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

Attention: Mr Ian Govey

SHARE CAPITAL RULES — Proposals for Simplification

The Office of Regulation Review (ORR) offers the following comments on the Share Capital Rules element of the Corporations Law Simplification Program.

The ORR submission on accounts and audit proposals for simplification provides an overview of the role of the ORR and highlights our goals in seeking to assist the simplification Task Force. A copy of this submission is attached.

Of the 27 specific proposals regarding share capital rules made by the Task Force, the ORR offers comments specifically on aspects of six: Proposals 8, 9, 17, 22, 23 and 25.

Some general themes and principles of good regulation making run through the following comments. For example, there should be resort to regulation only when it can be demonstrated that unregulated markets result in outcomes that are clearly unsatisfactory to the Australian community. If regulations are used, it is essential to specify clearly what are the objectives. And consideration should be given to achieving these objectives by means other than prescriptive government regulation. The ORR's submission of 31 January 1995 on 'Accounts and audit' drew attention to such general principles.

Proposal 8: A company may reduce its share capital if it follows the procedures in paragraphs 9-13.

Issues a) Should there be any limit on the size of capital reductions which can be made in any 12 month period? What should the limit be?

The proposal appears to be based upon the premise that there can be problems relating to the rate of capital reduction. If companies abuse their right to reduce capital, that may be to the disadvantage of the remaining shareholders and creditors.

Given the fiduciary duties imposed on a director by the Corporations Law, Common Law and the safeguards embodied in proposals 9 to 13, it is not clear that there is a need for a restriction of the type envisioned by proposal 8.

Proposal 9: A company must give the ASC 14 days notice of a proposed capital reduction.

This proposal requires companies to give advance notice to the Australian Securities Commission (ASC) of a proposed capital reduction. The notice will then be placed on a computerized information data base which is available to the public. Whilst not identified as such, the proposal appears directed towards correcting ‘market failure’ in the supply of information to relevant stakeholders, who include shareholders and creditors.

If regulation is required in the form of a notice, as proposed, sufficient time is needed to allow for action to be taken to protect the interests of stakeholders. The proposal has not demonstrated the adequacy of a 14 day notification period.

It should be noted that small proprietary companies are not required to lodge annual financial statements (as embodied in the First Corporations Law Simplification Bill) and without this information creditors and the public might not be able to assess the effect of a share capital reduction. For this reason, small proprietary companies should be exempt from this requirement.

Proposal 17: A company must give the ASC 14 days notice before giving financial assistance.

Issues: Should this be required in the circumstances referred to in paragraph 14? If not, should paragraphs 18 and 19 apply to those circumstances?

The problem that this regulation is proposing to correct is not clearly identified, nor have any non-regulatory measures been suggested. Possible reasons for the proposal include to overcome the lack of information available to creditors, and to allow the ASC time to analyze the effect of the financial assistance on shareholders and creditors.

In addition, for the reasons set out in proposal 9, small proprietary companies should be exempt from this requirement.

We understand that the ASC does not peruse proposed financial assistance notices and only places them on the public record. The necessity of this regulation can only be demonstrated if the advantages to large proprietary and public company creditors are greater than the costs involved with this regulation.

Proposal 22: If a company acquires control of an entity that has a relevant interest in a share in that company, then within 12 months, the company must either:

- **cause the controlled entity to dispose of its relevant interest in a share in the controlling company, or**
- **end its control of the controlled entity.**

During this period, the voting rights attaching to the shares in the controlling company cannot be exercised.

The problem that this regulation attempts to correct is not clear; it may be to prevent companies from controlling or influencing their own shares.

The proposal is a very broad and applies to all companies. As the accounting definition of control (AASB 1024) includes the ability to dominate decision making by any means, it

will require considerable effort by companies to ensure that they do not breach this regulation. When recommending such a regulation, the total costs and benefits need to be identified to ensure the benefits outweigh the costs and that non regulatory options, such as referral to the Corporations and Securities Panel, have been investigated and found unsuitable.

Proposal 23 : If a company acquires a relevant interest in 10% or more of its voting shares, the ASC may refer the acquisition to the Corporations and Securities Panel for a declaration that the acquisition is unacceptable, having regard to its effect on potential takeovers of the company.

This rule will not apply in the case of an acquisition arising from a buy-back.

It is not quite clear what this proposal is addressing; it may be that companies acquiring an interest in their own shares may reduce their susceptibility to, or influence the outcome of, a takeover. A company which acquires shares in itself denies these shares to a potential acquirer, and that may have a large impact upon any takeover activity.

The rationale for the ASC having sole power to refer activities to the Corporations and Securities Panel is not disclosed. The aim of the panel is to sanction offenders for unacceptable conduct. The ORR believes that any one should be able to petition the panel. This appears to work very successfully in the United Kingdom.

Proposal 25 : As at present, the maximum period within which options created by public companies over their unissued shares can be exercised will be 5 years.

The proposal has not identified a social or economic problem which would be corrected by this proposal. It would appear to be based upon the rationale that the market is unable to value an option over a share with a option period of more than 5 years.

This regulation may be circumvented by the use of appropriately designed derivative financial instruments which could be render it ineffective.

The ORR questions whether this regulation is necessary, and whether it is likely to achieve its goal of ensuring that an option over a share must be exercised within 5 years.

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The contact officer on these matters is Mr Barry Oliver whose telephone number is 264 2228.

Paul Coghlan
Assistant Commissioner
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