

Acquisition by a Company of its own Shares

Service area / [Corporate](#)

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This briefing note provides an overview of some of the commercial reasons for and the technical legal requirements of a company wishing to acquire its own shares (also referred to as “share buy-backs”).

There are many reasons why a company may wish to acquire its own shares. Listed companies may use this mechanism to return surplus cash to shareholders, to enhance earnings per share or net assets per share, or to adjust gearing ratios. Listed funds may wish to provide greater liquidity in their shares, especially if the market for its shares is relatively narrow. Private companies may effect share buybacks for a multitude of reasons, including to operate an employee incentive scheme or to re-engineer their balance sheets. Whatever the reasons for the transaction, there are many technical points to consider so as not to fall foul of The Companies (Guernsey) Law, 2008 (as amended) (the “Law”) and risk the acquisition being deemed unauthorised. The implications may involve trying to claw back money from shareholders and to the extent not recoverable, the directors of the company concerned may be personally liable to repay such shortfalls to the company.

So whilst in Guernsey companies are free to return capital and earnings to investors without recourse to the Courts and without creditor approval, there remain, nonetheless, considerable incentives for complying fully with the prescribed procedures.

Constitutional requirements

A company may acquire its own shares if authorised to do so by its Memorandum and Articles of Incorporation (“Memorandum and Articles”). The terms and manner of the acquisition will also be determined by any specific stipulations

of the Memorandum and Articles and the terms of issue of the shares concerned. The transaction cannot be carried out if it would result in no shareholders in the company at all.

The consent of the shareholder transferors must be obtained for the acquisition and a contract for the acquisition of shares must be authorised by shareholders. If the purchase is an “off-market acquisition”, the proposed contract must be authorised by an ordinary resolution of the company before the contract is entered into and an expiry date for the authority must be set out in the resolution.

In the case of a “market acquisition” (broadly, involving an acquisition of shares on a recognised investment exchange pursuant to a marketing arrangement) the acquisition need only be first authorised by ordinary resolution of the company unless a live authority is already present in the Memorandum and Articles. Wherever the authority appears, it may be general or limited to the acquisition of particular classes or descriptions of shares and it may be subject to conditions. In any event, it must set out (i) the maximum number of shares authorised to be acquired, (ii) determine both the maximum and minimum prices which may be paid for the shares and (iii) specify the expiry date of the authority. When conferring or renewing an authority by ordinary resolution, the date on which the new authority expires cannot be a date later than eighteen months after the date the resolution was passed.

Satisfying the solvency test

As explained above, companies are free to return capital and earnings to investors without recourse to the Courts and without creditor approval. Instead, it is for the board of directors (the “Board”) to consider whether the company will

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satisfy the solvency test set out in the Law immediately after effecting the acquisition of its own shares. This is because an acquisition by a company of its own shares constitutes a “distribution” for the purposes of the Law. Therefore, the Board may authorise an acquisition of the company’s own shares if:-

- a. it is satisfied on reasonable grounds that the company will, immediately after the acquisition, satisfy the solvency test prescribed by the Law; and
- b. it satisfies any other requirement in its Memorandum and Articles.

The Board must approve a certificate stating:-

- a. that in its opinion the company will, immediately after the acquisition, satisfy the solvency test; and
- b. the grounds for that opinion; and the certificate must be signed on the Board’s behalf by at least one of the directors.

For the purposes of the Law, a company satisfies the solvency test if:-

- a. it is able to pay its debts as they become due; and
- b. the value of its assets is greater than the value of its liabilities, and
- c. in the case of a company supervised by the GFSC, the company satisfies any other requirements as to solvency imposed in relation to it by the relevant legislation under which it is supervised.

Aside from any regulatory solvency requirements, essentially, the test constitutes a cash flow test and a net assets test.

In analysing the cash flow test, the Board should consider all the company’s debts for which a legal obligation exists or which the company is otherwise obligated to fulfil. The definition of “debts” includes fixed preferential returns on shares ranking ahead of those in respect of which the share buy-back is made (except where that fixed preferential return is expressed in the Memorandum or Articles as being subject to the power of the directors to make distributions). This does not include debts arising by reason of the authorisation to effect the buy-back.

There is no definition of what is meant by the phrase “as they become due”. Decisions of the English courts can be persuasive authority in the Royal Court of Guernsey. In the matter of *Cheyne Finance Plc (in receivership)* [2007] EWHC 2402 (Ch) judgment was given in respect of the meaning and interpretation of “unable to pay its debts as they fall due” in section 123(1)(e) of the UK Insolvency Act 1986. In particular, the court held that the phrase “as they become due” encompassed some consideration of the future debts of a company. The phrase also incorporates contingent liabilities, and these will need to be considered by the Board and determined by forming reasonable judgments as to the likelihood, amount and time of recovery against the company. A Board should also consider those contingent liabilities of the company which may not necessarily be recognised on its balance sheet by applicable accounting standards.

In considering the net assets test, “liabilities” include the amounts that would be required, if the company were to be dissolved after the buy-back, to repay all fixed preferential amounts payable by the company to members, at that time or on earlier redemption (except where such fixed preferential amounts are expressed in the Memorandum or Articles as being subject to the power of directors to make distributions). Subject to the definition of “debts” in the Law as set out above, “liabilities” do not include dividends payable in the future.

Information before the Board and directors’ knowledge

As for the level of information which should be tabled before the Board, the Law states that in determining whether the value of a company’s assets is greater than the value of its liabilities, the directors:-

- a. must have regard to:-
 - i. the most recent accounts of the company; and
 - ii. all other circumstances that the directors know or ought to know affect or may affect the value of the company’s assets and the value of the company’s liabilities; and
- b. may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.

The Board should consider up-to-date financial data, preferably using management accounts which draw down from the date of the last full accounts.

The directors must also have regard to what they actually know and what they should have known about the company’s financial position. All directors should conduct sufficient due diligence to ensure that they are aware of the financial status of the company before voting in respect of the share buy-back programme.

Continuing obligation of the Board

If, after an acquisition is authorised at Board level and before the acquisition is made, the Board ceases to be satisfied on reasonable grounds that the company will, immediately after the acquisition is made, satisfy the solvency test, any acquisition made by the company is deemed not to have been authorised and is therefore unlawful. Therefore, the Board should continue to monitor the solvency position of the company after the authorisation to ensure the solvency test will still be met immediately after the acquisition is made.

Unravelling a share buy-back for failure to satisfy the solvency test

If the solvency test was not satisfied at the relevant time, the Law essentially provides for claw-back provisions and puts the common law position with regard to directors’ liabilities in effecting unauthorised distributions on a statutory footing.

Thus, a payment made to shareholder at a time when the company did not immediately after the share buy-back satisfy the solvency test may be recovered by the company from the shareholder unless (i) the shareholder received the payment in

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good faith and without knowledge of the company's failure to satisfy the solvency test, (ii) the shareholder has altered its position in reliance on the validity of the receipt and (iii) it would be unfair to require repayment in full or at all.

So, if legal procedures for gaining shareholder approval of the share buy-back were not followed or if there were no reasonable grounds for believing that the company would pass the solvency test at the time the certificate was signed, a director who failed to take reasonable steps to ensure the legal procedure was followed or who nonetheless voted to approve the certificate, is personally liable to the company to repay any shortfall in the amounts not recoverable from the shareholders.

Listing rules of The International Stock Exchange

Where a class of shares of a company is listed on The International Stock Exchange ("TISE"), the Listing Rules stipulate that a company must not purchase its own shares at a time when, under the provisions of the Model Code appended to the Listing Rules, a director of the company would be prohibited from dealing in its securities. Essentially, this is when the relevant director is in possession of unpublished price-sensitive information in relation to those securities or during a close period.

TISE must be notified without delay of any Board decision to submit to shareholders a proposal for the company to be authorised to purchase its own equity shares, except in respect of a renewal of an existing authority. The notification must set out whether the proposal is of a general nature or whether it relates to specific purchases, in which case, the names of the transferors must be disclosed. The outcome of the shareholders' meeting should also be notified to TISE without delay.

Similarly, the actual purchase of the company's own equity shares by or on behalf of the company, or any member of its group must be notified to TISE within 3 business days of the date of purchase. The notification must include the date of purchase, the number of equity shares purchased, the purchase price for each equity share or the highest and lowest prices paid, where relevant.

Tax

This section considers only the Guernsey tax issues arising in respect of a Guernsey resident company effecting a purchase of own shares. A share buy-back will constitute a distribution for Guernsey income tax purposes unless, and to the extent that, it is a repayment of capital to the member or the amount of value of any new consideration given by the member for that distribution.

A non-Guernsey resident member will generally not be subject to any Guernsey tax on receipt of the distribution arising on the share buy-back (unless such member holds the shares through a permanent establishment in Guernsey).

A Guernsey resident member (or a non-Guernsey resident member holding their shares through a Guernsey permanent

establishment) will, subject to their personal circumstances, generally be subject to Guernsey income tax on the distribution arising from the share buy-back. However, by concession, if the distribution arising on the share buy-back is a distribution of capital made by the Guernsey company which arises from the disposal of assets or similar, is not treated as a distribution for income tax purposes (and is therefore not taxable in Guernsey), except to the extent that the company has undistributed income, which is treated as being distributed on the share buy-back in priority to any capital and is therefore taxed.

If the Guernsey member is an individual, the distribution may attract withholding tax at a rate which depends on the rate of tax paid by the company on the income from which the distribution arising on the share buy-back is derived. In general, a Guernsey member obtains a tax credit for any tax withheld by the company on the distribution and any tax paid by the company on the income from which the distribution is derived.



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