

Lecture 20: Transactions Affecting Share Capital

Maintenance of Share Capital

- To protect creditors and shareholders. Ensure that issued capital remains in company. Prohibits company from reducing its issued share capital.

Trevor Vs. Whitworth: Executors of W sold his shares to the company.

HELD: Company had no power to purchase its own shares. Prohibitions found in the following:

- Dividends may only be paid out of profits. Breach may amount to insolvent trading S254T
- The company cannot purchase its own shares S259A
- No taking of security interest over own shares (unless approved employee share scheme or taken by financial institution in ordinary course of business S259B)
- Cannot help others to purchase shares in its company or holding company unless approved by GM S260A (money is still leaving the company if X buys the holding companies shares)

Exceptions:

- Reduction of share capital 2J.1
- Share buy-back S2J.1 (When the company tells shareholders to sell back, this is allowed if certain criteria is met and the shares may be returned to the company)
- Financial Assistance S2J.3 (The company may help people buy shares if it doesn't harm the company)

1. Reduction of Capital:

- Chapter 2J. 1 covers share capital reductions and share buy-backs
- S256A purpose is to protect the shareholders and creditors by:
 - a) Addressing risk of companies insolvency if transaction is completed
 - b) Ensuring fairness between shareholders
 - c) Requiring the company to disclose all material information

Reasons for capital reductions:

- a) To return capital in excess of companies needs
- b) To bolster earnings per share (the number of shares becomes less so the companies earnings looks good)
- c) To exchange equity for debt (if it is more feasible to borrow money)
- d) To eliminate minority shareholder

2 Situations:

- S256B (1):
 - a) It must be fair and reasonable to shareholders as a whole
 - b) Does not materially prejudice companies ability to pay creditors
 - c) Approved by shareholders under S256C

a) Fair and Reasonable:

Factors:

- Adequacy of consideration
- Practical effect on different groups on shareholders
- Whether shareholder is being allowed to keep investment (there should not be a shift of control as a result – they should remain and have a proper stake in the company)

Re Fowlers Vacola Manufacturing Co Ltd

Payment only to ordinary shareholders was not fair to company's preference shareholders. Fairness required at least equal treatment as the constitution gave the preference shareholders a priority to a return of capital in the case of winding up.

b) Materially Prejudice:

Equal Vs. Elective Reduction: S256B (2):

- Equal ordinary shares and same terms equal – ordinary resolution S256C (1).
- Selective – special resolution (no votes cast by person who would receive consideration) or unanimous resolution – S256C (2).
- S256C (2) addition: If cancellation, special resolution by shareholders whose shares are to be cancelled (need permission from the group you are targeting).

Contravention S256D

- Transaction not valid S256D (2) (a) (If you are objecting, you must act quickly because failing to act will mean the company can remove)
- Company is not guilty of offence S256D (2) (b) (the director will be guilty)
- Person involved contravenes S256D (3) (Civil penalty provision, compensation under S1317H)
- If dishonest, guilty of offence under S256D (4).

Injunction remedy available to creditor or member if insolvency is an element of the contravention – S1324(1A) (b)

Onus on company to prove no contravention S1324 (1B)

Damages are also available S1324 (10)

Directors may also be liable under S588G, reduction deemed as incurring of debt when reduction takes place S588G (1A).

Share Buy-Back S257A

- The company offers to buy back shares but members can still say no
- In a capital reduction is a compulsory act
- There are restrictions in the constitution (see Note 1).
- Difference with capital reduction is that in share buy-back, shareholders have a choice.

- Requirements:
 - a) No material prejudice to pay creditors
 - b) Company follows procedures

Buy Back Procedure: S257B Table

- Approval of GM may be required, information
- 10 / 12 limit: If purchase is more than 10% of the number of shares every 12 months (only when it exceeds 10% do you have to seek GM approval)
- Equal access scheme S257B (2): Everyone is being offered the same terms, even if it exceeds the 10 / 12 limit, only an ordinary resolution is needed
- Minimum holding buy-back – cancel shares
- Employee share scheme buy-back over the 10 / 12 limit, ordinary resolution required.
- On-market buy-back: Over 10 / 12 limit, ordinary resolution required.

Selective Buy Back – S257D

- Special resolution or unanimous resolution
- Selling shareholders cannot vote on resolution

Other Consequences S257J Table

- Directors may be liable under S588G
- Injunction may be applied for by creditor or member S1324 (1A)
- If company fails to comply with procedure, S259A applies i.e. company contravenes by not guilty of offence S259F (1) and officers are liable for breach of civil penalty provision S259F (2) and may have committed an offence if there was dishonest intention S 259F (3).

Financial Assistance S260 A – C

Examples: Lending money, guaranteeing loan, providing its assets as security
Permitted in 3 situations:

- 1) No material prejudice to company, shareholders or creditors S260A
- 2) Shareholders approve assistance S260B (special resolution is required)
- 3) Exempted by S260C

Examples: Allowing instalment payment for shares, company is a bank, guarantee given by subsidiary of borrowing holding company, employee share scheme.

Contravention S260D

Does not affect the validity of financial assistance and company is not guilty of offence (the person involved S260D (2) Civil penalty provision. Damages under S1317H

Person may be liable criminally if dishonest intention shown S260D (3).

Directors continue to be liable S180 onwards: S260E

ASIC Vs. Adler

HIHC gave PEE financial assistance to acquire shares in HIH (holding company) and therefore there was a contravention of S260 onwards.