the event of the death or retirement from the business of one or more of the principal shareholders".

[203] The Committee also indicated that self-purchases could be used to eliminate share fractions or to collect or compromise debts owed to the company.

[204] The Committee recommended enactment of provisions comparable to the then New York Business Corporation Law which granted companies, subject to any restrictions contained in their charters (memorandum and articles) the power to purchase their own shares out of "surplus" (meaning realised profits less any accumulated past losses, which were otherwise available as dividends) unless the corporation was insolvent or would thereby be made insolvent. The Committee further recommended that companies be permitted to purchase their shares out of capital (subject to the solvency test) if the purchase was made for certain specific purposes such as eliminating fractions of common shares or collecting or compromising indebtedness to the company. It also recommended that reacquired shares might either be retained issued but unallotted "treasury shares" or be cancelled at the option of the directors, except that cancellation would be obligatory where shares were acquired out of capital. The power of a company to purchase its shares would be exercised by directors, subject to any obligation on their part to act in good faith and in the best interests of the company. The Committee placed no limits on the number of shares that might be purchased.

Dickerson Report (1971)

[205] This report set out the principles for a new Federal Business Corporation Law. The report recommended that companies be give a self-purchase power, though it would be necessary to prevent abuses such as market manipulation, unfair discrimination amongst shareholders or insider trading.

[206] Purchases would be allowed out of funds available for payment of dividends, subject to a solvency test. The acquired shares would be cancelled and either the authorized share capital would be reduced or the shares would become authorised but unissued capital. The Committee did not support the treasury share concept.

[207] Provisions enabling companies to purchase their shares have been adopted in the federal sphere and the provinces of Ontario, British Columbia, Manitoba, Alberta, Nova Scotia, New Brunswick and Saskatchewan. The Federal Act (Canada Business Corporations Act 1975 (CBCA)) and the Ontario Act (Ontario Business Corporations Act 1982 (OBCA)) are representative of the Canadian legislation. Under these provisions:

* the self-purchase power is subject to the articles of association of the company;

* each company may determine who shall exercise the power;

* self-purchases may be undertaken by on-market acquisitions, pari passu offers to all shareholders, or selective purchases;

* solvency but not source of funds requirements apply; and

* acquired shares must be cancelled and either the authorized share capital reduced or the shares restored to the status of authorised but unissued capital. Acquired shares cannot be held as issued but unallotted treasury shares.

UNITED KINGDOM

Jenkins Committee(1962)

[208] The Committee gave brief consideration to whether a company should be permitted to purchase its shares. The Committee conceded that such a power may be useful and gave the example of where members of a small company wished to retire, the shares were not readily marketable, and the remaining members were unable or unwilling to buy the shares

at a fair price. The Committee adopted the view that a general self-purchase power would require stringent safeguards to protect both creditors and shareholders. However the Committee indicated that it was not aware of any strong pressure for introduction of the reform. Accordingly there was no justification at that time for abrogation of the rule prohibiting a company purchasing its shares.

Consultative Document: The Purchase by a Company of its Own Shares(1980)

[209] This Document, prepared by Professor Gower, provided a general historical background to the prohibition on self-purchases, outlined the case for granting companies the power to acquire their own shares, and examined a number of possible alternatives.

[210] The Document listed the main claimed advantages for corporate buy-backs:

(a) it may enable the company to buy out a dissident shareholder;

(b) it facilitates the retention of family control;

(c) it provides a means whereby a shareholder, or the estate of a deceased shareholder, in a company whose shares are not listed, can find a buyer;

(d) it is particularly useful in relation to employee share schemes in enabling the shares of employees to be purchased on their ceasing to be employed by the company;

(e) it may help with the marketing of shares by enabling the company to give a subscriber an option to resell to the company;

(f) it enables companies to purchase their shares for use later in stock option plans or acquisition programmes;

(g) if redeemable shares are quoted at below the redemption price it enables the company to save money by buying up in advance of the redemption date;

(h) it permits the evolution of an open-ended investment company or mutual fund instead of having to operate through the mechanism of a unit trust;

(i) it provides a company with surplus cash with a further means of using it advantageously;

(j) it can be used to support the market for the shares if this is thought to be unduly depressed, thus preserving for the shareholders the value of their shares as marketable securities;

(k) if the company not only buys its shares but trades in the treasury shares thus acquired it may make money thereby.

[211] Of these claimed advantages, Professor Gower commented that (b), (c) and (d) could be valuable in the case of closely-held companies. In the case of public companies (a) - (d) were either of no or of lesser moment, (e) seemed undesirable in the case of listed securities, and (j) and (k) were actually or potentially objectionable. The only seemingly unobjectionable advantages appeared to be (f), (g), (h) and (i), though it was doubtful how much use would be made of any of them, other than (g).

Five possible reform options were considered:

Possibility A: expressly permit private companies to issue redeemable equity shares

[212] Professor Gower noted that since there was no statutory definition of "preference shares", the term would appear to cover any shares which afforded the holder a preference either as regards dividends, capital or otherwise. Accordingly, the legislation already permitted the issue of redeemable equity shares so long as they conferred some preferential rights in respect of dividends or capital repayment. Omission of the term "preference" in the relevant section (cf: Companies Code s120) would clarify the situation.

[213] If such a course were adopted it would be necessary to provide that the power to issue redeemable shares should not be exercised unless the company had another class of

irredeemable shares. This would be designed to ensure that a company, as a result of redemptions, did not end up without any members.

Possibility B: permit private companies to buy shares issued under an employees' share scheme

[214] This would be an alternative to the current method of vesting the shares in trustees.

Possibility C: additionally permit private companies the right of self-purchase

[215] The discussion paper identified a number of procedural issues that would arise from the granting of such a power. These included permissible sources of funds for self-purchases; determination of a fair price; whether purchased shares should be cancelled, or treated as treasury shares available for resale; whether to allow for executory or option contracts; and the inclusion of safeguards in the form of disclosure provisions, approval procedures, solvency requirements and insider trading liability.

[216] The paper also considered permitting a simplified form of capital reduction (cf: Companies Code s123) by dispensing with the requirement of court approval.

Possibility D: expressly permit public companies to issue redeemable equity shares

[217] The same considerations applied as in A.

Possibility E: permit public companies to purchase and cancel their shares

[218] The Consultative Document noted that any procedure would have to be tailored to the type of self-purchase. For example, it would be impractical in the case of on-market purchases to require each individual acquisition to be ratified by the general meeting. The paper favoured a more general authorisation procedure. Purchased shares should be cancelled rather than held as treasury shares available for resale.

UK Statutory Amendments

[219] The 1985 UK Companies Act Chapter VII, which reproduces the provisions first introduced in 1981 in response to the Consultative Document, grants companies the power to purchase their own shares.

[220] The Act permits a company limited by shares or guarantee and having a share capital, to issue equity shares redeemable at the option of the company or the shareholders. This represents an extension of the equivalent of s120 of the Companies Code which allows companies to issue redeemable preference shares.

[221] The UK Act permits companies with a share capital to purchase their own shares subject to satisfaction of the following conditions:

* The company's articles must permit the purchase.

* The purchase must be authorised by the shareholders: see further [223]-[226].

* The purchase must be out of distributable profits, proceeds of a fresh issue of shares, or in some cases capital: see further [222].

* The acquired shares must be fully paid.

* After purchase, the company must have at least two members, one of whom holds non-redeemable shares.

* Payment of the purchase price must be made on completion.

* An amount equivalent to the nominal value of the company's shares purchased must be transferred to a capital redemption reserve, so as to maintain capital.

* Shares acquired by the company must be cancelled, and the issued but not the authorized share capital reduced. The Act does not make provision for treasury shares.

* The company must lodge a return within 28 days disclosing details of its purchases.

Sources of Funds.

[222] The UK legislation places restrictions on the sources of funds available to the company purchasing its shares. These sources are:

* distributable profits (i.e., accumulated realized, profits so far as not previously utilised by distribution or capitalisation, less accumulated realised losses so far as not previously written off in a reduction or reorganisation of capital duly made)

* the proceeds of a fresh issue of shares made for the purpose of the self-purchase, or

* in the case of private companies only, out of capital. A private company that wishes to make a purchase or redemption of its own shares must in the first instance use up any available profits before drawing on capital.

Authorisation Process.

[223] A mandatory procedure similar to that found in s129(10)-(12) of the Companies Code applies where the redemption or purchase is out of capital. An auditor's report and a statutory declaration of solvency by the directors must confirm the viability of the payment. These documents must be made available to shareholders who must approve the transaction by special resolution. Vendor shareholders are ineligible to vote on the special resolution. Public notice of any approval must be made and dissenting members and creditors may apply to the court for cancellation of the resolution.

[224] Where purchases are made otherwise than out of capital, the terms of the proposed purchase must be authorised by a special resolution for off-market purchases or an ordinary resolution for on-market purchases. Votes attached to vendor shares are rendered ineligible.

[225] The authority conferred by an ordinary resolution for on-market acquisitions can be general or limited but it must:

* specify the maximum number of shares authorised to be acquired

* determine both the maximum and minimum price which may be paid for those shares (either by specifying a fixed sum or by providing a formula for ascertaining the price, but without reference to any person's discretion or opinion)

* specify a date on which the authority is to expire, though this may not be more than eighteen months after the date on which the resolution is passed.

[226] The authority to purchase on-market may be varied, revoked or renewed by ordinary resolution.

Recovery Upon Insolvency

[227] Where a company which has purchased its shares out of capital, becomes insolvent within twelve months of making the payment, the recipients of these payments are each liable to repay an amount not exceeding the amount paid to each by the company out of capital. Furthermore every director of the company who signs the relevant statutory declaration of solvency is jointly and severally liable with each vendor shareholder, except a director who can establish that he had reasonable grounds for forming the opinion set out in the declaration.

[228] The relevant provisions of the 1985 UK Act are found in Appendix 1.

Stock Exchange Rules.

[229] In addition to these statutory requirements, the London Stock Exchange imposes further rules on listed

companies wishing to make on-market self-purchases. These include:

* A company may not purchase its shares in the two months immediately preceding the announcement of its annual or half-yearly results.

* Purchases within a period of twelve months of 15% or more of a company's share capital must be made either by way of a tender or a partial offer to all shareholders. The tender offer must be made on the Stock Exchange at a stated maximum price.

* Purchases within the limit of 15% in twelve months may be made on-market in the ordinary way, provided that the price paid is not more than 5% above the average of the middle market quotation for the ten business days before the purchase is made.

* Details of purchases, including the number of shares purchased, together with the price per share (or the highest and lowest prices paid, where relevant) must be notified to the Stock Exchange by midday of the next business day.

London City Code

[230] The City Code on Take-overs and Mergers, while not having the force of law, prescribes rules for persons utilising the facilities of the UK securities market. Rule 37, introduced in 1985, contains various provisions governing self-purchases in the take-over context:

* a deeming provision as to the effect of self-purchases on the share acquisition levels of directors and their affiliates: Rule 37.1; 37.2;

* a stipulated procedure for self-purchases by an offeree company where a take-over bid is imminent or current: Rule 37.3;

* a self-purchase disclosure obligation for an offeror company: Rule 37.4.

OTHER EUROPEAN COUNTRIES

[231] Public limited companies in EEC countries are generally permitted to purchase their shares. The laws of member States (including the UK) are guided by the EEC Second Directive on Company Law (1977), which applies to public companies and provides (Articles 19-22) that:

* transactions may only be in fully paid-up shares;

* authorisation must be given, and the terms and conditions determined, by a general meeting of shareholders. The general meeting shall determine the maximum number of shares to be acquired, the duration of the period for which the authorisation is given (which may not exceed eighteen months) and the maximum and minimum consideration. Member states may allow for retrospective validation by the general meeting of a share purchase undertaken by company directors where the purchase was necessary to prevent serious and imminent harm to the company;

* details of the purchases and the reasons for them must be set out in the annual report;

* the number of shares a company can acquire and hold as treasury shares may not exceed 10% of its subscribed capital;

* the acquisitions must not have the effect of reducing net assets below the amount of subscribed capital plus undistributable reserves; and

* voting rights must be suspended in respect of treasury shares so long as they are held by the company.

[232] The UK and West Germany were the first member States to bring their laws on public companies into line with the Second Directive. Other member States have since followed. By way of example, Belgium introduced self-purchase provisions in 1985, though framed in very restrictive terms:

* A four-fifths majority of shareholders who vote is needed to authorise the purchase.

* This authority is valid for a maximum period of 18 months or such lesser time as stipulated 'in the resolution.

* Equal treatment of shareholders must be strictly respected. The company must make an identical purchase offer to all shareholders of the relevant class; on-market or selective purchases are prohibited.

* The purchased shares may be held as treasury shares and resold within 2 years, if so authorised by a majority vote of shareholders. Shares not sold within the 2 year period must be cancelled.

USA

[233] The law in the United States has changed on whether a corporation may acquire its own shares. Originally a self-purchase power was not permitted for various reasons, including that it went beyond the valid range of objects of corporations, and that it could accomplish a reduction of capital without following the prescribed procedure. However the self-purchase power has been recognized for some decades in all jurisdictions, either by express statutory provision, or through relevant case-law.

[234] The Model Business Corporation Act has been designed by the Corporate Section of the American Bar Association as a guide for legislation at the state level (though it is not necessarily followed in its entirety in all jurisdictions). It grants to corporations the power to acquire their own shares (s6), subject to satisfaction of solvency requirements:

"Subject to any restrictions in the articles of incorporation, the board of directors may authorise and the corporation may make distributions [defined to encompass self-purchases] except that no distribution may be made if, after giving effect thereto, either:

(a) the corporation would be unable to pay its debts as they become due in the usual course of its business; or

(b) the corporation's total assets would be less than the sum of its total liabilities and (unless the articles of incorporation otherwise permit) the maximum amount that then would be payable, in any liquidation, in respect of all outstanding shares having preferential rights in liquidation" (s45).

[235] The Model Act s6 originally restricted the funds available for self-purchase to unreserved and unrestricted earned revenue surplus (a concept similar to, but narrower than profits available as dividends) and where the articles so permitted, or with the affirmative vote of the holders of a majority of all shares entitled to vote, unreserved and unrestricted capital surplus. However these requirements were deleted under 1980 Amendments to the Model Act. (See The Business Lawyer Vol. 34 (1979) p1867-1889; Vol. 35 (1980) p1365; Vol. 38 (1983) p1019-1029.)

[236] The Model Act allowed for acquired shares to be cancelled (and either the authorized share capital reduced or the shares restored to the status of authorized but unissued capital) or held as issued but unallotted treasury shares. However the 1980 Amendments eliminated the concept of treasury shares.

[237] There is no requirement that self-purchases be pursuant to a general invitation to shareholders, and accordingly selective purchases from one or more shareholders are permitted. However some controls have been introduced by the Stock Exchanges. For instance the New York Exchange has taken the position that selective purchases from an officer, director or substantial shareholder of a listed company should have shareholder approval and failure to obtain it may lead to the delisting of the company's securities.

[238] The Federal Securities and Exchange Commission (SEC) has been involved in regulating issuer self-purchases since the 1968 amendments to the Securities Exchange Act. Section 13 (e) (1) prohibits self-purchases in contravention of the

rules adopted by the SEC. Pursuant to that power, the SEC has created a series of rules in recognition that although market purchases may be undertaken for legitimate purposes, substantial self-purchases can have a significant impact on the market price of securities and are therefore subject to abuse.

Rule 13e-1: Purchase of securities by the issuer

[239] This prohibits the target of an actual or pending tender offer from purchasing its own securities unless two disclosure requirements are met:

* Filing of a statement with the SEC setting forth the type and amount of shares to be purchased, the names of the persons or classes from whom the shares are to be purchased, and the market in which they are to be purchased; the reason for the purchase and whether the purchased shares are to be retired, held as treasury shares or disposed of; and the source and amount of funds to be used.

* The target must have provided the substance of this information to its equity security holders within the past six months.

[240] Privately negotiated as well as open-market purchases are permitted. There is no requirement that the issuer make a general or an on-market offer to all shareholders.

[241] Rule 13e-1 helps to create a degree of disclosure parity between the issuer target company undertaking the self-purchase and the bidder making the tender offer. It also alerts the shareholders to the fact that the future market price may reflect the issuer's entry into the market, thereby enabling them to make a more accurate evaluation of the merits of the tender offer.

Proposed Rule 13e-2 as substituted by Rule 10b-18.

[242] The proposed Rule 13e-2 was designed to impose certain time, price and volume limitations on issuer

self-purchases which did not amount to tender offers. The proposed rule was a response to perceived abuses arising from use of the self-purchase power to influence the market price of the securities. The proposals were designed to prevent conduct which might disturb the orderly functioning of the market, by prohibiting the issuer from unilaterally raising the market price, creating the appearance of widespread interest in the stock through the use of several brokers, or dominating the market in volume of shares purchased.

[243] In 1982 the SEC adopted Rule 10b-18 and withdrew the proposed Rule 13e-2. Rule 10b-18 provides issuers with a "safe harbour" (immunity) from possible liability for manipulation in on-market purchases if certain conditions are met:

* Limits on the time and price of the purchases. An issuer or its affiliates may not buy the company's shares on any given day until there has been an independent transaction, nor may they buy during the last half hour of trading on the Exchange. The price paid must not exceed the higher of the highest current independent published bid or the last independent sale price reported in the Exchange system.

* Limits on the volume of purchases. The maximum daily number of shares to be acquired by the issuer and its affiliates must not be more than 25% of the "trading volume" of that security, defined as the average daily trading volume in the security over the four calendar weeks preceding the week in which purchases are made.

* Limits on the number of brokers or dealers used to make purchases. The issuer and its affiliates are limited to the use of one broker or dealer to solicit purchases during any single day.

Rule 13e-3: Going private transactions.

[244] This rule imposes filing and disclosure requirements on self-purchase transactions which have either a reasonable likelihood of, or are intended to cause a class of securities

to be held by less than 300 persons, or which cause the class of securities to be no longer publicly listed or quoted.

Rule 13e-4: Tender offers by issuers.

[245] Under this rule a self-tender can be made only if certain information is disseminated to its shareholders concerning the purpose of the tender offer and these disclosure documents are filed with the SEC. The rule also provides that the tender offer by the issuer must remain operative for certain stipulated periods, acceptances shall be on a pro rata basis if the offer is for less than all of a class of securities, and the issuer must permit the withdrawal of tendered securities under certain circumstances. (See further Securities Regulation & Law Report Vol. 18 No 4 (1986) p125.)

Rule 10b-5: Market Manipulation

[246] Corporate self-purchases are also subject to Rule 10b-5 which makes it unlawful to employ in connection with "the purchase or sale of any security ... any manipulative or deceptive device". This rule is designed to counter market rigging and manipulation practices, including insider trading by, inter alia, requiring a company to promptly disclose publicly a self-purchase programme that may materially affect the market for or price of the securities. The Stock Exchanges adopt similar disclosure policies (e.g. the New York Exchange requires a company to promptly disclose to the public a self-purchase programme that may materially affect the market for its securities).

Chapter 3: Functions of the Self-Purchase Power

Introduction

[301] This Chapter seeks to identify the various grounds that have been advanced to support a self-purchase power. Chapter 4 outlines possible problems and shortcomings with any such grant of power, and what consequent protective restrictions may be necessary. A detailed analysis of these protective procedures is found in Chapter 5.

[302] The Committee emphasises that the various arguments found in the following chapters are put forward for the limited purpose of consideration and comment; they do not represent any settled views by the Committee, nor should they be taken as necessarily exhaustive of matters arising for examination under the self-purchase issue.

RETENTION OF POWER IN SMALL COMPANIES

[303] Where a major shareholder in a small or closely held company retires or dies, some or all of the remaining members may lack the funds or credit capacity to acquire these shares, or acquire them in proportion to their pre-existing shareholding entitlement. There may be instances where the only real option is to sell the shares disproportionately to current shareholders or sell them to a third party, thereby changing the existing balance of control. A self-purchase in these circumstances would help preserve the balance between the interests of continuing shareholders. This may be preferable in particular instances to the alternative course of a company providing financial assistance for the share acquisition.

ENHANCED OPPORTUNITIES FOR EQUITY RAISING

[304] A self-purchase power may enable the proprietors of non-public companies to raise equity capital without running the risk of jeopardising or forever surrendering control of the company.

[305] The right of self-purchase may act as an incentive for companies to offer their shares to lenders, and thereby raise additional capital. Small companies may be less reluctant to accept outside equity capital since any dilution of control would be reversible.

[306] The buy-back power benefits lenders by creating a new or further market for the sale of their shares and so alleviates problems associated with the marketability of securities in unlisted companies. Investors may be more willing to take up shares in the knowledge that they may be able to liquidate their investments through a formal company buy-back arrangement.

SHAREHOLDER LIQUIDITY PLANS

[307] Introduction of the self-purchase power may encourage the development of shareholder liquidity arrangements in smaller companies. As practised in Canada and the USA, a formal agreement is reached whereby the company alone (stock redemption plan) or the company, in combination with the remaining shareholders (stock cross purchase plan) undertakes to buy out a shareholder, according to the terms of a share valuation formula, either on an instrument basis or upon the happening of certain events e.g. the death or retirement of a shareholder.

[308] An installment buy-back agreement has a number of benefits both for the vendor shareholder and the company:

* Liquidity. A predictable measure of liquidity is made available to the selling shareholder.

* Collateral. Shares the subject of a compulsory buy-back arrangement may serve as a stronger or more attractive security for loans, as they provide some guaranteed measure of liquidity.

* Budgeting. A company may not have the financial resources to acquire all shares that members may wish to tender at any given time. An instrument liquidity plan based on some controlling formula (e.g. limiting purchases to an amount otherwise available for dividend distribution) allows for a more orderly and equitable system of self-purchase.

* Preserving the Company. The potential liquidity from a buy-back plan may diminish the pressure from shareholders to wind up the company in order to obtain a return of their equity contribution.

[309] A self-purchase agreement, activated upon the death of a shareholder, may be funded from the proceeds of a life insurance policy. The company is entitled to take out the policy as, by virtue of the buy-back agreement, it has an insurable interest in the life of the shareholder.

[310] Particular implementation issues arising from the use of shareholder liquidity plans are discussed at [5080]-[5084].

COMPROMISE OF A SHAREHOLDER'S INDEBTEDNESS

[311] Where a shareholder is indebted to the company, it may be to the company's advantage to settle the claim in whole or part by recovering the member's shares. A company is to some extent given this power pursuant to the Companies - Code s129(8)(e).

ENCOURAGEMENT OF EMPLOYEE SHARE SCHEMES

[312] A self-purchase power could facilitate such schemes by enabling a company to fulfil employee share acquisition options. If shares are acquired and held as treasury shares

for this purpose, rather than new shares being issued, the company could directly finance the option programme out of its internal resources without diluting the ownership interests of other shareholders. Similarly, cumbersome trusteeship arrangements could be avoided by conferring a direct power on the company to acquire the shares of retiring or departing employees.

MANAGERIAL EFFICIENCY

[313] It may contribute to the efficient or harmonious management of a company's business if dissident or apathetic shareholders can be bought out by the company. In some cases there may be no ready market for the shares in question and the other shareholders may not have sufficient funds to buy out the dissenting interest. A self-purchase may also bypass resort to an oppression action under s320 of the Companies Code.

[314] While from the managerial perspective a self-purchase may be attractive, a buy-out in these circumstances may not necessarily be in the best interests of the company and its remaining shareholders. It is arguable that managerial decision-making benefits from critical scrutiny and this may be discouraged if the self-purchase power is used to eliminate opposition from within the company.

SELF-INVESTMENT

[315] A self-purchase may be seen as a prudent commercial investment by the company when the current market price is less than the perceived long-term value of the shares. This may suggest an alert management acting in the best interests of shareholders by boosting the net asset value per share.

[316] From one perspective, a self-purchase is a minimum risk investment as the risk characteristics of the company are not substantially changed. Conversely, if the company buys another company's shares, the risk to the enterprise may

be increased by the possibly unfamiliar risk characteristics of the latter company.

[317] Some companies with surplus funds may perceive self-investment as preferable to acquiring substantial or controlling interests in other companies.

FINANCIAL RESTRUCTURING

[318] A company may reach a point in its development where, through lack of new investment opportunities, contraction of its market, or a decision to scale down its operations, it is desirable to reduce its equity base. A self-purchase would enable the company to adjust its equity base and its debt to equity ratio to accommodate these changing requirements.

[319] Self-purchases may also have favourable effects on the future earnings and asset backed value of remaining shares. A purchase may return value to remaining shareholders in the form of higher nominal prices for their shares and improved performance statistics (e.g. higher or sustained dividend returns, or alternatively reduced aggregate dividend outlays with greater retained earnings).

PREFERABLE METHOD OF CAPITAL REDUCTION FOR EXCESS CAPITAL COMPANIES

[320] Companies with excess equity may be more willing to return the surplus resources to shareholders through a self-purchase programme, rather than go through the procedural complexities of a capital reduction under s123 of the Companies Code which requires court approval. A self-purchase power may therefore encourage the retirement of capital no longer needed by companies.

[321] An on-market or pari passu offer purchase programme has the additional benefit of providing shareholders with the choice between an increased share of corporate ownership (by retaining their shares) or a cash return (by accepting the

purchase offer). By contrast the mandatory acquisition power given under a s123 capital reduction binds dissenting as well as assenting shareholders. Self-purchases can, from this perspective, be a more flexible and efficient financial technique for shareholders than a capital reduction.

SPECIAL DISTRIBUTIONS AS AN ALTERNATIVE TO DIVIDENDS

[322] Self-purchases at a premium may be a means of making a once only special distribution to particular vendor shareholders without raising the general dividend rate. Remaining shareholders have the benefit of a smaller equity base and may benefit in the future from increased dividends or capital gains on the value of their shares.

DIMINUTION OF ADMINISTRATIVE OVERHEADS

[323] Selective self-purchases may be used to eliminate fractional shares and odd lot holdings which may otherwise be costly for the company to administer. Currently Australian companies can eliminate odd lot holdings through a complicated process involving other companies or persons, or by issuing additional shares to bring odd lot holdings up to a convenient multiple. This process may be undesirable if the company does not wish to expand its issued capital.

OPEN-ENDED INVESTMENT COMPANIES (MUTUAL FUNDS)

[324] The self-purchase power may encourage the creation of open-ended investment companies. Similar investment vehicles currently operate through the medium of unit trusts, under the 'prescribed interest' provisions of the Companies Code (Part IV Division 6) which include "buy-back" requirements.

[325] The potential use of open-ended investment companies as an alternative to unit trusts would depend in large measure on any legislative procedures governing self-purchases. For instance it would be unworkable if each individual purchase had to be approved by a separate resolution of shareholders. It would be feasible to operate

this form of investment company only if the legislation allowed, for, say, a "standing authorisation" to be given at each annual general meeting whereby the directors were empowered to exercise the buy-back provisions: see further [5013]-[5014].

INCREASED CAPITAL MOBILITY IN THE SECURITIES MARKET

[326] A self-purchase power may act as a conduit for excess monetary capacity and a device to increase capital mobility in the securities market. Self-purchases may permit the "redistribution of risk-taking venturesome equity capital towards new and rapidly growing companies" and away from non-growth companies or companies with surplus to needs equity. On this view, self-purchases increase investment opportunities by releasing to shareholders unneeded funds for alternative investment and thereby promote the more efficient distribution and allocation of resources in the economy.

INCREASED MARKET INFORMATION

[327] An announcement of a proposed self-purchase may supply new or further information to the market about a company's operating performance and future projects, and thereby benefit all market participants. The announcement may act as a market signal that the company considers its shares undervalued.

LESSENING THE IMPACT OF "SHARE DUMPING"

[328] Where a large shareholder in a listed public company intends to sell his shares, the company may wish to ensure that these shares are not dumped on the market, with a resulting decline in the price of its shares. It may be in the interests of the company and its shareholders to purchase these shares.. A self-purchase power allows companies to directly enter the market and soak up such surplus stock, thereby increasing demand for the shares and supporting or maintaining their market price. The drawbacks of this approach, including the possibility of price manipulation and market rigging, are discussed at [406]-[410].

SELF-PURCHASES AS A TAKE-OVER DEFENCE

[329] The self-purchase power could be utilised as a defence technique in the face of a threatened, pending or actual takeover bid or as a preventive means of reducing a company's vulnerability to unwelcome offers. A defensive or preventive self-purchase programme may be undertaken for any or all of the following reasons:

* To lessen the attractiveness of the take-over target by altering the company's financial profile. The self-purchase programme would be designed to reduce the company's cash reserves and/or increase its loan to equity gearing ratio (a variant of the "scorched earth" defence) as well as improve the company's long term fiscal performance (e.g. increased earnings on the remaining shares). Defensive self-purchases may be most effective in the face of a "boot strap - acquisition" bid, i.e., where the bidder plans to finance the bid by eventually utilising the target cash or credit resources (e.g. Re Wellington Publishing Company Ltd. [1973] NZLR 133). This points to a possible anomaly which allows a successful bidder to use target company assets as a security to finance the acquisition, but which prevents an incumbent board from using these assets in a defence. The capacity of bidders to, in effect, finance their bid on the strength of the target company assets focuses attention on the equity of this aspect of take-overs.

* To support the market price of the company's shares and thereby thwart or diminish the capacity of potential or actual bidders to obtain a share foothold ('beachhead acquisition') at a reduced cost. Knowledge that the company is prepared to pay a higher than current market price could cause a re-evaluation by investors of the worth of the shares. With an increased market price, it is arguable that all shareholders (both vendors and non-participants) would be better off (provided the

higher price was maintained) and the danger of the take-over bid, based on asset-stripping motives, could be reduced.

* To "mop up" floating or uncommitted shares which a bidder may otherwise acquire as an easy first step in its take-over bid.

* To eliminate potentially dissident or wavering shareholders and so remove the threat of the shares falling into the hands of a "hostile" bidder.

* To "buy off" potential bidders by acquiring their shares, usually at a premium to market price (greenmail).

* To enhance the proportional holding of an existing control or management support group.

* To create a competitive price environment which may result in a greater return to shareholders, even if the self-purchase does not block the bid.

[330] However there may be significant impediments or disincentives in utilising the self-purchase power as a take-over defence:

* The number of shares that can be acquired will be limited by any restrictions imposed by the legislation on the sources of funds available for self-purchases: see [5025]-[5033]. Even without such constraints, a self-purchase programme of any magnitude may create major funding problems for the company. Self-purchases on a large scale are only possible where the target has sufficient unrestricted assets to support borrowings used to finance the acquisitions and/or where the company has the capacity to quickly sell its securities · to friendly acquirers.

* A target company would normally only have the capacity to launch a partial self-bid (assuming this was allowed for in the legislation). This may be less attractive to shareholders than a full bid by an outside party.

* The self-purchase programme may succeed in sustaining or increasing the market price of the shares, but this benefit to the target may be offset by the bidder having to acquire fewer shares in order to achieve control. This is the case where companies are required either to cancel purchased shares, or hold them as non-voting treasury shares. Where the bidder is already a shareholder, the self-purchase programme would serve to increase the bidder's percentage of the shareholding of the company. To this extent self-purchases may be less effective as take-over defence mechanisms than protective cross share buying, where the shares retain their voting power: see [131]-[135].

* Where the target purchases its shares at a substantial premium, a bidder may sell (subject to CASA s35) some of its shares back to the target at a considerable profit with minimum diminution of its percentage shareholding.
(This possibility was recognised by the directors of the target company in Unocal v Pickens 608 F. Supp. 1081 (1985). The bidder had acquired 13% of Unocal shares and had made a tender offer for an additional 37% of Unocal shares at $54 per share. Unocal responded with its own partial tender offer for 49% of the shares, offering senior subordinated debentures having a face value of $72 per Unocal share. Unocal directors believed that, given the expected very high acceptance rate by shareholders, this defensive 'scorched earth' strategy would succeed only if it excluded the bidder from participation in its tender offer. Otherwise, the bidder could tender its shares, have the pro-rated portion of its shares purchased by the target company at a huge profit to the bidder, and retain its unpurchased shares, representing

approximately the same percentage of Unocal shares as before the partial self-tender. Accordingly, Unocal made its self-tender offer to all shareholders, except the bidder, thereby significantly increasing the number of shares other shareholders could sell and dooming the bidder to huge losses since the market price of Unocal shares would undoubtedly decline sharply after Unocal's tender offer. This "reverse greenmail" strategy was upheld by the Delaware Supreme Court. The SEC has since indicated its opposition to this strategy, and has foreshadowed the introduction of an "all holders" rule that would bar such discriminatory offers. This strategy would not be available in Australia as CASA applies the policy of equal opportunity: s16(2)(c); s17(2); s40; s59.)

* The self-purchase power may be unable to achieve the objectives of buying-off dissident or wavering shareholders or potential bidders if anti-greenmail provisions were in force: see [5010]; [5046]-[5048].

* The self-purchase programme may come too late to significantly influence the outcome of the bid. The procedural requirements may be too time-consuming to provide companies with a quick and effective response to an anticipated or announced bid: see [5007]-[5018].

[331] Recognising that the self-purchase power may be used as a take-over defence, overseas jurisdictions have introduced or proposed various control mechanisms.

[332] The London City Code on Take-Overs and Mergers Rule 37.3(a) provides that during the course of a take-over offer, or' where the target directors have reason to believe that a bona fide offer might be imminent, the target company shall not purchase its shares (except pursuant to an existing contract) without the approval of the shareholders in general meeting: (cf: AASE Listing Rule 3R(3)). This is in addition to the authorisation procedure required under the UK Companies Act. Rule 37.3(b) requires that during the offer period the offeree company must immediately disclose to the

Exchange, the Panel and the press the total number of its own shares which it has purchased in the market or otherwise, and the price or prices paid. The offeree company must also disclose the total number of outstanding issued shares following a self-purchase; cf. CASA s39.

[333] In the USA, the SEC has expressed concern at the use of self-purchases as a take-over defence mechanism. It believed that defensive self-tenders were too often motivated by the self-interest of directors and existing disclosure obligations (Rule 13e-1; 13e-4: see [239-241]; [245]) did not provide sufficient protection. Initially the SEC sought a ban on defensive self-tenders during the course of a take-over bid. However this policy was modified in a 1984 Congressional Bill (HR 5963) which proposed a prohibition on a self-tender during the course of a take-over offer by another bidder, except when the self-tender had been approved by the affirmative vote of a majority of the aggregate voting securities of the issuer. The promoters of the Bill argued that a self-tender may be consistent with shareholder objectives, provided shareholders were adequately informed about the terms and purpose of the self-tender and consent to it. The Bill has since lapsed.

[334] From the above discussion the following questions arise. Given an actual or pending take-over bid:

* Should offeree companies be entitled to mount a self-purchase defence?

* Should there be any restrictions on the number of shares that may be acquired? For instance should offeree companies be entitled to self-tender?

* Would it be appropriate to introduce specific procedural requirements, such as found in the London City Code or the US Congressional Bill for (a) all self-purchases, or (b) self-tenders only, by the offeree company, during the anticipated and/or actual offer period?

[335] Introduction of the self-purchase power, and its potential use as a take-over bid defence, would also appear to require some fundamental reformulation or clarification of the powers and duties of target company directors, eg. in what circumstances would it be appropriate for them to use corporate assets to defend against a take-over bid? This raises legal questions concerning the purposes and motives of company directors which are only dealt with to a limited extent in existing Australian company law: see further [415]-[424].

LEVERAGED BUY-OUTS: PUBLIC COMPANIES GOING PRIVATE

[336] The self-purchase power has been utilized in the USA to restore "close control" of public companies through financial arrangements known as leveraged buy-outs. These usually involve the company undertaking a self-tender for the purpose of contracting its capital base and/or providing financial assistance by way of loan securities to enable the management group to acquire all or a majority of the outstanding, shares. A buy-out may be prompted by a desire of management to gain greater autonomy in decision making, eliminate public accountability to shareholders, or protect management against the consequences of an unwelcome take-over bid (see generally Lowenstein L: "Management Buyouts" Columbia Law Review Vol. 85 No 4 (1985) p730-784).

[337] Use of the self-purchase power to effect a buy-out has been criticized as contrary to the principle of encouraging wide public equity participation. It has been argued that it is prima facie undesirable, from the perspective of public policy, that legislation should facilitate the reduction or elimination of public ownership of companies. Introduction of a self-purchase power (combined with the existing financial assistance provisions: s129(10)) may result in a reduction in the levels of public equity participation, and this is arguably against the public interest. Similarly

Australian Stock Exchanges, which seek to attract more equity to the securities market, may be concerned about public companies buying out their shareholders.

Appendix B

Chapter 4: Problems Arising From The Self-Purchase Power

Introduction

[401] The arguments against granting companies the capacity to purchase their shares have as their common premise a concern that this power may be open to substantial abuse or misuse. This concern has been longstanding. For instance in Trevor v Whitworth (1887) 12 App. Cos. 409 at 435, Lord Macnaghten observed that it may be detrimental to the management of companies to allow directors to buy out inquisitive and troublesome critics. In an earlier case, the court commented that a self-purchase power may result in companies speculating or trafficking in their own shares: Hope v International Financial Society (1876) 4 Ch D 327 at 339. More recently a number of Canadian commentators have concluded that:

"Considering the potential for abuse of the power and the necessary safeguards and checks which must be adopted, we seriously wonder whether the power to purchase is warranted ... we do not believe the case for companies needing the power has been shown to outweigh the serious disadvantages." (Iaccobucci F; Pilkington M; Prichard J: Canadian Business Corporations; An Analysis of Recent Leqislative Developments (Canada Law Book Co.) 1977 p121).

[402] In Australia strong reservations were expressed by Professor Harding of the University of New South Wales in a series of articles (Commercial Law Association Bulletin Vol. 10 (1978) p1-27; 31-38; 53-61).

[403] This Chapter outlines and analyses the various criticisms of the self-purchase power. At issue, is whether

the advantages of a self-purchase power are outweighed by the dangers that the power will be abused, and the difficulties of regulating against such abuses.

INTERNAL INEQUITIES

[404] An unregulated self-purchase power may result in improper discrimination between shareholders, e.g. where favoured members are brought out at a substantial premium to the market or true value of the shares. Another possible instance may be where a company acquires shares at a discount to their true value, thereby increasing the equity value of the remaining shares at the expense of the vendor shareholders.

[405] The potential for disparate treatment may be lessened by the application of existing statutory (Companies Code s229) and common law (e.g. Coleman v Myers [1977] 2 NZLR 225) fiduciary duty doctrines, and other shareholder remedies: s320; s364(1) (f) (fa)(fb)(j); $574. Discriminatory self bids would be prohibited under CASA. However it is questionable whether these protections are adequate without further procedural safeguards. These could:

* Require that self-purchases be approved by a special or ordinary resolution of shareholders, who have been provided with full and complete information on the affairs and prospects of the company pertaining to the purchase, as well as any other information which would enable them to assess whether the shareholders would be treated fairly and equally by the proposed purchase: cf s129(10) (12). See further [5008]-[5012];

* Ensure that there is full and complete public disclosure by the company in advance of its on-market or off-market purchases, so that each shareholder would have an equal opportunity to make an informed decision concerning the self-purchase. See further [5064]-[5069]; and/or

* Confine off-market purchases to pari passu offers to all shareholders within the class of affected shares. This would provide all shareholders with an equal opportunity to sell their shares and may overcome the otherwise perceived lack of independence and arms-length buying inherent in any situation where a company is dealing with controlling or influential shareholders. A range of exceptions may be necessary to the principle of "all holders" offers, particularly with close corporations, as otherwise the requirements may be too inflexible. A procedure analogous to CASA s12(g) might be appropriate, thereby allowing for selective purchases with the consent of the remaining shareholders: see further [5042]-[5050].

MARKET PRICE MANIPULATION

[406] In an efficient market, the price for any security represents an equilibrium between demand and supply. A substantial increase in buying, reflecting increased demand, without any corresponding increase in supply, should lead to higher market prices. A substantial purchase by a public listed company of its own shares could significantly increase their market price. Company controllers may seek therefore to exercise the self-purchase power in order to:

* retard or reverse a decline in the share price and thereby create a new market price equilibrium by "soaking up" a proportion of the shares offered for sale;

* put a "floor" under the current market price so as to preserve for shareholders the value of their marketable securities;

* neutralize inexplicable short term fluctuations in the market price and thereby maintain a more stable share price;

* lessen or eliminate any discrepancy between the market price of the shares and their estimated long-term net

asset backing; e.g. where a company has undertaken a major investment which has temporarily depressed the price of its shares;

* protect incumbent management from exposure to shareholder discontent that might otherwise follow from a substantial decline in the market price of the shares;

* improve the market price for the purpose of attracting new investors, thereby increasing demand for the shares and further raising the market price (snowball effect);

* influence the market price of the shares in anticipation of the company conducting a take-over bid or entering into merger negotiations, where its shares are offered as consideration in whole or part;

* support the market price (through limited self-purchases) where the company intends to make a further (and larger) issue of shares, the success of which may be jeopardised by any decline in the price of existing issued shares;

* support the price of company shares pledged by shareholders as security for loans; support the price of company shares where the company intends to offer its shares as consideration in the acquisition of assets;

* allow a company to raise necessary additional equity capital in a manner that minimises dilution of the ownership interests of existing shareholders. Selective purchases, designed to maintain or increase the market price of the shares, may allow the company to issue fewer shares, but at a considerable premium.

[407] The market price of shares may also be affected if companies are entitled to hold reacquired shares as treasury shares rather than cancelling them. An unregulated self-purchase power may enable a public company to buy shares, hold them as an asset, and later resell them. The company would then have the ability to advance the market

price through large-scale anonymous purchases, and likewise depress the market price by putting a large block of purchased shares back onto the market.

[408] Self-purchases, for the purpose of influencing the share market price, may constitute a form of market rigging, in breach of the Securities Industry Code (Part X; cf North v Matra Developments Ltd. (198'1) 37 ALR 341) and other State based criminal legislation. However this legislation may not suffice to counter the potential for price manipulation. It may also be necessary to impose on companies an obligation of full and complete public disclosure of its self-purchase intentions and transactions. By this means, the market, the company shareholders and potential investors would be made aware of the influence of the company in the market, and thereby could make more reasoned investment decisions.

[409] In the USA, the SEC has responded to the problems of market price manipulation by introducing Rule 10b-18, which provides a company with a "safe harbour" (immunity) from liability for manipulation in connection with self-purchases, provided certain limitations concerning the time, price and volume ~f the purchases by the company and its affiliates are met: see [242]-[243]. The London Exchange has similar control mechanisms: see [229].

[410] From the above discussion, the following issues arise for consideration in the event that the self-purchase prohibition is relaxed:

* In what circumstances, if any, should companies be entitled to trade in their shares for the purpose of influencing the market price?

* What measures would best guard against improper share price manipulation? See further [5051]-[5069].

* Would there be merit in introducing a self-purchase immunity provision modelled on the SEC Rule 10b-18?

INSIDER TRADING

[411] An unregulated self-purchase power could increase the possibility of insider trading both by the company which acquires its shares and other insiders.

[412] A company would breach the insider trading provisions if it acquired its shares while its decision makers were in possession of confidential price sensitive information concerning those shares: Securities Industry Code

s128(6) (7). It would not be uncommon for a company to have material information of this nature in its possession, and this could severely inhibit its capacity to purchase its shares. Public release of such information may not suffice to avoid the company engaging in insider trading unless the market is able to appreciate its price sensitive qualities. (What constitutes sufficient publication turns on the meaning of such phrases as "information ... not generally available" in s128(1) and "... knew or ought reasonably to have known" in s128(10).) Even if no breach of s128 takes place, the impression could still be created that the company has unfairly taken advantage of the market.

[413] Insiders may also benefit improperly from corporate self-purchases. For instance, insiders who are aware that the company proposes to acquire its shares at a premium price to the market, may be tempted to acquire company shares in advance of any public announcement of the intended purchase. The possibility of such illegal gain from insider trading is not peculiar to self-purchases (e.g. knowledge by insiders of a company's intentions regarding trading in the shares of other companies is an equally fertile ground for insider trading); corporate self-purchases merely create another avenue for its exercise.

[414] The likelihood of insider trading may be lessened if companies are required to provide full disclosure both of their intentions to embark upon purchases, and of all

relevant price sensitive information. Corporate self-purchases create a category of information which is both price sensitive and material in terms of informed investment decisions, and this should be readily available to the market: see further [5064]-[5069].

IMPROPER ATTEMPTS TO SECURE OR CONSOLIDATE CORPORATE CONTROL

[415] The initiative to exercise the self-purchase power would usually lie with the directors, albeit that shareholders consent for such acquisitions may be required. This creates the potential for abuse to the extent that directors may act in their own interests and in breach of their fiduciary duties to the company. The potential conflict of duty and self-interest would arise where directors embark upon a purchase programme for the purpose of gaining or maintaining their control of the company or to defend against an actual or potential takeover bid.

[416] This fiduciary duty issue has not arisen directly in Australia although the courts have examined whether the interests of the company as a whole justify directors in engaging in other defensive activities such as share issues (Harlowe's Nominees Pty. Ltd. v Woodside (Lakes Entrance) Oil Company NL (1968) 121 CLR 483; Howard Smith Ltd. v Ampol Petroleum Ltd. [1974] AC 821), mergers, expansions or formation of new companies (Winthrop Investments Ltd. v Winns Ltd. (1979) 4 ACLR 1; Rossfield Group Operation Pty. Ltd. v Austral Group Ltd. (1980) 5 ACLR 290; Pinevale Investments Ltd. v McDonnell and East Ltd. (1983) 8 ACLR 199) or creation of employee share trusts (Condraulics Pty. Ltd. v Barry and Roberts Ltd. (1984) 8 ACLR 915).

[417] In the USA, allegations that directors of companies have breached their fiduciary duties in exercising the self-purchase power are dealt with by reference to the business judgement rule. This rule is based on the presumption that the directors of a company have acted

properly unless a plaintiff can establish that a transaction was tainted by directors' self-interest (a violation of the fiduciary duty of loyalty) or that the directors did not give the matter the attention it merited (a violation of the fiduciary duty of care). The presumption will not be overcome if a "good faith decision" can be attributed to any rational business purpose; a court will not substitute its own notions of what is sound business judgement.

[418] The business judgement rule will not protect directors from breach of fiduciary duty where they have effected self-purchases for the sole, or overriding purpose of preserving or entrenching their management. However, subject to this limitation, the business judgement rule has been characterised as a shield for strenuous target company defence tactics, including issuer self-purchases. This has been illustrated in a number of recent cases.

[419] In Crane Co. v Horsco Corp. 511 F Supp 294 (1981) the Delaware Supreme Court ruled that the board of directors may show a valid corporate purpose in one of two ways:

"It can show either that some consideration other than the perceived threat to control was the primary reason for the stock purchase, or it can admit that the stock purchase was intended primarily as a defensive manoeuvre, and show that the directors reasonably determined that a change in control would constitute a clear threat to the future business or the existing, successful policy of the corporation" (at 305).

[420] These principles were applied in Turner Broadcasting Systems v CBS (1985) (CCH Fed. Sec. Law Reports 92, 440) which held that the CBS board exercised their proper business judgment in formulating a take-over defence that included a self-purchase. The board could reasonably conclude that the offer, with its use of high risk securities ("junk bonds")

and questionable financial desirability, was not in the best interests of the shareholders. The mere fact that the directors remained on the board was insufficient to taint their actions; self interest was not their sole or primary purpose.

[421] In Unocal v Pickens 608 F Supp 1081 (1985) the Delaware Supreme Court upheld the right of a company to make a discriminatory self-tender offer, ruling that the target's board of directors had broad discretion under the business judgement rule to take defensive action in the face of a hostile tender which it determined was inadequate. In Pogo Producing Co. v Northwest Industries Inc. (The Review of Securities and Commodities Regulation Vol. 19 No 2 (1986) p25) the bidder argued that the target company's defensive self-tender had no legitimate purpose and was nothing more than the directors' attempt to preserve their control. The court was not persuaded by this argument and concluded that the self-tender was made in good faith and was not primarily motivated by a desire to entrench the incumbent directors. The court held that it was reasonable for the directors to conclude that the bidder lacked the experience to manage the target, and to justify the defensive self-purchase on these grounds.

[422] These cases emphasise that under the business judgement rule, target self-purchases will be found illegitimate only if their primary purpose is the entrenchment of the present management.

[423] Some dissatisfaction has been expressed in the USA with this state of the law. A 1984 Congressional Bill (HR 5695) would have required the management of a target company to satisfy the business judgment rule, and also show that a defensive self-tender was prudent for the target and fair to its shareholders. The Bill has since lapsed.

[424] From this discussion the following issues arise:

* Are the principles derived from existing Australian law on directors' fiduciary duties suitable for application to self-purchases? Would it be possible, for instance, to differentiate between proper and improper use of the self-purchase power?

* Should Australian law move in the direction of applying the business judgement rule, with or without the gloss of the Congressional Bill, in the context of self-purchases?

* To what extent may these fiduciary duty problems be resolved by reliance on shareholder approval or ratification of the purchases? Should shareholders of the target be entitled to ratify such breaches or approve purely defensive self-purchases? Would shareholder ratification fully protect the interests of other affected parties, such as creditors?

GREENMAIL

[425] The term "greenmail" applies to privately negotiated selective self-purchases, usually from a dissident shareholder, at a premium to market price. As used in this sense it is to be distinguished from the existing Australian variation of greenmail whereby "acquisitors" are bought out, not by the company, but by one or more of its supporters or "white knights", with the possibility of the company providing financial assistance for the purchase.

[426] Greenmail purchases are intended as a defensive technique, employed by management to rid the company of shareholders threatening to initiate a take-over bid or otherwise disrupt the company ' s affairs (e.g. by mounting proxy contests), unless their shares are purchased by the company at a premium. Greenmail purchases are frequently accompanied by "standstill agreements whereby the vendor shareholder undertakes to limit its shareholding in the company for a specific time period.

[427] In the USA greenmail transactions are becoming both more frequent and controversial, and it appears that some corporate investors are amassing shares simply for the purpose of selling their holdings back to the target companies at a significant profit.

Support for Greenmail

[428] The practice of greenmail has been defended as potentially beneficial to the target company and its non-participating shareholders, and that to introduce restrictions may have deleterious consequences. Theoretical support for this position is found in two theses:

* information thesis;
* shareholder welfare thesis.

Information Thesis

[429] This thesis argues that greenmail premiums represent an efficient means of compensating persons for supplying important information to the company, its shareholders and the market, about the value of the company's shares. Potential greenmailers make a considerable contribution to the process of market value creation by locating undervalued shares and transmitting this information to the market via the greenmail transaction. The purchase premium acts as a "finder's fee" for this information-providing activity. Greenmail permits sellers of information to specialise in this activity, and provides them with a return, without having to proceed to a take-over bid or otherwise involve themselves in management. Specialisation in providing this information lowers costs, leading to an overall increase in (a) information produced to the company, its shareholders and the market; (b) take-over bids generated; and (c) the monitoring of management.

[430] The placing of constraints on greenmail transactions would, according to this thesis, lessen the incentive for greenmailers to invest significant resources in this information gathering exercise.

Shareholder Welfare Thesis

[431] According to this view, greenmail purchases eliminate troublesome minority shareholders, may protect shareholders from inadequate offers by "predators", and allow management to concentrate on profit-generating endeavours to the benefit of non-participating shareholders. The long-term cost and opportunity savings in buying out disruptive greenmailers may outweigh any losses or incremental inefficiencies resulting from the premium payment.

[432] Greenmail may also facilitate an auction market for the company's shares. Premium purchases could be interpreted by the market as an indication that the company's shares are under-valued. Removal of the greenmailer through a buy-out (linked to a "standstill agreement") provides other potential bidders with more time and information to formulate their bids. Unlike other defensive measures (e.g. mergers; share issues; shark repellant articles), the effect of greenmail is confined to the acquisitor and does not directly discourage other take-over bids (though the premium paid may lessen the attractiveness of the company as a target, in which case greenmail could be described as analogous, in effect, to "scorched earth" or "sale of the crown jewels" defences).

Objections to Greenmail

[433] Criticism of greenmail has taken three principal forms:

* management entrenchment thesis
* shareholder unfairness thesis
* manipulation thesis.

Management Entrenchment Thesis

[434] This thesis argues that directors may engage in, or sponsor, greenmail transactions for no better reason than a self-serving attempt to prevent a shift in corporate control

that could jeopardise their position. Directors may employ corporate assets to protect themselves against take-over bids that could otherwise benefit non-participating shareholders. Selective premium purchases may constitute a collusive mutual self-interest activity between company controllers and greenmailers, to the detriment of other shareholders.

[435] The loss to the company and its remaining shareholders, is not confined to assets dissipated in greenmail transactions. The ability of a company to offer premium purchases may be used to induce parties to retire, rather than undertake a take-over bid. In this way, greenmail may reduce competition for corporate control and deny to non-participating shareholders the benefits of that competition.

[436] This thesis contradicts the view advanced under the shareholder welfare thesis that greenmail may encourage take-over bids or an auction market in the company's shares.

Shareholder Unfairness Thesis

[437] Under this thesis greenmail purchases treat shareholders unfairly, with the greenmailer pre-empting for itself all or part of the premium usually available to all the shareholders upon a formal take-over bid. Greenmail violates the principle that all shareholders of a particular class should be treated equally by the company. It is also inconsistent with the view that each share provides identical rights and commands the same unit price regardless of the quantity owned by various shareholders. Greenmail thereby fosters and encourages shareholder discrimination.

[438] This thesis also disputes the claim under the information thesis that greenmail premiums represent a separate and beneficial payment for information. Critics of greenmail claim that it provides little real information to the market other than that certain persons are engaging in this coercive exercise.

Manipulation Thesis

[439] Potential greenmailers may, by careful selection of target companies, and reliance upon their own reputation as "acquisition-minded", effectively achieve a "no loss" outcome. If the target, in response to the take-over or other disruptive threats of the acquirer, agrees to a merger or take-over, the acquisitor gets a friendly acquisition with little risk of a competing bid; if the target responds by promoting its own friendly bidders, the acquisitor can always sell out to a "white knight" of the target, usually at a substantial profit: if the target is willing to discuss a share buy back, again the acquirer can gain financially. In effect, the acquirer is relying upon its ability to assemble a shareholding block at a relatively low price and then stimulate the dynamics of a take-over bid for its own ends. According to the manipulation thesis, this constitutes an unwarranted and unjustified power in the hands of particular individuals and corporations.

Empirical Analysis

[440] A series of American studies have examined the overall impact of greenmail transactions on non-participating shareholders, as measured in terms of the company's share price performance. The results, while not uniform, favour the conclusion that share prices decline significantly in the wake of greenmail payments, and such decline outweighs any price increases arising from the initial greenmail acquisitions (see Journal of Financial Economics Vol. 11 (1983) p275-300; 301-328; The Yale Law Journal Vol. 95 No 1 (1985) p43-48; Harvard Law Review Vol. 98 (1985) p1051-1056). The majority conclusion is that greenmail is deleterious to shareholder welfare.

[441] A Study by the SEC Office of the Chief Economist in 1984: The Impact of Targeted Share Repurchases (Greenmail) on Stock Prices, found that the payment of greenmail was against

the best interests of non-participating shareholders:

"The evidence suggests that non-participating shareholders suffer substantial and statistically significant share price declines upon the announcement of targeted repurchases at premiums above market value. The overall impact on share prices from the date the initial foothold position is established to the date the block is repurchased is also negative. The appreciation in stock prices caused by the initial foothold acquisition is more than offset by the decline in stock prices in response to events subsequent to the initial acquisition, on average … We conclude that the overall impact of targeted share repurchases on the wealth of non-participating target shareholders is negative. The stock price evidence indicates that the magnitude of losses to non-participating target shareholders is at least equal to the wealth loss implied by the cash premium paid for the block repurchase. The losses are more severe in cases where there is evidence that the foothold acquisition and disposition was associated with a struggle for corporate control, such as a possible tender offer or proxy fight."

Legislative and Judicial Response in the USA

[442] There is currently little legislative inhibition on greenmail transactions at the State level, though some jurisdictions are now introducing restrictions. For instance, the State of New York in December 1985 passed legislation prohibiting a company purchasing 10% or more of its shares at a price higher than the market value, unless the premium purchase was approved by both the company's board of directors and shareholders. This anti-greenmail provision would not apply to a pari passu premium offer to all shareholders or the selective premium purchase of shares that had been owned for more than two years. The State of Indiana

introduced similar laws in 1986, for the stated purpose of preventing financiers from purchasing large blocks of shares, then forcing the target company to buy them back at an inflated price.

[443] The only relevant Federal legislation is the general anti-fraud provisions of rule 10b-5 and the tender offer anti-fraud provision of s14(e) of the Securities Exchange Act. However in order to successfully challenge a greenmail transaction under these provisions, a plaintiff must prove that the target's directors either misrepresented the company's affairs or failed to disclose material information during the greenmail transaction. These provisions do not look to the substantive fairness of management's defensive actions.

[444] The SEC proposed, in 1984, that legislation be introduced to prohibit a target company purchasing its shares, at a premium to market price, from any person who held more than 3% of the company's shares for two years or less, unless the shareholders approved the selective purchase, or the company made the same purchase offer to all shareholders. Draft Bills were introduced in Congress in 1984 (S2782) (HR5693) and 1985 (S286), but were not proceeded with.

[445] Greenmail transactions are subject to the business judgement rule, and in this context mirror the rule's traditional application to managerial actions affecting corporate control generally. Under the rule, the directors of a company paying greenmail are required to state the business purpose of corporate actions taken to thwart a take-over bid. If the court views the greenmail payments as simply a vehicle for entrenching incumbent management, and the managers cannot provide coherent alternative justifications, such payments may be prohibited. Similarly, if retention of control is a factor in the management's decision to enter a greenmail transaction, the directors must show that the transaction was fair and reasonable to the

corporation. However under the business judgement rule the initial burden remains on the plaintiff to show that the directors have breached their fiduciary duties of loyalty or care. (A useful summary of the leading cases is found in The Yale Law Journal Vol. 95 No 1 (1985) p53-60; Harvard Law Review Vol. 98 (1985) p1056-1059.)

[446] These case-law principles may be exemplified in two recent decisions. In Polk v Good (Securities Regulation and Law Report Vol. 18 No 12 (1986) p404) the Delaware Supreme Court upheld a greenmail transaction in the face of a complaint that the premium paid was excessive and the purchase did not serve any legitimate corporate purpose. The Court ruled that the complainant did not meet the heavy burden under the business judgement rule of establishing that the directors' action in approving the purchase was not made in good faith or independently (a violation of the fiduciary duty of loyalty):

"The payment of a premium ... seems reasonable in relation to the immediate disruptive effect and the potential long-term threat which the [greenmailer] posed. Clearly [the greenmail buyout] was a benefit to the company and most of its stockholders."

[447] Remedies arising from breach of the business judgement rule were examined in Heckman v Ahmanson 214 Cal. Rptr (1985). A California State Appeals court granted an injunction to the plaintiff shareholders who had objected to alleged greenmail profits realised by a potential acquirer of Walt Disney Productions. The Court ruled that the plaintiffs had satisfied the initial evidential burden and the directors had failed to show that the self-purchase transaction was entered into in good faith and that it was fair to the company and its shareholders. The greenmailer was liable as an aider and abettor as it was aware of the purpose behind the transaction. Accordingly the shareholders were entitled to an injunction imposing a constructive trust on the premium paid under the greenmail transaction.

[448] If a corporate self-purchase power is introduced into Australian law, the following greenmail issues would need to be addressed:

* Should special provision be made for greenmail transactions?

* In what circumstances, if any, would it be appropriate to implement an "all holders" rule whereby the company must extend an equal opportunity to all shareholders to sell their shares in a premium self-purchase situation?

* Would potential greenmail problems be overcome by a requirement of shareholder approval or ratification of selective premium self-purchase transactions? See further [5010].

* Would the US State legislation or SEC proposals (see [442]-[444]) be an appropriate model for Australian law?

* What remedies should be available in the event of an illegal greenmail transaction? See further [5095]-[5100].

INCREASING THE RISK OF CORPORATE FAILURE

[449] A self-purchase transaction involves a distribution of corporate assets to shareholders, and to this extent increases the financial risk to creditors and remaining shareholders. Self-purchases appear to reverse the priorities between creditors and shareholders in the distribution of corporate assets, while simultaneously reducing the company's margin of financial viability.

[450] The rights of creditors and remaining shareholders could be protected in the following ways:

* Restrictions in debt covenants. Debenture trust deeds already require companies to maintain a stated balance between assets and liabilities, and such deeds may be employed to restrain the company from purchase transactions detrimental to secured creditors.

Imposition purchases. embarking solvency of solvency tests as prerequisites to Companies could be prohibited from on purchase transactions unless certain requirements are fulfilled: see further [5034]-[5041].

* Restrictions on the source of funds available for purchases. The effect of a self-purchase is, from the perspective of creditors, analogous to a cash dividend distribution, and accordingly the same principles and restrictions could be applied: see further [5025]-[5033].

* Provision of appeal rights by creditors and dissenting shareholders to a proposed purchase: cf Companies Code s123(3); s129(12): see further [5015]-[5018].

Chapter 5: Implementing a Self :'Purchase Power

Introduction

[5001] Chapters 3 and 4 have outlined and analysed the arguments for and against the introduction of a share self-purchase power, and the issues arising therefrom. This Chapter goes further and examines the procedural questions and options that would arise if this power were implemented. The Committee emphasises that the purpose of this Chapter is to identify and discuss these implementation issues, not to pre-empt debate on the intrinsic merits of the self-purchase power.

SOURCE OF THE SELF-PURCHASE POWER

[5002] A self-purchase power could be framed in the legislation with varying degrees of restriction:

* an inherent right

* a right, subject to any contrary statement in the Memo or Articles, or

* a right only if authorised by the Memo or Articles.

Inherent Right.

[5003] The legislation could provide for a statutory based general grant of power, notwithstanding anything contained in the Memo or Articles, cf. Companies Code s129(10). This would have the attraction over the other two options of certainty and uniformity.

Right, subject to the Memo or Articles.

[5004] Under this option a company would be eligible to exercise the self-purchase power, unless an express prohibition was placed in its constitution. The Canadian

legislation adopts this approach (OBCA s30(1); CBCA s32(1)). The shareholders could prohibit the exercise of the self-purchase power by a special resolution to that effect.

Right, only if authorised by the Memo or Articles.

[50053 A company could exercise the self-purchase power only if an enabling provision was found in its constitution. This is the most restrictive of the three options, but may provide the greatest protection to shareholders. This method is adopted in the UK: Companies Act s162(1); cf. Companies Code s120(1); s123(1). A further limitation could be the inclusion of a statutory sunset provision whereby any self-purchase power would lapse after a set period, unless renewed by a further special resolution.

[5006] What would be the most suitable way of framing any self-purchase power in Australian legislation?

AUTHORISATION PROCEDURE

[5007] Consideration of the procedure for empowering a company to purchase its shares raises a number of inter-related policy questions:

* Who should be authorised to exercise the power?

* What information should be provided to the decision makers?

* What should be the terms of any authorisation?

* What appeal procedures should be available from the authorisation?

* What should be the consequences of an irregular authorisation?

Persons authorised

[5008] In determining who should be entitled to exercise these powers, a graduated range of restrictions may he identified:

* by such person or persons as authorised by each company at its discretion (Canada: in practice the board of directors);

* by ordinary resolution of the directors, with or without a right of delegation of that power (US Model Business Corporation Act);

* by super majority resolution of directors (no precedent);

* ordinary resolution of shareholders (UK: on-market transactions); or

* by special resolution of shareholders (UK: off-market transactions).

[5009] It is not necessary that the same authorisation procedure precede every type of purchase. The legislation could vary the stipulated procedure depending upon whether the proposed self-purchase is by way of:

* on-market acquisitions
* off-market pari passu offers, or
* off-market selective self-purchases.

[5010] There is a strong argument that at least in respect of selective self-purchases (if allowed for in the legislation) a more restrictive option should be adopted (e.g. ordinary or special resolution of shareholders, excluding the vendor shareholder and its associates) to counter the possibilities of internal inequities (see [404]-[405]) and greenmail (see [425]-[448]): cf. CASA s12(g). Conversely a less restrictive procedure (e.g. an ordinary resolution of directors) might be suitable for on-market or pari passu purchases where the dangers of these abuses are reduced. This would provide companies with greater flexibility to purchase their shares on-market at optimal times and rapidly respond to changing conditions in the securities market.

[5011] The benefit of flexibility is also recognised in the EEC Second Directive Article 19, which allows the laws of the member States to dispense with the stipulated procedure (shareholder approval) where the purchase "is necessary to prevent serious and imminent harm to the company". The Article provides that in such a case the relevant information

must be given to the next general meeting of shareholders. Would a similar provision be beneficial in Australia?

Information to the decision makers.

[5012] The identity of the decision makers will determine the need for any statutory provision for the supply of information. Where this power resides with directors there would be little need for statutory direction. By contrast shareholders would be unable to make a fully-informed judgement on any proposed acquisition unless supplied with detailed information on the terms of the purchase (including a copy of any contract pertaining to a selective self-purchase); the reasons for it; and its anticipated financial consequences: cf, UK Companies Act s164(6). The Companies Code s129(10)(c) identifies the information that must be supplied to shareholders in advance of any special resolution granting financial assistance. Would this provide a suitable model in the self-purchase context?

Terms of the authorisation.

[5013] The legislation could set down the necessary terms of any authorisation. For instance the EEC Second Directive Article 19 provides that the general meeting "shall determine the terms and conditions of such acquisitions, and in particular the maximum number of shares to be acquired, the duration of the period for which the authorisation is given and which may not exceed eighteen months, and, in the case of acquisitions for value the maximum and minimum
consideration". These requirements are reflected in the UK Act: s164-166. No equivalent controls are found in the Canadian legislation or the US Model Business Corporation Act.

[5014] The European approach is designed to ensure that where the authorisation power rests with the shareholders, they effectively regulate the self-purchase process without impinging on its day to day exercise. This policy might be undermined if, for instance, shareholders could validly pass vaguely worded or open-ended authorisations, (e.g. "the

company shall purchase such number of its shares and, on such terms and conditions, as the directors may from time to time determine"). To avoid this possibility, would restrictions similar to those found in the EEC Second Directive be suitable? The same considerations would not apply where the authorisation power resided in the hands of the directors.

Appeal procedures from authorisations.

[5015] The provision of specific appeal rights, and the nature of their exercise, must be considered in the context of the potentially conflicting interests of the parties affected by the acquisition. From the perspective of creditors and dissenting shareholders, statutory appeal rights are a necessary protective mechanism to ensure that exercise of the self-purchase power is in conformity with the procedural requirements and not prejudicial to their legitimate interests. The procedure found in the Companies Code s129(12) (13) may attain these ends.

[5016] The benefits to creditors and dissenting shareholders of specific appeal rights must be weighed against the potential costs to the company and other shareholders. Appeal rights introduce further complexities and potential delays in the exercise of self-purchase powers, and may jeopardise the capacity of companies to make effective and expeditious use of them. Appeal procedures may also be utilised for tactical reasons, particularly in the context of takeovers. For instance if the s129(12)(13) appeal structure were adopted without alteration, a bidder with~ only a minimum shareholding in a target company could appeal against and thereby further delay (taking into account the mandatory 21 day wait period) a defensive self-purchase programme, irrespective of whether this had been approved by, or was in the best interests of, the majority of target company shareholders.

[5017] Overseas legislation, apart from the UK, contains no appeal provisions specifically directed at self-purchases, but instead relies on general appeal rights. The UK Act

s176; 177 has adopted an appeal structure but it is confined to self-purchases by private companies out of capital. It has no application to self-purchases by public companies or by private companies out of profits or fresh share issues. Given these considerations, various appeal procedures could be created including:

(a) no self-purchase appeal structure, with reliance instead on existing provisions e.g. Companies Code s320; s574;

(b) a self-purchase appeal structure, but limited to specific types of self-purchases e.g. selective self-purchases: see [5046]-[5048] and/or self-purchases from various funds e.g. capital (UK): see [5031]-[5033];

(c) multiple appeal structures, differing according to the factors identified in (b); or

(d) a uniform appeal structure based on the s129(12)(13) precedent.

[5018] What appeal structure(s) would be most suitable for Australian conditions?

Consequences of an irregular authorisation.

[5019] The more complex the authorisation procedure (including the satisfaction of any source of funds and solvency tests: see [5024]-[5041], the greater the likelihood that irregularities may occur. The Companies Code s539 deals with the problem of minor procedural irregularities, and a provision similar to s129(11) may also be useful to resolve doubts on the procedure followed. However, where the breaches cannot be remedied under these provisions, further policy issues arise:

* the status of affected transactions; and
* remedies for breach.

[5020] Status of affected transactions. Prior to the introduction of the Companies Code, any transaction in breach of the prohibition on a company acquiring or financing the acquisition of its own shares was deemed illegal and void. A party could not place reliance upon or produce evidence of such a transaction either to establish a claim or sustain a defence. The courts recognised a number of exceptions to this doctrine of illegality, but nevertheless parties could unjustifiably benefit or alternatively suffer a detriment from a finding that a prohibited acquisition had taken place.

[5021] The Companies Code now deals with self-purchase transactions, but in the context of their general prohibition. Section 130(1) (b) (c) provides that the contract or transaction that affects the self-purchase is void. By contrast, irregular financial assistance transactions are voidable. On one view both self-purchase and financial assistance transactions should be treated on a uniform basis as voidable, subject to the discretionary powers and remedies found in s130(2)-(5) (13). This may be a suitable policy for selective privately negotiated self-purchases, but query whether on-market or pari passu acquisitions should be open to challenge as either void or voidable?

[5022] The interests of bona fide vendor shareholders of potentially voidable contracts might be protected by utilising the certification procedure, as it currently applies to financial assistance transactions s130(6)-(10). Signatories to the certificate would be subject to the terms of s130(11) (12).

[5023] Remedies for breach. This matter is considered at [5092]-[5104].

FINANCIAL CONSIDERATIONS

[5024] Imprudent use of the self-purchase powers could so deplete a company' s assets as to lead to insolvency, or seriously lessen its margin of financial viability. Certain

controls could be introduced to reduce this risk and further protect creditors and remaining shareholders against corporate failure:

* restrictions on the sources of funds available for self-purchases; and/or

* imposition of solvency requirements on self-purchases.

Sources of Funds

[5025] The Canadian legislation and US Model Act provide maximum scope for companies to utilise the self-purchase power by imposing no restrictions on the source of available funds. A company may finance its self-acquisitions in the same manner as it would any other commercial transactions, though subject to stipulated solvency requirements: see [5036]-[5040]; cf. s129(10).

[5026] The UK legislation is far more restrictive. It limits the available funds to:

* profits otherwise available as dividends (distributable profits);

* proceeds of a fresh issue of shares made for the purpose of the self-purchase; and

* capital (in limited circumstances).

[5027] Distributable profits. Use of distributable profits is not inconsistent with the interests of creditors. A company may lawfully reduce its assets by payment of a dividend, and should be able to make the same reduction by acquiring its shares. A share acquisition from distributable profits also adds to shareholder flexibility by providing them with a choice as to the degree of participation in a corporate cash distribution.

[5028] Although no objection could be taken to funding self-purchases out of profits, differences arise as to the

meaning of this term. The UK Act restricts distributable profits to:

"Accumulated, realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated, realised losses, so far as not previously written off in a reduction or reorganisation of capital duly made".

[5029] This contrasts with the Australian approach which, in accordance with common law principles, defines profits in a more permissive manner: (Marra Developments Ltd. v Rofe Pty. Ltd. (1977) 2 ACLR 296; Industrial Equity Ltd. v Blackburn (1977) 3 ACLR 89.) The UK definition provides creditors with greater protection, but would it be suitable to adopt this definition in Australia in the limited context of self-purchases?

[5030] Proceeds of a fresh issue of shares. The UK legislation acknowledges this as a further funding source for corporate self-purchases: Companies Act s160(1)(a); s162(2); cf. Companies Code s120(3) (b). Whether this should be allowed in Australia is problematical, given its potential as a takeover defence mechanism. For instance a company could fund a defensive self-purchase in whole or part by the issue of its shares to "white knights". Query whether this is acceptable in principle, and whether the existing fiduciary duty controls over share issues would suffice to prevent abuse?

[5031] Capital. The UK Act allows private companies to purchase their shares out of capital, though this power is circumscribed with disclosure, plebiscite and appeal procedures and solvency requirements:

* The company's Articles must authorise the purchase out of capital: s171 (1).

* The company must first use all available profits or fresh issue proceeds before making any inroads into its capital: s171; s172.

* The directors must make a statutory declaration of solvency, accompanied by an auditor ' s report: s173 (3)-(5)

* The payment out of capital must be approved by a special resolution of shareholders, excluding any votes by vendor shareholders: s173(2); s174.

* Following the resolution, the proposed payment must be publicly notified: s175.

* Dissenting members and creditors may apply to the court for cancellation of the resolution: s176; s177.

[5032] If a private company purchases its shares out of capital but goes into liquidation within one year of the date of purchase, then:

* the vendor shareholders (up to the amount of their share of the capital payment) and

* the directors of the company who signed the necessary statutory declaration, other than those who show that they had reasonable grounds for forming the opinion set out in the statutory declaration,

may be liable to meet the company's outstanding debts and costs on winding-up: s504.

[5033] The right of a private company to utilise capital was justified on the basis that otherwise some companies may be unable to use the self-purchase powers. There may be less strength in this rationale in Australia, given the more permissive interpretation of profits.

Solvency Requirements

[5034] A further or alternative means of reducing the financial risks to creditors and remaining shareholders would

be to introduce a solvency requirement as a stipulated prerequisite to corporate self-purchases. This raises the following issues:

(i) Should there be a solvency test in addition to or in lieu of controls over the sources of funds available for self-purchases? The Australian legislation could provide for any of the following alternatives:

* impose both a source of funds restriction and an express solvency requirement for all self-purchases;

* maintain a general source of funds restriction and attach an express solvency requirement only to a particular source of funds e.g. self-purchases out of capital (the UK approach);

* further limit the sources of funds available for self-purchases (e.g. confine to distributable profits and the proceeds of fresh share issues) and omit any solvency requirement; or

* desist with any restrictions on sources of funds, but impose a solvency requirement on all self-purchases (e.g. Canada; the US Model Business Corporation Act).

(ii) If a solvency test is applied to all or some self-purchases, what form should it take?

[5035] A distinction can be drawn between the equity and bankruptcy definitions of insolvency. The equity definition equates insolvency with a corporation's inability to pay debts and liabilities as they become due. The bankruptcy definition equates insolvency with an excess of the company's liabilities over the realisable value of its assets. These differing concepts are, to varying degrees, reflected in existing self-purchase legislation.

[5036] The Canadian legislation applies both an equity and bankruptcy definition so that if either test of insolvency applies, the corporation is barred from purchasing its shares: CBCA s32(2), OBCA s30(2); 31(3). The UK legislation focuses on the equity definition: s173(3) (a) (b), while analogous Australian legislation dealing with financial assistance for the purchase of shares applies a broad based bankruptcy test: s129(10) (c).

[5037] The US Model Business Corporations Act s45 imposes a double solvency requirement on corporate self-purchases:

* an equity insolvency test, and
* a balance sheet test.

[5038] The Model Act prohibits self-purchases if the corporation is, or as a result of the proposed purchase would become, insolvent in the equity sense. In making this determination, the directors are required to make certain judgements as to the future course of the corporation's business, including the likelihood (based on existing and contemplated demand for the corporation's products or services) that it will be able to generate funds from its operations or from any contemplated orderly disposition of its assets sufficient to satisfy its existing and reasonably anticipated obligations as they mature. (For further details see The Business Lawyer Vol. 34 (1979) p1881-83.)

[5039] The balance sheet test, as introduced in 1980, requires that, after giving effect to any distribution, the corporation's assets equal or exceed its liabilities and liquidation preferences on senior

equity. In making this Judgement the directors may rely on opinions, reports or statements including financial statements and other financial data prepared or presented by public accountants or others. (For further details see The Business Lawyer Vol. 34 (1979)
p1883-85.)

[5040] The Model Act recognises the need to specify the time at which the two tests imposed by s45 should be measured. Accordingly, where shares of the corporation are acquired by it, the date approximating the earlier of the payment date or the date the shareholder ceases to be a shareholder with respect to such shares is to be used as the measuring date.

[5041] Query which solvency test or tests should be utilised for corporate self-purchases?

(iii) What remedies should be available in the event of an insolvent self-purchase? Note the UK provisions: [5032] and see further [5101]-[5104].

METHOD OF PURCHASE

[5042] A company could purchase its shares by:

* on-market acquisitions (for listed public companies);
* off-market pari passu offers;
* off-market tender offers from shareholders;
* selective (privately negotiated) purchases;
* mandatory acquisitions.

Which of these procedures should be allowed for in any Australian legislation?

On-market acquisitions.

[5043] This would appear to be a suitable method of acquisition provided all shareholders have an equal opportunity of participation. This might be achieved by requiring that all shareholders receive adequate notice of

the forthcoming self-purchase: see further [5064]-[5069]. Without prompt disclosure, some shareholders might unfairly benefit from advance knowledge of the self-purchase (e.g. those shareholders who attended the authorisation meeting).

Off-market pari passu offers.

[5044] This method of self-purchase provides shareholders with the choice between a cash return (by selling) and an increased share of ownership (by retaining their shares). A company could pro-rata excess acceptances where its resulting self-entitlement is less than 20% of its shares; above that threshold it would be obliged to conduct a full or proportional partial bid.

Off-market tender offers from shareholders.

[5045] A novel repurchase method was found in the old Ontario legislation (1970). It provided for self-purchases to be made "by invitation addressed to all shareholders for tenders of shares and pro-rata from the shares so tendered". The shareholders individually, rather than the company, would tender a selling price and the company was obliged to buy at "the lowest price at which, in the opinion of the directors, such shares are obtainable". This provision was not included in the current Ontario legislation. It is doubtful whether this would be a suitable method of self-purchase for Australia, given the lack of information by many shareholders as the true value of their shares, and the opportunities for insider trading that could arise.

Selective self-purchases.

[5046] There may be valid commercial reasons for companies wishing to enter into purchase agreements with particular shareholders. However these selective transactions provide the opportunity for greenmail and other forms of discrimination between shareholders. These potential abuses may be lessened by:

* limiting the circumstances in which selective self-purchases may be made; and/or

* imposing a restrictive authorisation procedure.

[5047] Possible instances where selective self-purchases might be permitted are:

* to settle or compromise a bona fide debt due to the company by a shareholder

* to eliminate fractional shares

* to fulfill the terms of an employee share scheme

* to honour shareholder liquidity agreements in closely held companies

* to comply with a court order.

[5048] The alternative or additional protection would be to impose controls through the authorisation procedure. Various shareholder approval proposals have been put forward in the USA, applicable to selective self-purchases at a premium to market price: see [442]-[444]. Would it suffice to allow companies to enter into selective self-purchases, but only upon the authority of the shareholders excluding the vendor shareholder and its associates; if so should this be by ordinary or special resolution? See also [5009]-[5010].

Mandatory self-purchases.

[5049] Should any self-purchase legislation empower companies to compulsorily acquire their shares? Currently companies can achieve this end by means of a formal reduction of share capital pursuant to the terms of s123 of the Companies Code. The question is whether to provide companies with an alternative avenue for a compulsory reduction of capital.

[5050] There appears to be strong policy reasons against this extension:

* the mandatory acquisition power is already available under s123, and to that extent a similar power in any self-purchase legislation would be redundant;

* its inclusion in the self-purchase provisions would attract the need for greater authorisation controls and judicial involvement in the acquisition process;

* the self selectivity inherent in voluntary purchases adds considerable flexibility to shareholder decision making and this may be lost with compulsory acquisitions.

Arguably, on these grounds any legislation should be confined to voluntary transactions.

TYPE, VOLUME, PRICE AND TIMING CONTROLS ON SELF-PURCHASES

Type

[5051] Should only fully paid shares be capable of acquisition? The principal argument for this limitation is that to allow partly paid shares to be purchased may result in the company further subsidising the price of its shares. In addition, if the acquired shares are not cancelled but held as treasury shares (assuming this is allowed for in the legislation), this may give the false impression that someone other than the company remains liable for the unpaid balance on the shares. These potential problems could be overcome by prohibiting the purchase of partly paid shares: see UK Companies Act s162(2); s159(3); cf. Companies Code s120 (2)(c).

Volume

[5052] There are various controls which could be imposed on the number of its shares a company may acquire:

* minimum membership requirements

* maximum on-market acquisitions within a given period

* maximum total acquisitions as a proportion of the company's share capital.

[5053] Minimum membership requirement. Australian companies, except for wholly-owned subsidiaries, must have a minimum membership of two shareholders (proprietary companies) or five shareholders (public companies): s82. It

would be consistent with this principle to prohibit any self-purchase which may result in a company having fewer than the statutory minimum membership. However would a specific provision in this context be necessary?

[5054] The UK Companies Act s162(3) further prohibits self-purchases if, as a result, there would be no members other than the holders of redeemable shares. A similar provision may be suitable.

[5055] Maximum on-market acquisitions within a given period. As a preventive measure against acquiring companies dominating the market turnover and thereby the price of their shares, controls have been introduced both in the UK and USA on the volume of on-market purchases within a given time period. The London Exchange prohibits a listed company from buying 15% or more of its shares within any twelve month period except by way of a general or partial tender offer to all shareholders. The US Rule 10b-18 places limits on the daily volume of on-market purchases, being a maximum of 25% of the trading volume of that security, defined as the average daily trading volume in the security over the four calendar weeks preceding the week in which the repurchases are made. Breach of Rule 10b-18 does not result in a statutory violation; rather the acquiring company forfeits any immunity from possible liability for market manipulation.

[5056] Would the principles underlying either the London Exchange or US Rule be suitable for Australian Exchanges?

[5057] Another suggested volume control is that on-market purchases be subject to limits on the size of parcels to ensure that small holders have a chance to sell their shares and that no crossing or specials be allowed. Would such controls be useful?

[5058] Maximum total acquisitions as a proportion of the company's share capital. The EEC Second Directive Article 19 states that the number of shares a company may acquire and

hold as treasury shares may not exceed 10% of its subscribed capital. The apparent purpose behind this rule is to restrict the extent to which self-purchases might be used to enhance the position of a company's control group or increase the value of their shares. Would a rule of this nature perform any useful function in Australia, given the 20% entitlement threshold of CASA?

Price

[5059] The capacity of listed companies to purchase their shares on-market provides them with a means of directly influencing the market price: see [406]. To counter possible abuses, the London Exchange stipulates that for all self-purchases other than pursuant to a tender offer, the buying price must be no more than 5% above the average of the middle market quotation in those shares for the ten business days prior to the purchase. The US Rule 10b-18 states that in order for companies to enjoy the immunity protection, the price paid by them must not exceed the higher of either the highest current independent published bid or the last independent sale price reported in the Exchange system.

[5060] Would the London or US Rule, or some other price control formula, be appropriate for on-market self-purchases in Australia?

[5061] A separate pricing issue concerns the means of valuing shares the subject of off-market self-purchases. Without some controls, shares may be substantially under or over valued, thereby discriminating between participating and non-participating shareholders and in some instances unnecessarily draining the funds of the company. Given this possibility, a number of options are open:

* leave this issue to be resolved in accordance with existing fiduciary duty principles; (Would this suffice to overcome the potential conflict of interest between the company and the vendor shareholder(s)?)

* require that directors provide shareholders with sufficient information to allow them to arrive at a reasonable estimation of the true value of their shares; or

* introduce an independent share valuation mechanism, cf. CASA s23.

Timing

[5062] The timing of on-market purchases may have a significant impact on their market price. US Rule 10b-18 seeks to counter the possible distorting effects of early or late market trading by denying the issuer or its affiliates the right to purchase their shares on any given day until there has been an independent transaction in those shares; nor may they buy their shares during the last half hour of trading on the exchange. Consideration might be given to introduction of a similar rule for Australian Exchanges.

[5063] The London Exchange has a wider rule whereby a company may not purchase its shares in the two months immediately preceding the announcement of its annual or half-yearly results. This is designed to inhibit the possibility of companies either themselves engaging in insider trading or intentionally or inadvertently arousing market speculation over these results and their share price implications. Would a similar restriction be desirable in Australia?

MARKET DISCLOSURE OF INTENDED SELF-PURCHASES

[5064] Inclusion of a market disclosure requirement as a pre-condition to on-market self-purchases could achieve the following results:

* lessen the possibility of market price manipulation: see [406]-[410];

* diminish the opportunities for insider trading: see [411]-[414];

* counter the problem of internal internal inequities: see [404]-[405]; and

* allow shareholders and potential investors to make more fully informed investment decisions.

[5065] In the USA, the SEC Rules 13e-1 and 13e-4 impose advance disclosure obligations on take-over targets which intend either to purchase any of their own shares or conduct a self-tender: see [239]-[241]; [245].

[5066] A possible drawback with an advance disclosure policy is that it might limit the company's capacity to acquire shares at optimal times and also generate share speculation in anticipation of the purchase. These factors would need to be taken into account in determining the minimum length of a mandatory notice period.

[5067] The information required to be disclosed could encompass all or some of the following:

* the identity of the company as the intended purchaser and of any nominees or associates to be involved in the acquisition;

* the identity of the intended broker (note the US Rule 10b-18 which limits the company and its affiliates to the use of one broker or dealer to solicit purchases during any single day);

* the terms and conditions of the self-purchases including the maximum number of shares to be acquired; the maximum consideration to be offered; and the duration of the purchase period;

* the reasons for the acquisition;

* the dates and prices of self-purchases within the previous (say) 12 month period;

* the anticipated effect of the purchase, if successful, on the future funding and profitability of the company;

* the source and amount of funds to be used in the purchase;

* the substance of information held by the company which is relevant to determining the true value of the shares;

* whether the acquired shares are to be cancelled or held as treasury shares (if this option is allowed for in the legislation);

* whether the purchase, if successful, would have any effect on the listing of the company's securities (see SEC Rule 13e-3: [244]).

[5068] The company could be required to notify changes, by way of an amended disclosure document, within a stipulated time, up to the end of the purchase period. Penalties for breach could be included.

[5069] This gives rise to the following questions:

* Should provision be made for a mandatory market disclosure document, and if so, what information should it contain?

* Should the disclosure document be either registered or lodged with the NCSC prior to its distribution? (Registration would involve an evaluation of its contents, cf. Companies Code s103; CASA s18.)

* To Whom should the disclosure document be made available; the Stock Exchanges; all shareholders? Should companies be required to provide a media notice?

* Should there be a compulsory wait period, and if so of what length, between the publication of the disclosure document and the commencement of purchasing?

* Would the existing CASA Part A; Part C disclosure requirements suffice where a company undertakes a self-bid (assuming the legislation allows for self-tenders)? The London Code Rule 37.4(b) requires an on-market offeror to disclose its self-purchases within the previous 12 months, including details of acquisition dates and prices.

* What mechanism, if any, should be provided whereby companies may seek exemption from particular disclosure provisions? Should the legislation identify possible grounds of exemption?

* What civil remedies should be available in the event of a material misstatement or omission in the disclosure document? (See further [5100])

DISCLOSURE OF COMPLETED TRANSACTIONS

[5070] It would be consistent with the principle of a fully informed market that companies be required to disclose substantial acquisitions of their own shares, as well as those of other companies. The Companies Code Part IV Division 4 and CASA s39 impose notification obligations which, in principle, should apply equally to self-purchases, if this power is introduced. However, given the potential impact of self-purchases both for the market and within the company, should acquiring companies, unlisted as well as listed, be subject to further disclosure obligations, to cover situations where the above provisions do not apply?

[5071] The London Exchange requires listed companies to notify it of all self-purchases, regardless of size, and details of prices paid, by midday of the following business day. This might be a suitable rule for companies listed on Australian Exchanges.

[5072] In addition the UK Companies Act s169 creates specific disclosure requirements for all companies, regardless of whether the transactions are on-market or off-market. It may be preferable to follow this precedent in any Australian legislation and establish a separate self-purchase register with stipulated times for entry and information provisions, rather than graft self-purchase transactions onto existing share register provisions (such as are found in Part V Division 4 of the Companies Code). Provision could be made for inclusion of register details in the company's annual report.

STATUS OF SELF-PURCHASED SHARES

[5073] A number of policy alternatives are available for the classification of these shares. They could be treated as:

* Treasury shares; or
* Cancelled shares

Treasury shares.

[5074] This classification was employed in the US Model Business Corporation Act prior to the 1980 amendments. A self-purchase did not reduce the number of issued shares or the issued share capital, nor did the resale of these shares increase the number of issued shares or the amount of issued capital. Instead, during the period that they were held by the company as issued but unallotted shares available for resale, they remained in a dormant form without voting or dividend rights. This formula was criticised as both fictitious (a company holding a claim against itself) and confusing and has been replaced in the Model Act. However the laws in many states of the USA retain this treasury share concept.

[5075] This classification is not unknown in Australian company law. Shares forfeited for non-payment of calls or instruments are treated as issued, and may be resold or disposed of as the directors think fit (Table A Reg. 28) or in the case of shares in no liability companies, by auction: Companies Code s479. Until resold, forfeited shares in no liability companies are held by the directors in trust for the company but carry no voting rights: s480(3); see also AASE Listing Rule 3P.

Cancelled Shares.

[5076] The UK legislation provides that shares which are purchased by the company must be cancelled, and the amount of the company's issued capital diminished by the nominal value of the shares acquired: s162(2); s160(4). The purchase does not reduce the company's authorised share capital, cf. Companies Code s123(1)(2). Cancelled shares shall constitute authorized but unissued capital (except where the company has already issued all of its authorized capital). The benefit of this approach is that it avoids the accounting and resale problems which dealings in treasury shares may involve.

[5077] By amendments introduced in 1980, the US Model Business Corporation Act (s6) provides that all self-purchased shares shall be treated as authorised but unissued shares, unless the company's Articles prohibit their reissue, whereupon the authorized share capital shall be reduced by the number of shares acquired. The Canadian legislation has similar provisions (CBCA s37(5); OBCA s35(6)). Unissued shares, by definition, carry no voting or dividend rights and this avoids the need to make specific provision suspending such rights for reacquired shares.

[5078] Matters for consideration:

* What would be the most appropriate status for self-purchased shares?

* Should this be settled by legislation or left to the determination of companies?

* If self-purchased shares may be held as treasury shares, what controls, if any, (in addition to the Companies Code s552) are required over their resale?

[5079] The classification of self-purchased shares as cancelled may necessitate amendment to some key provisions of the Companies and Securities legislation. For instance CASA s11 and the Companies Code Part IV Division 4 (substantial

shareholdings) apply only to voting shares, which as defined (Companies Code s5(1)) exclude unissued shares. A company might acquire a majority of its shares free of the CASA provisions through a series of discrete 'small bite' acquisitions, each for less than 20% of the outstanding (i.e. non cancelled) issued share capital. Clearly it would be anomalous if companies could purchase their shares in this manner, oblivious to these takeover and disclosure provisions. One possible solution would be to provide that for the purpose of these and other relevant sections (e.g. CASA s39) self-purchased shares shall, for a stipulated period, be treated as issued voting shares held by the company.

EXECUTORY AND PARTIALLY PERFORMED CONTRACTS

[5080] Companies may, for good reason, enter into conditional, installment based or optional self-purchase contracts (e.g. shareholder liquidity plans). It is possible that at the maturity date of any such contract, or during the course of a partially completed installment agreement, the company is unable to honour its commitments. Questions then arise as to the status and enforceability of these contracts and the rights of other affected parties e.g. creditors; remaining shareholders.

[5081] The Canadian legislation (CBCA s38; OBCA s36) provides that executory contracts are specifically enforceable against the corporation, except where this would result in a company's breach of its statutory solvency requirements. The section stipulates that in any action to enforce an executory contract, the corporation carries the burden of proof that performance of the contract is prohibited under the statute. However, such contracts are not rendered void or unenforceable. The Act provides that until the contract is fully performed, the shareholder will be regarded as a claimant entitled to be paid as soon as this is lawful. In the event of intervening liquidation, the

claimant shareholder will be ranked subordinate to creditors but in priority to other shareholders.

[5082] The UK Act contains detailed provisions regulating both the creation and enforcement of executory contracts. Contingent purchase contracts must be approved in advance by special resolution of the company: s165; a company is prohibited from assigning its rights under such contracts; s167(1) and any agreement releasing the rights of the company under the contract must be approved in advance by special resolution: s167(2).

[5083] In the event that a company fails to honour an executory contract, the contractual rights of the vendor shareholder are preserved. However the company is not liable in damages, nor may the court grant an order for specific performance where the company shows that it is unable to meet the acquisition costs out of distributable profits: s178(2) (3). Where, at the commencement of a winding up, an executory contract remains outstanding, it may still be enforced against the company, though subject to rights of creditors and any stipulated preferred rights of shareholders: s178(4)(6). However this enforcement right applies only if the contract is then current and enforceable and the company could have, at some time between the contractual completion date and the commencement of winding up, lawfully made a distribution equal in value to the contract price: s178(5). An executory contract with a maturity date later than the commencement of winding up cannot be enforced.

[5084] Australian courts have examined the status of executory contracts within the analogous context of redemption of redeemable preference shares, but without the benefit of statutory direction: (Re Matra Developments Ltd.
(No 2) (1978) 3 ACLR. 798; FCT v Coppleson (1981) 34 ALR 377; 6 ACLR 428). This seems a less satisfactory approach than including specific guiding provisions in the legislation. These might be modelled either on the Canadian or UK precedents.

SELF-PURCHASE RELATED DEBT

[5085] In acquiring its shares, a company may, as an alternative to paying cash or other consideration, prefer to incur a debt to the former shareholder. The status of any outstanding indebtedness needs to be clarified if the company later goes into liquidation.

[5086] The US Model Business Corporation Act s45 contains two governing principles:

* Such debts are treated as on a parity with those of unsecured creditors, though they may be subordinated by agreement. The stated rationale is that unsecured creditors are better off in this situation than they would have been if cash or other property had been paid out for the shares, and no worse off than if assets had been paid out to the shareholder, who had then promptly loaned them back to the corporation and thereby become a creditor.

* In applying the solvency tests in the Act: see [00] the legality of a distribution under this provision will be measured at the time of incurring the debt (i.e. when the share purchase took place), not at a later date when the debt is actually paid. A payment that is made in consequence of a self-purchase that satisfies the solvency tests at the time of incurring of the debt is valid, notwithstanding a subsequent insolvency, though it could constitute a preferential payment amongst creditors.

[5087] In the UK this problem is overcome by requiring companies to pay for the shares at the time of their acquisition: s159(3); s162(2). Self-purchase related debts are prohibited.

[5088] From this the following issues arise:

* Should Australian legislation prohibit or alternatively allow for self-purchase related debts?

* In the event that they are permitted, would the US provisions be necessary or suitable?

CASA: SECTION 11 IMPLICATIONS

[5089] Self-purchases will increase the proportion of issued capital held by non (or lesser) participating shareholders. As a result companies may be unfairly prevented from acquiring their shares by the operation of s11. This section prohibits "a person" (the company) from acquiring shares if the entitlement of "any person" (e.g. one or more non-participating shareholders) would exceed the 20% threshold. A self-purchase may result in the entitlement of one or more non-participating shareholders crossing this threshold or increasing within the 20-90% shareholding range. A blanket ban on corporate self-purchases in these circumstances (other than under the s12-17 exceptions), regardless of the number of shares held or sought by the company, or the relationship between the company and the shareholder(s), appears to exceed the underlying policy of the legislation.

[5090] A possible solution is offered by the London Code Rule 37.1. This Rule focuses on changes to the shareholding entitlement of the directors and affiliates of the acquiring company. It provides that where a company purchases its own voting shares, a resulting increase in the percentage voting rights carried by shareholdings of the directors and persons acting in concert with them shall be treated as an acquisition for the purposes of Rule 9 (the takeover threshold: cf. CASA s11). This rule might be adapted to CASA to provide that in respect of self-purchases the phrase "any person" and "relevant person" in s11(1)(2) shall be limited to, say, the acquiring company and its associates. This may overcome artificial barriers to corporate self-

purchases caused by s11, while maintaining the CASA regulatory framework where corporate controllers seek to increase their own shareholdings through such acquisitions.

[5091] The problem of applying CASA principles to cancelled shares is discussed at [5079].

CRIMINAL LIABILITY

[5092] Currently the Companies Code s129(5) imposes criminal liability on various parties, should a company unlawfully acquire its own shares. Introduction of a self-purchase power would alter the focus of criminal sanctions from prohibition to procedural breaches such as:

* the information required to be disclosed to the decision makers was false, incomplete or misleading in a material particular;

* the self-purchase breached a financial requirement (e.g. an applicable solvency test);

* the stipulated self-purchase procedure was not otherwise complied with;

* the mandatory disclosure documents were false, incomplete or misleading in a material respect; or

* a self-purchase took place in breach of one or more of the authorisation conditions.

[5093] Given this, are the terms of s129(5) suitable and adequate, when considered in combination with any default liability that may be attached to the disclosure provisions, and other applicable provisions of the Companies and Securities legislation?

Company immune from criminal liability.

[5094] Under s129(5), the company is no longer deemed to have committed a criminal offence. The Eggleston Committee Fifth Interim Report (para 94) pointed out that if the real object of the self-purchase prohibition was to protect creditors and remaining shareholders, little would be

achieved by imposing a criminal penalty on the company. This principle would appear equally applicable to procedural breaches of the self-purchase power.

Criminal penalties for defaulting officers.

[5095] Under s129(5) each officer of the company who is in default is guilty of an offence. "Officers" are broadly defined under s5(1) of the Companies Code to include any director (as defined in s5(1)), secretary, executive officer (as defined in s5(1)) or employee of the company. The term "officer in default" is defined in s572 of the Companies Code as "any officer of the corporation (including a person who subsequently ceased to be an officer of the corporation) ... who is any way, by act or omission, directly or indirectly, knowingly concerned in or party to the contravention or failure". These provisions, when combined with the terms of $563 and s564 of the Companies Code may be an adequate response to procedural breaches of the self-purchase powers (except, possibly, self-purchases in breach of the authorisation conditions).

[5096] The actions of directors may also involve them in criminal breaches of their fiduciary duties. For instance, directors would be in breach of s229 of the Companies Code if, in preparing their statements to shareholders, they acted dishonestly or without a reasonable degree of care and diligence. The legislation should make clear that any subsequent shareholder ratification of the self-purchase does not immunise directors from such liability; cf. s129(15).

Liability of other parties.

[5097] The Companies and Securities (Interpretation and Miscellaneous Provisions) Act s38(1) provides that "a person who aids, abets, counsels or procures or by act or omission is any way directly or indirectly knowingly concerned in or party to, the commission of an offence against any relevant Act shall be deemed to have committed that offence and is punishable accordingly". This provision would apply to any vendor shareholder knowingly involved in a procedural breach

e.g. a greenmailer acting in collusion with company directors to deceive shareholders on the reasons for, or terms' of, the selective self-purchase. No further or alternative provisions would appear necessary.

CIVIL REMEDIES

[5098] Civil recovery rights provide both a disincentive against, and protection from the detrimental effects of, criminal or otherwise illegal behaviour. Would these objectives be met adequately if the existing civil remedies in the Companies and Securities legislation were applied to self-purchase transactions?

Existing civil remedies.

[5099] Section 129 (6) provides that where a person is convicted of an offence under s129(5), or under s38(1) of the Interpretation and Miscellaneous Provisions Act, the criminal court may, in addition to imposing a criminal penalty, order the convicted person to pay compensation to the company or another person who has suffered loss or damage as a result of the contravention. Section 130(4)(5)(13) provide the court with wide remedial powers, limited only by the protection afforded to holders of certificates of compliance. Under s229(6), the company is entitled to compensation against officers in breach of their statutory fiduciary duties, while a potentially wide-ranging compensation right is found in s574(8).

Possible civil actions.

[5100] A range of civil claims are conceivable:

(i) The company (either itself, through the liquidator or in a derivative shareholder action) against directors, for abuse of their powers.

Remedies would be available under s129(6); s130(4) (5); s229(6) and s574(8). Section 129(15) overcomes any suggestion that an authorisation procedure involving shareholders supersedes the duties of directors or

constitutes a form of ratification of possible fiduciary duty breaches. Query whether' a further civil remedy is needed to cover self-purchases in breach of the authorisation conditions?

(ii) The company against the vendor shareholders for recovery of funds paid. In this context two quite different situations may be considered:

* A civil action against a vendor shareholder party to the breach. In this instance s129(6); s130(4) (5) and s574(8) would apply. The defaulting vendor shareholder would enjoy no immunity from holding a certificate of compliance: s130(7) (8).

* A civil action against bona fide vendor shareholders. Where the transactions take place on-market or pursuant to a general pari passu offer, query whether any civil remedies should be available. With selective self-purchases, should innocent vendor shareholders be entitled to utilise the certification procedure under s130(6) to avoid civil liability?

(iii) Vendor shareholders against the authors of misleading information in the mandatory disclosure document.

There may be a case for introducing civil remedies drafted, possibly, on the lines of the Companies Code s107 (Civil Liability for Untrue Statements or Non Disclosures in a Prospectus). Alternatively s129 (6) and s130(4)(5) could be utilised.

(iv) Non-participating shareholders against the authors of the misleading disclosure document.

Shareholders may determine, on the basis of false or misleading information, not to sell their .shares. They might later claim damages for lost opportunities. A provision based on s107 would be ineffective in this context as it does not apply to non-participants. Theoretically s129(6) and s130(4) (5) are applicable, but it would be necessary to establish that claimants had suffered "loss or damage ... as a result of" the contravention. This causation restriction may be necessary to avoid an undue extension of civil liability. A further remedy may be available under s574(8).

Civil recovery upon insolvency

[5101] The final matter is whether, independently of the above, there should be a separate civil remedy where self-purchases have taken place in breach of any statutory solvency requirements. This raises the general question of the balance of interest between vendor shareholders, creditors, and remaining shareholders.

[5102] A recovery right would provide much greater protection to creditors and remaining shareholders and to this extent lessen one of the principal objections to corporate self-purchases. The UK Companies Act s504 provides that where a company purchases its shares out of capital and then goes into liquidation within one year of the date of purchase, the vendor shareholders and the directors of the company who signed the necessary statutory declaration are liable to compensate the company. Vendor shareholders must reimburse their share of the capital payment, while directors are jointly and severally liable with all the shareholders concerned.

[5103] The argument against granting a recovery right is that it may create too many uncertainties and procedural complexities, particularly if a solvency requirement is

attached to all self-purchases, including on-market acquisitions. On-market vendor shareholders 'may find themselves at risk of disgorgement, depending upon the often arbitrary factor of whether they contracted with the company or some other market purchaser. In other circumstances e.g. off-market pari passu offers or selective self-purchases, vendor shareholders would remain at risk for the duration of any stipulated solvency period.

[5104] The Companies Code s451 provides that certain dispositions of money or property by an insolvent company may be challenged in a liquidation as a voidable preference. The principles underlying this section could be applied to corporate self-purchases, though some adaptations may be necessary (e.g. under s451, which incorporates s122 of the Bankruptcy Act, the transaction must have involved a person in a creditor capacity; query whether this would cover a vendor shareholder in a self-purchase transaction). Would this provision sufficiently balance the interests of all concerned?

Appendix B

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APPENDIX 1:

UK COMPANIES ACT 1985

Chapter VII-Redeemable Shares; Purchase by a Company of its Own Shares

REDEMPTION AND PRUCHASE GENERALLY

SEC. **159 Power to issue redeemable shares**

159(1) [Power] Subject to the provisions of this Chapter, a company limited by shares or limited by guarantee and having a share capital may, if authorised to do so by its articles, issue shares which are to be redeemed or are liable to be redeemed at the option of the company or the shareholder.
159(2) [Must be issued shares] No redeemable shares may be issued at a time when there are no issued shares of the company which are not redeemable.
159(3) [Shares must be fully paid] Redeemable shares may not be redeemed unless they are fully paid: and the terms of redemption must provide for payment on redemption.

SEC. **160 Financing, etc. of redemption**

160(1) [From distributable profits of company] Subject to the next subsection and to sections 171 (private companies redeeming or purchasing own shares out of capital) and 178(4) (terms of redemption of purchase enforceable in a winding up)-

(a) redeemable shares may only be redeemed out of distributable profits of the company or out of the proceeds of a fresh issue of shares made for the purposes of the redemption; and
(b) any premium payable of redemption must be paid out of distributable profits of the company.

160(2) [Premiums payable of redemption] If the redeemable shares were issued at a premium, any premium payable on their redemption may be paid out of the proceeds of a fresh issue of shares made for the purposes of the redemption, up to an amount equal to –

(a) the aggregate of the premiums received by the company on the issue of the shares redeemed, or
(b) the current amount of the company's share premium account (including any sum transferred to that account in respect of premiums on the new shares),

whichever is the less; and in that case the amount of the company's share premium account shall be reduced by a sum corresponding (or by sums in the aggregate corresponding to the amount of any payment made by virtue of this subsection out of the proceeds of the issue of the new shares.
160(3) [Redemption in accordance with articles] Subject to the following provisions of this Chapter, redemption of shares may be effected on such terms and is such manner as may be provided by the company's articles.
160(4) [Shares redeemed treated as cancelled] Shares redeemed under this section shall be treated as cancelled on redemption, and the amount of the company's issued share capital shall be diminished by the nominal value of those shares accordingly; but the redemption of shares by a company is not to be taken as reducing the amount of the company's authorised share capital.
160(5) [Extent of power to issue shares] Without prejudice to subsection (4), where a company is about to redeem shares, it has power or issue shares up to the nominal value of the shares to be redeemed as if those shares had never been issued.

SEC. 161 Stamp duty on redemption of shares

161(1) [Chargeable transaction under sec. 47, Finance Act 1973] For the purposes of section 47 of the Finance Act 1973, the issue of shares by a company in place of shares redeemed under section 160 constitutes a chargeable transaction if, and only if, the actual value of the shares so issued exceeds the value of the shares redeemed at the date of their redemption.

161(2) [Amount of stamp duty under sec. 47(5), 1973 Act] Where the issue of the shares does constitute a chargeable transaction for those purposes, the amount on which stamp duty on the relevant document relating to that transaction is chargeable under section 47(5) of the Finance Act 1973 is the difference between-

(a) the amount of which that duty would be so chargeable if the shares had not been issued on place of shares redeemed under section 160; and

(b) the value of the shares redeemed at the date of their redemption.

161(3) [Shares issued by a company under sec. 161(1), (2)] Subject to the following subsection, for the purposes of subsections (1) and (2) shares issued by a company-

(a) up to the nominal amount of any shares which the company has redeemed under section 160; or

(b) in pursuance of section 160(5) before the redemption of shares which the company's about to redeem under that section,

are to be regarded as issued in place of the shares redeemed or (as the case may be) about to be redeemed.

161(4) [Shares issued in pursuance of sec. 160(5)] Shares issued in pursuance of section 160(5) are not to be regarded for purposes of subsection (1) and (2) of this section as issued in place of the shares about to be redeemed, unless those shares are redeemed within one month after the issue of the new shares.

SEC. 162 Power of company to purchase own shares

162(1) [Power] Subject to the following provisions of this Chapter, a company limited by shares or limited by guarantee and having a share capital may, if authorised to do so by its articles, purchase its own shares (including any redeemable shares).

162(2) [Application of sec. 159 to 161] Sections 159 to 161 apply to the purchase by a company under this section of its own shares as they apply to the redemption of redeemable shares, save that the terms and manner of purchase need not be determined by the articles as required by section 160(3).

162(3) [Limitation on purchase] A company may not under this section purchase its shares if as a result of the purchase there would no longer be any member of the company holding shares other than redeemable shares.

SEC. 163 Definitions of "off-market" and "market" purchase

163(1) ["Off-market" purchase] A purchase by a company of its own shares is "off-market" if the shares either-

(a) are purchased otherwise than o a recognised stock exchange, or

(b) are purchased on a recognised stock exchange but are not subject to a marketing arrangement on that stock exchange.

163(2) [Interpretation of sec. 163(1)] For this purpose, a company's shares are subject to a marketing arrangement on a recognised stock exchange if either-

(a) they are listed on that stock exchange; or

(b) the company has been afforded facilities for dealing in those shares to take place on that stock exchange without prior permission for individual transactions from the authority governing that stock exchange and without limit as to the time during which those facilities are to be available.

163(3) ["Market" purchase] A purchase by a company of its own shares is a 'market purchase' if it is a purchase made on a recognised stock exchange, other than a purchase which is an off-market purchase by virtue of subsection (1)(b).

SEC. **164 Authority for off-market purchase**

164(1) [Limitation of off-market purchase] A company may only make an off-market purchase of its won shares in pursuance of a contract approved in advance in accordance with this section or under section 165 below.

164(2) [Authority for proposed contract] The terms of the proposed contract must be authorised by a specific resolution of the company before the contract is entered into; and the following subsections apply with respect to that authority and to resolutions conferring it.

164(3) [Variation etc. of authority] Subject to the next subsection, the authority may be varied, revoked or from time to time renewed by special resolution of the company.

164(4) [Authority for public company] In the case of a public company, the authority conferred by the resolution must specify a date on which the authority is to expire; and in a resolution conferring or renewing authority that date must not be later than 18 months after that on which the resolution is passed.

164(5) [Special resolution not effective in certain cases] A special resolution to confer, vary, revoke or renew authority is not effective if any member of the company holding shares to which the resolution relates exercises the voting rights carried by any of those shares in voting on the resolution and the resolution would not have been passed if he had not done so.

For this purpose-

(a) a member who holds shares to which the resolution relates is regarded as exercising the voting rights carried by those shares not only if he votes in respect of them on a poll on the question whether the resolution shall be passed, but also if he votes on the resolution otherwise than on a poll;

(b) notwithstanding anything in the company's articles, any member of the company may demand a poll on that question; and

(c) a vote and a demand for a poll by a person as proxy for a member are the same respectively as a vote and a demand by the member.

164(6) [copy of contract or terms to be available for inspection] Such a resolution is not effective for the purposes of this section unless (if the proposed contract is in writing) a copy of the contract or (if not) a written memorandum of its terms is available for inspection by members of the company both-

(a) at the company's registered office for not less than 15 days ending with the date of the meeting at which the resolution is passed, and

(b) at the meeting itself.

A memorandum of contract terms so made available must include the manes of any members holding shares to which the contract relates; and a copy of the contract so made available must have annexed to it a written memorandum specifying any such names which do not appear in the contract itself.

164(7) [Limited on variation of existing contract] A company may agree to a variation of an existing contract so approved, but only if the variation is authorised by a special resolution of the company before it is agreed to; and subsections (3) to (6) above apply to the authority for a proposed variation as they apply to the authority for a proposed contract, save that a copy of the original contract or (as the case may require) a memorandum of its terms, together with any variations previously made, must also be available for inspection in accordance with subsection (6).

SEC. **165 Authority for contingent purchase contract**
165(1) [Contingent purchase contract] A contingent purchase contract is a contract entered into by a company and relating to any of its shares-
(a) which does not amount to a contract to purchase those shares, but
(b) under which the company may (subject to any conditions) become entitled or obligated to purchase those shares.
165(2) [Approval in advance] A company may only make a purchase of its own shares in pursuance of a contingent purchase contract if the contract is approved in advance by a special resolution of the company before the contract is entered into; and subsections (3) to (7) of sections 164 apply to the contract and its terms.

SEC. **166 Authority for market purchase**
166(1) [Authority by company in general meeting] A company shall not make a market purchase of its won shares unless the purchase has first been authorised by the company in general meeting.
166(2) [Types of authority] That authority-
(a) may be general for the purpose, or limited to the purchase of shares of any particular class of description, and
(b) may be unconditional or subject to conditions.
166(3) [Requirements of authority] The authority must-
(a) specify the maximum number of shares authorised to be acquired.
(b) Determine both the maximum and the minimum prices which may be paid for the shares, and
(c) Specify a date on which it is to expire.
166(4) [Variation, revocation, renewal of authority] The authority may be varied, revoked or from time to time renewed by the company in general meeting, but this is subject to subsection (3) above; and in a resolution to confer or renew authority, the date on which the authority is to expire must not be later than 18months after that on which the resolution is passed.
166(5) [Company's purchase of own shares] A company may under this section make a purchase of its own shares after the expiry of the time limit imposed to comply with subsection (3)©, if the contract of purchase was concluded before the authority expired and the terms of the authority permitted the company to make a contract of purchase which would or might be executed wholly or partly after its expiration.
166(6) [Resolution conferring or varying authority] A resolution of a company conferring, varying, or revoking or renewing authority under this section is subject to section 380 (resolution to be sent to registrar of companies within 15 days).

SEC. **167 Assignment or release of company's right to purchase own shares**
167(1) [Prohibition of assignment] The rights of a company under a contract approved under section 164 or 165, or under a contract for a purchase authorised under section 166, are not capable of being assigned.
167(2) [Release of rights- conditions] An agreement by a company to release its rights under a contract approved under section 164 or 165 is void unless the terms of the release agreement are approved in advance by a special resolution of the company before the agreement is entered into; and subsection (3) to (7) of section 164 apply to approval for a proposed release agreement as to authority for a proposed variation of an existing contract.

SEC. **168 Payments apart from purchase price to be made out of distributable profits**

168(1) [Types of payment] A payment made by a company in consideration of
(a) acquiring any right with respect to the purchase of its own shares in pursuance of a contract approved under section 165, or
(b) the variation of a contract approved under section 164 or 165, or
(c) the release of any of the company's obligations with respect to the purchase any of its own shares under a contract approved under section 164 or 165 or under a contract for a purchase authorised under section 166,

must be made out of the company's distributable profits.

168(2) [Effect of not satisfying sec. 168(2) requirements] If the requirements of subsection (1) are not satisfied in relation to a contract-
(a) in a case within paragraph (a) of the subsection, no purchase by the company of its own shares in pursuance of that contracts is lawful under this Chapter,
(b) in a case within paragraph (b), no such purchase following the variation is lawful under this Chapter, and
(c) in a case within paragraph (c), the purported release is void.

SEC. **169 Disclosure by company of purchase of own shares**

169(1) [Return to registrar] Within the period of 28 days beginning with the date on which any shares purchased by a company under with Chapter are delivered to it, the company shall deliver to the registrar of companies for registration a return in the prescribed form stating with respect to shares of each class purchased the number and nominal value of those shares and the date on which they were delivered to the company.

169(2) [Return for public company] In the case of public company, the return shall also state-
(a) the aggregate amount paid by the company for the shares; and
(b) the maximum and minimum prices paid in respect of shares of each class purchased.

169(3) [Inclusion in single return] Particulars of shares delivered to the company on different dates and under different contracts may be included in a single return to the registrar; and in such a case the amount required to be stated under subsection (2)(a) is the aggregate amount paid by the company for all the shares to which the return relates.

169(4) [Particular of authorised contracts to be kept at registered office] Where a company enters into a contract approved under section 164 or 165, or a contract for a purchase authorised under section 166, the company for all the shares to which the return relates.

169(5) [Sec. 169(4) particulars open for inspection] Every copy and memorandum so required to be kept shall, during business hours (subject to such reasonable restrictions as the company may in general meeting impose, provided that not less than 2 hours in each day are allowed for inspection) be open to inspection without charge-
(a) by any member of the company, and
(b) if it is a public company, by any other person.

169(6) [Penalty for non-delivery of return] If default is made in delivering to the registrar any return required by this section, every officer of the company who is in default is liable to a fine and, for continued contravention, to a daily default fine.

169(7) [Penalty for contravention of sec. 169(4), (5)] If default is made in complying with subsection (4), or if an inspection required under subsection (5) is refused, the company and every officer of it who is in default is liable to a fine and, for continued contravention, to a daily default fine.

169(8) [Power of court to compel sec. 169(4) inspection] In the case of a refusal of an inspection required under subsection (5) of a copy or memorandum, the court may by order compel an immediate inspection of it.
169(9) [Application of sec. 169(40)] The obligation of a company under subsection (4) to keep a copy of any contract or (as the case may be) a memorandum of its terms applies to any variation of the contract so long as it applies to the contract.

SEC. **170 The capital redemption reserve**

170(1) ["Capital redemption reserve"] Where under this Chapter shares of a company are redeemed or purchased wholly out of the company's profits, the amount by which the company's issued share capital is diminished in accordance with section 160(4)on cancellation of the shares redeemed or purchased shall be transferred to a reserve, called "the capital redemption reserve".
170(2) [Transfer to capital redemption reserve] If the shares are redeemed or purchased wholly or partly out of the proceeds of a fresh issue and the aggregate amount of those proceeds is less than the aggregate nominal value of the shares redeemed or purchased, the amount of the difference shall be transferred to the capital redemption reserve.
170(3) [Exception to application of sec. 170(2)] But subsection (2) does not apply if the proceeds of the fresh issue are applied by the company in making a redemption or purchase of its own shares in addition to a payment out of capital under section 171.
170(4) [Reduction of share capital provisions] The provisions of this Act relation to the reduction of a company's share capital apply as if the capital redemption reserve were paid-up share capital of the company, except that the reserve may be applied by the company in paying up its unissued shares to be allotted to members of the company as fully paid bonus shares.

REDEMPTION OR PURCHASE OF OWN SHARES OUT OF CAPITAL
(PRIVATE COMPANIES ONLY)

SEC. **171 Power of private companies to redeem or purchase own shares out of capital**

171(1) [Source of payment] Subject to the following provisions of this Chapter, a private company limited by shares or limited by guarantee and having a share capital may, if so authorised by its articles, make a payment in respect of the redemption or purchase under section 160 or (as the case may be) section 162, of its own shares otherwise than out of its distributable profits or the proceeds of a fresh issue of shares.
171(2) [References to payment out of capital] References below in this Chapter to payment out of capital are (subject to subsection (6)) to any payment so made, whether or not it would be regarded apart from this section as a payment out of capital.
171(3) [Amount of payment] The payment which may (if authorised in accordance with the following provisions of this Chapter) be made by a company out of capital in respect of the redemption or purchase of its own shares is such an amount as, taken together with-
(a) any available profits of the company,and
(b) the proceeds of any fresh issue of shares made for the purposes of the redemption or purchase,

is equal to the price of redemption or purchase; and the payment permissible under this subsection is referred to below in this Chapter as the permissible capital payment for the shares.
171(4) [Transfer to capital redemption reserve] Subject to subsection (6), if the permissible capital payment for shares redeemed or purchased is less than their nominal amount, the amount of the difference shall be transferred to the company's capital redemption reserve.

171(5) [Permissible capital payment exceeding nominal amount of shares] Subject to subsection (6), if the permissible capital payment is greater than the nominal amount of the shares redeemed or purchased-

(a) the amount of any capital redemption reserve, share premium account or fully paid share capital of the company, and

(b) any amount representing unrealised profits of the company for the time being standing to the credit of any reserve maintained by the company in accordance with paragraph 34 of Schedule 4 (revaluation reserve),

may be reduced by a sum not exceeding (or by sums not in the aggregate exceeding) the amount by which the permissible capital payment exceeds the nominal amount of the shares.

171(6) [Proceeds of fresh issue] Where the proceeds of a fresh issue are applied by a company in making any redemption or purchase of its own shares in addition to a payment out of capital under this section, the reference in subsections(4) and (5) to the permissible capital payment are to be read as referring to the aggregate that payment and those proceeds.

SEC. **Availability of profits for purposes of sec. 171**

172(1) [Reference to available profits of the company] The reference in section 171(3)(a) to available profits of the company is to the company's profits which are available for distribution (within the meaning of Part VIII); but the question whether a company has any profits so available and the amount of any such profits are to be determined for purposes of the section in accordance with the following subsections, instead of section 270 to 275 in that Part.

172(2) [Determination of amount of profits] Subject to the next subsection, that question is to be determined by reference to-

(a) profits, losses, assets and liabilities,

(b) provisions of any of the kinds mentioned in paragraphs 88 and 89 to Schedule 4 (depreciation, diminution in value of assets, retentions to meet liabilities, etc.), and

(c) share capital and reserves (including undistributable reserves),

as stated in the relevant accounts for determining the permissible capital payment for shares.

172(3) [The relevant accounts in sec, 172(2)] The relevant accounts for this purpose are such accounts, prepared as at any date within the period determining the amount of the permissible capital payment, as are necessary to enable a reasonable judgment to be made as to the amounts of any of the items mentioned in subsection (2)(a) to (c) above.

172(4) [Determination of amount of permissible capital payment] For purposes of determining the amount of the permissible payment for shares, the amount of the company's available profits (if any) determined in accordance with subsections (2) and (3) is treated as reduced by the amount of any distributions lawfully made by the company after the date of the relevant accounts and before the end of the period for determining the amount of that payment.

172(5) [Lawful distribution in sec. 172(4)] The reference in subsection (4) to distributions lawfully made by the company includes-

(a) financial assistance lawfully given out of distributable profits in a case falling within section 154 or 155,

(b) any payment lawfully made by the company in respect of the purchase by it of any shares in the company (except a payment lawfully made otherwise than out of distributable profits), and

(c) a payment of any description specified in section 168(1) lawfully made by the company.

172(6) [Period for determining the amount of permissible capital payment] References in this section to the period for determining the amount of the permissible capital payment for shares are to the period of 3 months ending with the date on which the statutory declaration of the directors purporting to specify the amount of that payment is made in accordance with subsection (3) of the section next following.

SEC. **173 Conditions for payment out of capital**

173(1) [Requirements for payment by private company] Subject to any order of the court under section 177, a payment out of capital by a private company for the redemption or purchase of its own shares is not lawful unless the requirements of this and the next two sections are satisfied.

173(2) [Approval by special resolution] The payment out of capital must be approved by a special resolution of the company.

173(3) [Statutory declaration by directors] The company's directors must make a statutory declaration specifying the amount of the permissible capital payment for the shares in question and stating that, having made full inquiry into the affairs and prospects of the company, they have formed the opinion-

(a) as regards its initial situation immediately following the date on which the payment out of capital is proposed to be made, that there will be no grounds on which the company could then be found unable to pay its debts, and

(b) as regards its prospects for the year immediately following that date, that, having regard to their intentions with respect to the management of the company's business during that year and to the amount and character of the financial resources which will in their view be available to the company during that year, the company will be able to continue to carry on business as a going concern (and will accordingly be able to pay its debts as they fall due) throughout that year.

173(4) [Directors' opinion in sec. 173(3)(a)] In forming their opinion for purposes of subsection (3)(a), the directors shall take into account the same liabilities (including prospective and contingent liabilities) as would be relevant under section 517 (winding up by the court) to the question whether a company is unable to pay its debts.

173(5) [Form and content of statutory declaration, auditors' report] The directors' statutory declaration must be in the prescribed form and contain such information with respect to the nature of the company's business as may be prescribed, and must in addition have annexed to it a report addressed to the directors by the company's auditors stating that-

(a) they have inquired into the company's state of affairs; and

(b) the amount specified in the declaration as the permissible capital payment for the shares in question is in their view properly determined in accordance with sections 171 and 172; and

(c) they are not aware of anything to indicate that the opinion expressed by the directors in the declaration as to any of the matters mentioned in subsection (3) is unreasonable in all the circumstances.

173(6) [Penalty for unreasonable declaration] A director who makes a declaration under this section without having reasonable grounds for the opinion expressed in the declaration is liable to imprisonment or a fine, or both.

SEC. 174 Procedure for special resolution under sec. 173

174(1) [Dates for special resolution and payment out of capital] The resolution required by section 173 must be passed on, or within the week immediately following, the date on which the directors make the statutory declaration required by that section; and the payment out of capital must be made no earlier than 5 nor more than 7 weeks after the date of the resolution.

174(2) [Limitation of approval by special resolution] The resolution is ineffective in any member of the company holdings shares to which the resolution relates exercises the voting rights carried by any of those shares in voting on the resolution and the resolution would not have been passed if he had not done so.

174(3) [Interpretation of sec. 174(2)] For purposes of subsection (2), a member who holds such shares is to be regarded as exercising the voting rights carried by them in voting on the resolution not only if he votes in respect of them on a poll on the question whether the resolution shall be passed, but also if he votes on the resolution otherwise than on a poll; and, not withstanding anything in a company's articles, any member of the company may demand a poll on that question.

174(4) [Inspection of statutory declaration and auditors' report] The resolution is ineffective unless the statutory declaration and auditors' report required by the section are available for inspection by members of the company at the meeting at which the resolution is passed.

174(5) [Vote and demand for poll be person as proxy] For purposes of this section a vote and a demand for a poll by a person as proxy for a member are the some (respectively) as a vote and demand by the member.

SEC. 175 Publicity for proposed payment out of capital

175(1) [Notice in Gazette] Within the week immediately following the date of the resolution for payment out of capital the company must cause to be published in the Gazette a notice-

(a) stating that the company has approved a payment out of capital for the purpose of acquiring its own shares by redemption or purchase or both (as the case may be);

(b) specifying the amount of the permissible capital payment for the shares in question and the date of the resolution under section 173;

(c) stating that the statutory declaration of the directors and the auditors' report required by that section are available for inspection at the company's registered office; and

(d) stating that any creditor of the company may at any time within the 5 weeks immediately following the date of the resolution for payment out of capital apply to the court under section 176 for an order prohibiting the payment.

175(2) [Notice in appropriate national newspapers] Within the week immediately following the date of the resolution the company must also either cause a notice to the same effect as that required by subsection (1) to be published in an appropriate national newspaper or give notice in writing to that effect to each of its creditors.

175(3) ["An appropriate national newspaper"'] "An appropriate national newspaper" means a newspaper circulating throughout England and Wales (in the case of a company registered in England and Wales), and a newspaper circulating throughout Scotland (in the case of a company registered in Scotland).

175(4) [References to first notice date] References below in this section to the first notice date are to the day on which the company first publishes the notice required by subsection (1) or first publishes or gives the notice required by subsection (2) (whichever is the earlier).

175(5) [Statutory declaration and auditors' report to register] Not later than the first notice date the company must deliver to companies a copy of the statutory declaration of the directors and of the auditors' report required by section 173.

175(6) [Statutory declaration and auditors' report available for inspection] The statutory declaration and auditors' report-

(a) shall be kept at the company's registered office throughout the period beginning with the first notice date and ending 5 weeks after the date of the resolution for payment out of capital, and

(b) shall during business hours on any day during that period be open to the inspection of any member or creditor of the company without charge.

175(7) [Penalty on refusal of sec. 175(6) inspection] If an inspection required under subsection (6) is refused, the company and every officer of it who is in default is liable to a fine and, for continued contravention, to a daily default fine.

175(8) [Power of court to compel inspection] In the case of refusal of an inspection required under subsection (6) of a declaration or report, the court may by order compel an immediate inspection of the declaration or report.

SEC. 176 Objections by company's members or creditors

176(1) [Application for cancellation] Where a private company passes a special resolution approving for purposes of this Chapter any payment out of capital for the redemption or purchase of any of its shares-

(a) any member of the company other than one who consented to or voted in favour off the resolution; and

(b) any creditor of the company,

may within 5 weeks of the date on which the resolution was passed apply to the court for cancellation of the resolution.

176(2) [Maker of application] The application may be made on behalf of the persons entitled to make it by such one or more of their number as they may appoint in writing for the purpose.

176(3) [Obligations of company] If an application is made, the company shall-

(a) forthwith give notice in the prescribed form of that fact to the registrar of companies; and

(b) within 15 days from the making of any order of the court on the hearing of the application, or such longer period as the court may by order direct, deliver an office copy of the order to the registrar.

176(4) [Penalty] A company which fails to comply with subsection (3), and any officer of it who is in default, is liable to a fine and for continued contravention, to a daily default fine.

SEC. 177 Powers of court on application under sec. 176

177(1) [Adjournment, directions and orders by court] On the hearing of an application under section 176 the court may, if it thinks fit, adjourn the proceedings in order that an arrangement may be made to the court's satisfaction for the purchase of the interests of dissentient members or for the protection of dissentient creditors (as the case may be); and the court may give such directions and make such orders as it thinks expedient for facilitating or carrying into effect any such arrangement.

177(2) [Terms of court order etc.] Without prejudice to its powers under subsection (1), the court shall make an order on such terms and conditions as it thinks fit either confirming or cancelling the resolution; and, if the court confirms the resolution, it may in particular by order alter or extend any date or period of time specified in the resolution or in any provision in this Chapter which applies to the redemption or purchase of shares to which the resolution refers.

177(3) [Further scope of court order] The court's order may, if the court thinks fit, provide for the purchase by the company of the shares of any of its members and for the reduction accordingly of the company's memorandum and articles as may be required in consequence of that provision.
177(4) [Where order requires no alteration in memorandum or articles] If the court's order requires the company not to make any, or any specified, alteration in its memorandum or articles, the company has not then power without leave of the court to make any such alteration in breach of the requirement.
177(5) [Effect of sec. 177(4) alteration] An alteration in the memorandum or articles made by virtue of an order under this section, if not made by resolution of the company, is of the same effect as if duly made by resolution; and this Act applies accordingly to the memorandum or articles as so altered.

SUPPLEMENTARY

SEC. 178 Effect of company's failure to redeem or purchase

178(1) [Effect] This section has effect where a company has, no or after 15th June 1982,-
(a) issued shares in terms that they are or are liable to be redeemed, or
(b) agreed to purchase any of its own shares.
178(2) [Company not liable in damages] The company is not liable in damages in respect of any failure on its part to redeem or purchase any of the shares.
178(3) [Qualification to sec. 178(2)] Subsection (2) is without prejudice to any right of the holder of the shares other than his right to sue the company for damages in respect of its failure; but the court shall not grant an order for specific performance of the terms of redemption or purchase if the company shows that it is unable to meet the costs of redeeming or purchasing the shares in question out of distributable profits.
178(4) [Enforcement of terms of redemption or purchase] If the company is wound up and at the commencement of the winding up any of the shares have not been redeemed or purchased, the terms of redemption or purchase may be enforced against the company; and when shares are redeemed or purchased under this subsection, they are treated as cancelled.
178(5) [Non-application of sec. 178(4)] However, subsection (4) does not apply if-
(a) the terms provided for the redemption or purchase to take place at a date later than that of the commencement of the winding up, or
(b) during the period beginning with the date on which the redemption or purchase was to have taken place and ending with the commencement of the winding up the company could not at any time have lawfully made a distribution equal in value to the price at which the shares were to have been redeemed or purchased.
178(6) [Priority payments] There shall be paid in priority to any amount which the company is liable under subsection (4) to pay in respect of any shares-
(a) all other debts and liabilities of the company (other than any due to members in their character as such),
(b) if other shares carry rights (whether as to capital or as to income) which are preferred to the rights as to capital attaching to the first-mentioned shares, any amount due in satisfaction of those preferred rights;
but, subject to that, any such amount shall be paid in priority to any amounts due to members in satisfaction of their rights (whether as to capital or income) as members.
178(7) [Liability to pay interest] Where by virtue of section 66 of the Bankruptcy Act 1914 (payment of interest on debts) as applied by section 612 (application of bankruptcy rules to insolvent companies in England and Wales) a creditor of a company is entitled to payment of any interest only after payment of all other debts of the company, the company's debts and liabilities for purposes of sub-section (6) of this section include the liability to pay that interest.

SEC. **179 Power for Secretary of State to modify this Chapter**

179(1) [Regulations modifying provisions of Ch. VII] The Secretary of State may by regulations made by statutory instrument modify the provisions of this Chapter with respect to any of the following matters-

(a) the authority required for a purchase by a company of its own shares,
(b) the authority required for the release by a company or its rights under a contract for the purchase of its own shares or a contract under which the company may (subject to any conditions) become entitles or obliged to purchase its own shares,
(c) the information to be including a return delivered by a company to the registrar of companies in accordance with section 169(1),
(d) the matters to be dealt with in the statutory declaration of the directions under section 173 with a view to indicating their opinion of their company's ability to make a proposed payment out of capital with due regard to its financial situation and prospects, and
(e) the contents of the auditors' report required by the section to be annexed to that declaration.

179(2) [Further regulations] The Secretary of State may also be regulations so made make such provision (including modification of the provisions of this Chapter) as appears to him to be appropriate-

(a) for wholly or partly relieving companies from the requirement of section 171(3)(a) that any available profits must be taken into account in determining the amount of the permissible capital payment for shares under that section, or
(b) for permitting a company's share premium account to be applied, to any extent appearing to the Secretary of State to be appropriate, in providing for the premiums payable on the redemption or purchase by the company of any of its own shares.

179(3) [Content of regulations] Regulations under this section-

(a) may make such further modification of any provisions of this Chapter as appears to the Secretary of State to be reasonably necessary in consequence of any provision made under such regulations by virtue of subsection (1) or (2),
(b) may make different provision for different cases or classes of case, and
(c) may contain such further consequential provisions, and such incidental and supplementary provisions, as the Secretary of State thinks fit.

179(4) [Approval of regulations] No regulations shall be made under this section unless a draft of the instrument containing them has been laid before Parliament and approved by resolution of each House.

SEC. **504 Liability of past directors and shareholders**

504(1) [Application] This section applies where a company is being wound up and-

(a) it has under Chapter VII of Part V made a payment out of capital in respect of the redemption or purchase of any of its own shares (the payment being referred to below as "the relevant payment"), and

(b) the aggregate amount of the company's assets and the amounts paid by way of contribution to its assets (apart from this section) is not sufficient for payment of its debts and liabilities and the costs, charges and expenses of the winding up.

504(2) [Contribution of past shareholders and directors] If the winding up commenced within one year of the date on which the relevant payment was made then-

(a) the person from whom the shares were redeemed or purchased, and

(b) the direction who signed the statutory declaration made in accordance with section 173(3) for purposes of the redemption or purchase (except a director who shows that he had reasonable grounds for forming the opinion set out in the declaration),

are, so as to enable that insufficiency to be met, liable to contribute to the following extent to the company's assets.

504(3) [Amount payable] A person from whom any of the shares were redeemed or purchased is liable to contribute an amount not exceeding so much of the relevant payment as was made by the company in respect of his shares and the directors are jointly and severally liable with that person to contribute that amount.

504(4) [Application to court] A person who has contributed any amount tot he assets in pursuance of this section may apply to the court for an order directing any other person jointly and severally liable in respect of that amount to pay him such amount as the court thinks just and equitable.

504(5) [Non-application of sec. 502, 503] Sections 502 and 503 above do not apply in relation to liability accruing by virtue of this section.

504(6) [Regulations under sec. 179] This section is deemed including in Chapter VII of Part V for the purposes of the Secretary of State's power to make regulations under section 179.

APPENDIX 2

AUSTRALIAN ASSOCIATED STOCK EXCHANGES: DISCUSSION PAPER (1986): SUMMARY OF RECOMMENDATIONS [Cross Referenced to relevant paragraphs of the CSLRC Discussion Paper]

The AASE, having examined the issue of whether Australian companies should be allowed to purchase their own shares, recommends that Australian company law be amended to permit companies to purchase their own shares, subject to the following safeguards:

(1) companies purchasing their own shares must do so out of undistributed profits: see [5025]-[5033],

(2) when a company has purchased its own shares, the shares shall be cancelled and treated as authorized but unissued capital: see [5073]-[5079],

(3) a listed company shall not purchase its own shares unless authorized initially by its members to do so at a general meeting of the company. After the initial authorization by shareholders a listed company may purchase:

(i) up to 10% of its shares on issue during any period of 12 months without further reference to shareholders,

(ii) up to an additional 10% of its shares in any period of 12 months provided shareholders have specifically authorized the purchase in excess of the first 10%. This specific authorization is to expire 12 months after it is given, and

(iii) any number of shares by way of a tender to all shareholders: see [5008] - [5014],; [5043] - [5044]; [5055] - [5058].

(4) for reasons of flexibility, these percentage limit safeguards should be prescribed by stock exchange listing rules rather than by statute or statutory regulations:

[no cross-reference],

(5) listed companies should be required to purchase their own shares in the ordinary course of business at an Official Meeting of a stock market of a stock exchange unless:

(i) the offer to purchase is by way of tender to all shareholders,

(ii) the offer is to purchase odd lots, or

(iii) the offer is to purchase shares to which employees are entitled and those shares were issued to employees in accordance with an employees share ownership scheme: see [5042]-J50501,

(6) in the case of an unlisted company each proposed purchase by a company of its own shares shall have the prior approval of its shareholders. At a meeting of shareholders to approve the contracts of sale no voting rights shall be permitted to the registered holder(s) of the shares to be purchased by the company: see [5008]-[5014],

(7) when a company buys its own shares it should be an implied condition, and recorded in the company's minutes, that the directors are of the opinion that the purchase will not affect the company's ability to pay its debts as they fall due. The directors should be made liable if this opinion is later proven either dishonest or negligent in its determination: see [5034]-5041]; [5095]-[5096]; [5100]-[5104].

(8) the laws relating to insider trading shall apply to a company purchasing its own shares: see [411]-[414].

(9) companies must disclose to the NCSC, and in the case of a listed company to the stock exchanges, details of purchases of their own shares within one month of the

purchase date. The details to be disclosed are the number of shares purchased, the aggregate amount paid for the shares, the minimum and maximum prices paid per share and the issued capital of the company after the purchase: see [5070]-[5071].

(10) a company which purchases its own shares during a financial year shall disclose details of the purchases in its annual report as a note to its accounts or group accounts, as the case may be: see [5072].

(11) companies shall not purchase their own partly paid shares: see 150511, and

(12) a company shall maintain a register of all contracts for the purchase of its own shares and keep them available for inspection by shareholders: see 15072].