



MEMO

To: Board of Directors
From: Company Secretary
Subject: **RETURN OF CAPITAL**

The Corporations Act “maintenance of capital” principles generally restrict the ability of a company to reduce its issued share capital. However, there are some “return of capital” processes available under the Act which are designed to protect the interests of shareholders and creditors (sec 256A):

- (a) address and minimise the risks of such action leading to the company’s insolvency
- (b) seek to ensure fairness between the company’s shareholders
- (c) require disclosure by the company of all material information.

Part 2J.1 Division 1 of the Act covers the provisions relative to and governing share capital reductions. However, it is noted that this Part does not specify the ways in which share capital is actually reduced, so various alternatives are open to the company (generally they are as addressed below).

A company may wish to reduce paid up capital simply because it has surplus capital in excess of its needs. Therefore, it will look to reduce the capital and/or return capital monies to shareholders. So, a reduction in a company’s share capital will occur when any money paid to a company to acquire shares is repaid/returned to the shareholder and/or the relevant shares are cancelled. Repayment may be in cash or in kind (eg, *in specie* distribution of company assets).

However, such action could impact on the ability of a company to pay its creditors, hence the process to protect creditors is made “public” through lodgement of documents with ASIC, the calling of a shareholders’ meeting, and in some cases mandating certain minimum time frames between events/actions (see also various cases such as *ANZ Executors & Trustees v. Qintex* [1990] on these points). Directors need to be mindful too of the solvency provisions of sec 588G of the Act when undertaking a share capital reduction.

Return of capital through a share capital reduction is allowed under sec 256B(1) if it:

- (a) is fair and reasonable to the shareholders as a whole; and
- (b) does not materially prejudice the company’s ability to pay its creditors; and
- (c) is approved by shareholders under sec 256C of the Act

or otherwise in one of the other ways specifically allowed under the Act such as through a share buy-back or redeeming preference shares.*



Pursuant to sec 256B(2), a share capital reduction can be either:

- (i) an equal reduction; or
- (ii) a selective reduction.

Shareholder approval is required to approve the reduction (by ordinary resolution if 'equal' and special resolution if 'selective'). The requirements in relation to shareholder approval are set out in sec 256C.

Once approved, the reduction applies to all relevant shareholders whether or not they voted in favour. Also, a selective reduction may have the capacity to advantage some shareholders over others.

If the reduction also involves the cancellation of shares, a separate special resolution passed by the shareholders whose shares are to be cancelled is required – sec 256C(2). However, capital can be returned to shareholders without need to actually cancel any shares. Conversely, the object or outcome of a share capital reduction might be that shares are cancelled with no return of capital (i.e., for no consideration).

In the case of ACP Holdings Limited, it appears that the reduction is 'equal' as the terms are the same for all shareholders. In all other cases the reduction would be 'selective'.

I have not looked at ACPH's Constitution (or any Shareholders' Agreement) to see if there are additional/alternative requirements for this type of corporate action, but given that we are expecting 100% consent in any case then I think this is largely irrelevant.

Equal Reduction Procedure

The procedure for an 'equal reduction' in a company's share capital must be based on sec 256C of the Act, with steps as set out hereunder. The procedure for a 'selective reduction' is basically the same, and noted where applicable below.

1. The first step in the process is a directors' meeting (or circulating directors' resolution) to recommend the return of capital and call an Extraordinary General Meeting (or circulating shareholders' resolution – if a proprietary limited company) for shareholders to consider the proposal.

Note: sec 249A allows a circulating shareholder resolution in a proprietary company and states that it should be treated as if it was a meeting, particularly with regard to distribution to shareholders and lodgement with ASIC of 'meeting documents', information, etc.

2. 'Meeting documents' comprising a Notice of Meeting and an Explanatory Memorandum are then prepared. The Memorandum must set out all information that is material to the shareholders' voting decision – sec 256C(4). And depending on the



circumstances – perhaps to minimize any creditor ‘backlash’ – it may be prudent to obtain an independent expert’s report concluding that the proposal is ‘fair and reasonable’.

3. Form 2560 “Notification of Reduction in Share Capital Details” must be lodged with ASIC, with a copy of the ‘meeting documents’, at least the day before [the date of] the notice calling the shareholders’ meeting (EGM), or circulating shareholders’ resolution, is despatched – sec 256C(5).

4. And whilst no longer required under the Act, some consider that it may also be prudent at that time to notify the Taxation Office of the proposed capital reduction/return to ensure that they have no objection to it proceeding.

5. The EGM is called with at least 21 days’ notice (28 days for listed companies). Short meeting notice appears to be allowed (for other than a listed company); i.e., subject to at least 95% of shareholders approving.

6. It is usual that just before or just after the EGM the shareholders whose shares are to be cancelled (following the capital reduction) hold a ‘class meeting’ to pass a special resolution approving that, as required under sec 256C(2). The notice of this ‘class meeting’ should form part of the ‘meeting documents’.

7. Only an ordinary resolution is required to be passed by shareholders at the EGM for an equal reduction. But a selective reduction must be approved by either a special resolution passed by the shareholders not participating or a resolution approved by all shareholders.

8. For a selective reduction Form 2205 “Notification of Resolutions Regarding Shares” with a copy of the approved resolution(s) must be lodged with ASIC within 14 days of being passed – sec 256C(3).

9. The actual share capital reduction and return of capital, if any, can be made immediately following the EGM approval with an equal reduction. But with a selective reduction, under sec 256C(3), the capital reduction/return of capital cannot be made until at least 14 days after lodgement of Form 2205.

10. Upon reduction of the company’s share capital, details of holdings must be adjusted in the Share Register to reflect, for example, new shareholding numbers and paid up capital amounts. Replacement Share Certificates or Holding Statements may also be required, which should be sent out to shareholders with a suitable covering letter noting each shareholder’s specific details of the capital repayment.

11. Also, Form 484 “Change to Company Details” (Section C1 Cancellation of Shares) must be lodged within 28 days of the actual share capital reduction date to effect the return of capital in ASIC’s records (and effect any share cancellations – which may not necessarily be the case for ACPH). For proprietary limited companies appropriate adjustments to the ‘top 20’ shareholders on the ASIC database would also have to be made.



Single Shareholder Companies

A single shareholder company does not need to issue a notice of meeting or hold a meeting to pass a resolution. A company that has only one shareholder may pass a resolution by the shareholder recording it and signing the record as per sec 249B(1). Passage of the resolution must be recorded in the company's minute books – sec 251A(1)(c). In this situation, the company is not required to lodge any documents with ASIC relating to the share capital reduction before the resolution is passed.

However, if the sec 249B(1) approach is taken, then within 14 days after the resolution is signed by the single shareholder, the company is required by sec 249B(2) to lodge a Form 2205, irrespective of whether it was an equal or selective reduction (because for a single shareholder company that is, of course, irrelevant), stating that the resolution was passed and accompanied by a copy of the resolution signed by the single shareholder (and probably also accompanied by the 'meeting documents' to fully satisfy sec 249(2) – but this is unclear in ASIC pronouncements, partially because if a resolution is signed then it could be said there has been no 'meeting').

I note it is equally unclear whether there is also a need to then wait another 14 days (which under sec 256C(3) would usually be the case when lodging a Form 2205 for a selective reduction) before actually making the capital reduction/return of capital, but in my opinion it is probably prudent to do so.

* other situations relate to 'lost' capital (no longer represented by assets), extinguishment of uncalled liability on partly-paid shares, or an unlimited company (which can reduce capital in any way it chooses).

DISCLAIMER

The comments in this memo reflect some commercial aspects and observations on the matter experienced or observed by the writer in practice as he understands them. The information is given as a guide only and does not represent a definitive or legal view of any of the issues raised, covered or referred to and the reader is urged to seek his own professional advice on all aspects of, or pertaining to, this and any related matter.
