

Regulation of Treasury Shares in Kuwaiti Law: A Comparative Study

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Abstract

Treasury shares have a significant role in companies and capital markets' regulations. As a result, it gained the attention of legislators and legal scholars. This paper examines the regulatory rules regarding treasury shares in Kuwaiti law, its philosophy, and practicality. The paper adopts a comparative, analytical approach addressing the historical evolution of treasury shares and comparing related regulations and legal provisions in many jurisdictions. With comparative law at hand, this paper aims to thoroughly examine the concept of treasury shares and their legal nature, their characteristics, buy-back procedures, treasury shares' relation with the company's capital structure, and ultimately, the uses of treasury shares. By analyzing Law No. 7 of 2010 Regarding the Establishment of the Capital Markets Authority and Regulating Securities Activities and Law No. 1 of 2016 Regarding Companies Law and by incorporating comparative law such as Swiss, German, Swedish, Danish and other laws, this study demonstrates different matters related to treasury shares that are not yet regulated in Kuwait. The research assesses the legal provisions governing treasury shares, addressing matters such as shareholder rights, voting power, and market manipulation concerns. It argues for regulatory reform to further enhance the provisions governing treasury shares. As a result of the analysis given, recommendations are provided to enhance the regulatory framework in Kuwait.

Keywords: Treasury shares; Shareholding companies; Capital; Capital structure; Share buy-back

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التنظيم التشريعي لأسهم الخزينة في القانون الكويتي، دراسة مقارنة

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ملخص

تحتل أسهم الخزينة بأهمية في نطاق قانون الشركات وأسواق المال؛ حيث إن لها أثرًا مهمًا في شركات المساهمة. وقد حظيت هذه الأهمية بعناية المشرع والفقهاء القانونيين. يتناول البحث أسهم الخزينة بشكل مفصل من حيث فلسفتها وأهميتها العملية. يهدف البحث إلى تسليط الضوء على التنظيم التشريعي لأسهم الخزينة. وقد اعتمد المنهج التحليلي المقارن؛ حيث يتناول العديد من الأحكام والقواعد القانونية التي تنظم أسهم الخزينة في مختلف النظم القانونية. يُناقش البحث ماهية أسهم الخزينة وطبيعتها القانونية وفلسفة وجودها المتصلة بإدارة رأس مال الشركة والمحافظة عليه، ويتطرق إلى خصائص أسهم الخزينة، والإجراءات المتعلقة بإعادة شراء الشركة لأسهمها، وعلاقة أسهم الخزينة بهيكل رأس مال الشركة، واستخدامات تلك الأسهم.

واستنادًا إلى القانون رقم 7 لسنة 2010 بشأن إنشاء هيئة أسواق المال وتنظيم نشاط الأوراق المالية، والقانون رقم 1 لسنة 2016 بشأن إصدار قانون الشركات، ومن خلال دمج وجهة نظر تشريعية مقارنة بعدة قوانين، كالقانون السويسري، والألماني، والسويدي، والدنماركي، وغيرها من القوانين... يوضح البحث القواعد التي تنظم أسهم الخزينة والمسائل المختلفة التي تتعلق بها، التي لم تُنظم في ظل القانون الكويتي. كما يدعو البحث إلى سد الثغرات في القانون الكويتي، وتبني قواعد قانونية تحقق الفلسفة التي ابتغها المشرع من إباحة تملك الشركة لأسهمها، والتي بموجبها نظم أسهم الخزينة، وتدفع أيضًا لتحسين النظام القانوني لأسهم الخزينة. وبعد التحليل المقدم، يختتم البحث بمجموعة من التوصيات التي من شأنها الإفادة في تعديل التشريعات الحالية، وتحسين التنظيم التشريعي المتعلق بأسهم الخزينة في القانون الكويتي.

الكلمات المفتاحية: أسهم الخزينة، شركات المساهمة، رأس المال، هيكل رأس المال، إعادة شراء الأسهم

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© 2024، التميمي، الجهة المرخص لها: دار نشر جامعة قطر. تم نشر هذه المقالة البحثية وفقًا لشروط Creative Commons Attribution-NonCommercial 4.0 International (CC BY-NC 4.0). تسمح هذه الرخصة بالاستخدام غير التجاري، وينبغي نسبة العمل إلى صاحبه، مع بيان أي تعديلات عليه. كما تتيح حرية نسخ، وتوزيع، ونقل العمل بأي شكل من الأشكال، أو بأية وسيلة، ومزجه وتحويله والبناء عليه، طالما يُنسب العمل الأصلي إلى المؤلف.

1 Introduction

Treasury shares have emerged as a significant and complex concept in modern corporate governance, influencing the dynamics of shareholding companies worldwide. The practicality of treasury shares, as an integral component of corporate finance and management has gained growing attention from scholars, legal practitioners, and regulators. This paper embarks on a comparative study to examine the underlying philosophy of treasury shares. Treasury shares, also known as treasury stock or company stock represent the shares of a company's issued capital, which are reacquired from shareholders and held in its treasury. Understanding the philosophical side of treasury shares in shareholding companies is a vital issue to analyze their potential impact on corporate governance, shareholder rights, and corporate capital.

The aim of this study is to examine the principles and reasons behind the use of treasury shares in shareholding companies, as well as to explain the similarities and differences between various legal systems. The study covers the definition and legal status of treasury shares, their characteristics, the process of buying them back, their relationship with the company's capital structure, and their uses. By comparing the approaches of different legal systems, the study seeks to shed light on how these systems address the complex issues surrounding treasury shares, and how their approaches can affect corporate governance, financing, and shareholder protection. Kuwaiti law mainly adopts a conservative approach when it comes to treasury shares. However, other comparative laws take a more flexible stance. The comparative analysis will involve examining key legal provisions and regulations related to treasury shares and capital structure. The study aims to contribute to the existing knowledge on treasury shares and corporate governance in shareholding companies, by providing valuable perspectives for policymakers, legal practitioners, corporations, and shareholders. Furthermore, the study aims to deepen understanding of this important part of modern corporate finance and law by examining how do regulatory rules governing treasury shares in Kuwaiti law compare with the regulations in other jurisdictions. By highlighting the complexities, surrounding treasury shares and how different jurisdictions regulate them and indicating key matters related to treasury shares that are not yet regulated in Kuwait. the study hopes to stimulate further academic discussions, promote advancements in corporate governance practices, and support the development of the regulatory framework in Kuwait.

2 What are Treasury Shares?

Accurately speaking, a company acquiring its shares and therefore becoming a member of itself is considered logically impossible. This is due to the debt and the corresponding claim belonging to one person, which as a result, offset each other and disappear as a result of confusion.¹ Furthermore, Kuwaiti Civil Code states that if one person has the qualities of a creditor and a debtor, with respect to the same obligation, this obligation shall terminate² to the extent of the merger of obligations.² Consequently, share

1 Goya Kobayashi, & Irome Takayuki, *Share Buyback Rules under Japanese Corporate Law and Shareholders' Return*, 34 *Zeitschrift für Japanisches Recht*, 183-184 (2012).

2 Kuwaiti Civil Code of 1980, Article 433.

buy-backs were unregulated.³ However, the need for treasury shares resulted in legislative reform giving the right for a corporation to acquire its own shares. Therefore, although corporations cannot become their own shareholders, the law permits a company to buy its shares to be held in its treasury. Thus, treasury shares are defined as the "company's shares which the issuing company repurchases or buys back or otherwise makes use of"⁴. The law did not permit companies to repurchase their own shares except to achieve an end. Legal, economic, financial, and commercial purposes lie behind creating the notion of treasury shares.

Companies repurchase their own shares and hold them for a definite or an indefinite period for future use and resort to treasury shares for numerous reasons. Treasury shares can be meant to be used in the company's employee remuneration and compensation plans,⁵ as an alternative to dividend distribution which has a positive impact on the company's share price, to generate additional demand for the company's shares by reducing existing shares and thus increasing earnings per share, to control capital structure, or to meet the requirements needed for a merger with another company.⁶ They are also an indirect way to return capital to shareholders whose shares were bought back. Treasury shares could help with indicating the company's confidence in achieving future profits, display the existence of a cash surplus with the company, act as an alternative to dividends, and as a defense strategy to avoid acquiring the company.⁷ All this explains the philosophy behind regulating treasury shares and the evolving reform allowing companies to repurchase their own shares and resulting in the rise of the notion of treasury shares.

The legal status of treasury shares is a matter of disagreement. Many consider treasury shares as suspended shares, neither existing nor retired. Others argue that treasury shares are in fact a new issue of shares but are no more outstanding shares in the hands of the shareholder and their existence as issued shares is fiction. In reality, treasury shares retain their character as subscribed, issued, and outstanding shares after the share buy-back as long as they have not been retired nor canceled upon repurchase as the law requires for the reduction of capital.⁸

1 Characteristics of Treasury Shares

Treasury shares differ from ordinary shares. Although the company can own its shares under the law, it doesn't enjoy the rights that a shareholder usually enjoys over their shares. Treasury shares lose voting power, pre-emption rights, right to entitlement to cash dividends or participation in the general meeting. Therefore, these shares are not part of the company's assets and can't be considered an asset

3 Companies buying back their own shares from shareholders.

4 Kuwait Capital Markets Law Executive Bylaws, Module One: Glossary.

5 See: Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-2.

6 Nidal R. Sabri, *A Treasury "Repurchase" Share as a Stabilizing Instrument in the World Stock Markets*, 1-2 (Birzeit University Working paper 2022).

7 Isaac Otchere, & Matthew Ross, *Do share buy-back announcements convey firm-specific or industry-wide information?: A test of the undervaluation hypothesis*, 4 International Review of Financial Analysis, 7-8 (2002).

8 Harry Kottler, *Treasury Stock; A Corporate Anomaly*, 1 Clev.-Marshall L. Rev, 11-13 (1952).

when calculating net assets or surplus available for dividends.⁹

2 Treasury Shares Are Not Assets

Shares in general are included in the calculation of the company's net assets. Treasury shares are an exception as they are not considered assets and should not be treated as assets regarded in the calculation of the surplus needed to distribute profits to shareholders. Subsequently, they have no value in the event of liquidation. Therefore, the rights of creditors are disturbed since treasury shares are considered worthless at the time most needed by creditors, in the event of liquidation.¹⁰ The status of treasury shares is still not agreed upon yet many consider them a reduction of equity and not an asset.¹¹

3 Voting Rights

In past times, companies were prohibited from acquiring treasury shares primarily because it would otherwise violate voting rights at the annual general meeting. However, with the integration of regulatory rules governing treasury shares, voting rights associated with treasury shares are suspended as long as the shares are at the company's disposal and in its treasury. The reason behind suspending the voting rights of treasury shares is that the legislator aims to grant a fair and equal distribution of voting rights among shareholders and prevent board members from extending their control over the company.¹² According to that, Kuwait Capital Markets bylaws states that: "Treasury Shares shall not be taken into account in calculating the quorum of the general meeting and voting on the resolutions thereof..."¹³. In comparative law, if a company buys back its shares, the right to vote is suspended. As a result, if the right to vote is exercised even though it is suspended, the provisions regarding unauthorized participation in the general meeting apply.¹⁴

4 Right to Share in Dividends

Contrary to one of the rights enjoyed by usual shareholders, companies holding treasury shares do not enjoy the right to receive cash dividends arising from their own shares.¹⁵ It is inconceivable that a company would pay dividends to itself as the owner of its shares. Kuwait Capital Markets Law bylaws confirmed this by stipulating that: "Treasury Shares shall not confer the right to dividends"¹⁶.

9 Henry W. Ballantine, *The curious fiction of treasury shares*, 34 Calif. L. Rev, 536 (1946).

10 Kottler, *supra* note 8, at 4.

11 Norlin G. Rueschhoff, *The evolution of accounting for corporate treasury stock in the United States*, 5 Accounting Historians Journal, 1 (1978).

12 Kottler, *supra* note 8, at 16.

13 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-14.

14 German Stock Corporations Act of 1965, Article 71b; Swiss Civil Code of 1911, Article 659; unauthorized participation in the general meeting (Swiss Civil Code of 1911, Article 691): is where persons who are not authorized to participate in the general meeting participate in a decision on a resolution, any shareholder may challenge that resolution even if they have not raised an objection unless the company can prove that their involvement exerted no influence on the decision made.

15 Kuwait Companies Law of 2016, Article 178: "A member in the company shall particularly enjoy the following rights: 1. Receiving profits and bonus shares that are resolved to be distributed..."

16 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-13.

Thus, when a company buys back its own shares and holds them as treasury shares, those shares are not entitled to receive dividends. This is agreed upon by many legislations in different countries. For instance, Swiss law states that in the case that a company acquires its own shares, the rights associated with these shares are suspended.¹⁷

5 Right of Receiving Bonus Shares

Bonus shares are additional shares that are given to shareholders after the company capitalizes its reserves.¹⁸ Capitalization of the reserve refers to merging the reserve with the capital of the company creating bonus shares to be distributed to shareholders.¹⁹ Shareholders have been offered bonus shares by companies as a smart alternative to cash dividends since bonus issues are a form of reinvesting cash into the company by giving additional shares to shareholders.²⁰ Kuwait Capital Markets Law states that companies holding treasury shares are entitled to bonus shares upon issuance having the same rights as other shareholders.²¹

6 Pre-emption Rights

Pre-emption rights or subscription rights are the rights of shareholders to maintain their ownership and to buy shares before third parties if a company issues new shares. The executive bylaws of Kuwait Capital Markets Law specify that the company may not exercise the pre-emptive right in a subscription resulting from the ownership of treasury shares and that this right is limited to other shareholders only.²² However, other comparative laws follow a different path, in the UAE for instance, there is no provision suspending pre-emption rights deriving from treasury shares.²³

7 Share Buyback Procedures

Treasury shares are not issued as treasury shares, but ordinary shares obtain the term 'treasury shares' when they are repurchased. Treasury shares are part of the issued capital that was subject to subscription by the shareholders. The shares are then repurchased by the issuing company to be held or re-used later on. The pre-requirements for a share buyback are the following:

- 1- The company making the purchase must be a shareholding company as the provisions relating to treasury shares apply only to public and closed shareholding companies.²⁴ Additionally, some laws require that the company making the purchase is incorporated for at least two fiscal years.²⁵

¹⁷ Swiss Civil Code of 1911, Article 659.

¹⁸ Barry Elliott, & Jamie Elliott, Financial accounting and reporting 631 (Pearson Education 13th ed. 2007).

¹⁹ UAE Commercial Companies Law of 2021, Article 202.

²⁰ James S. Murray, & Michael T. Skully, *Dividends, reinvestment and bonus shares: The shareholder's choice 2* (Monash University Working paper 2003).

²¹ Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-9.

²² *Id.*

²³ See: UAE Commercial Companies Law of 2021, Article 221.

²⁴ Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-1.

²⁵ UAE Commercial Companies Law of 2021, Article 221.

This aims to make sure of the company's sustainable financial basis and proper management to carry out the buyback.

- 2- A resolution by the general meeting authorizing the board of directors to carry out the buyback is required.²⁶ Regulations in Kuwait did not specify whether the resolution regarding share buyback authorization falls within the competency of the ordinary or the extraordinary general meeting. Swedish law, however, requires an extraordinary majority of no less than two-thirds of both the votes cast and the shares represented at the general meeting.²⁷ Although most laws require a resolution from the general meeting for a share buy-back, Danish law allows for a company to buy back its shares where it is necessary in order to avoid significant and imminent detriment to the company without authority from the general meeting.²⁸ This provision demonstrates a level of flexibility in Danish corporate law. It indicates that in critical situations, waiting for a general meeting to authorize share buybacks may not be practical and in result may lead to significant harm to the company's interests. The primary intention of this provision is to protect the company's interests as it provides a mechanism to take instant action to avoid an imminent detriment to the company. This flexibility is nonexistent in Kuwaiti law.
- 3- Since shareholders are unable to dispose of their shares until after the publication of the company's first balance sheet for at least twelve months.²⁹ That balance sheet publication is a pre-requirement for a share buy-back.
- 4- Approval of the Capital Markets Authority.³⁰
- 5- The percentage of treasury shares owned by the company and its subsidiaries must not surpass 10% of the total number of shares issued by the company.³¹ Laws in Germany, Sweden, and the UAE set the same limit.³² In Swiss law, if the repurchase is connected with a restriction on transferability or an action for dissolution, the previous upper limit is 20 percent.³³ The exception found in Swiss law allowing a 20% ownership limit in specific cases acknowledges that there may be situations where it is necessary for a company to own a larger percentage of its shares. For example, in cases where there is a pending action for dissolution, the company might need a larger percentage to impose its control on the situation. This is another proof of flexibility in comparative regulations.

26 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-3.

27 Swedish Companies Act of 2005, Chapter 19, Section. 18.

28 Danish Companies Act of 2021, Article 199.

29 Kuwait Companies Law of 2016, Article 172.

30 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-3.

31 *Id*, Article 14-12.

32 German Stock Corporations Act of 1965, Article 71; Swedish Companies Act of 2005, Chapter 19, Section 15; UAE Commercial Companies Law of 2021, Article 221.

33 Swiss Civil Code of 1911, Article 659.

6. In the case of capital reduction, the buy-back must be carried out under the procedures required in the executive bylaws of Companies Law.³⁴

Although Kuwait Capital Markets Law does not state that share buy-backs are carried out on the exchange, it is implied in its bylaws which state that unlisted companies must consider equality between shareholders in the offer of sale or purchase request, and when some shareholders do not wish to sell or buy shares, the company may either revoke its offer or conclude a disposition with the shareholders who have expressed their desire to do so.³⁵ The previous provision states that unlisted companies buy back their shares through a repurchase offer made to shareholders (off-market buy-back). In return, it also implies that buy-backs take place on the exchange for listed companies (market buy-backs) however; an offer to purchase can be directed to all shareholders. While off-market and market buy-backs are unregulated in Kuwait, they can differ significantly in comparative law. For instance, in the United States, market buy-backs don't require shareholders' approval.³⁶ Moreover, generally, all shares are subject to buy-backs. However, there are some exceptions. For instance, companies can't buy back shares with legal restrictions such as the incorporators' shares »before the lapse of two financial years from the date of the company's registration in the commercial register.³⁷ The company's capital may not be used as a source to finance the company's repurchase of its shares.³⁸ Therefore, the purchase of treasury shares is valid only if it is financed out of surplus, which requires that the corporation has assets over and above its liabilities and is solvent.³⁹ In addition to that, a company that owns treasury shares must freeze part of its reserves comprising distribution of net profits, carried-over profits and share premium account which equals the cost of treasury shares and consider it non-distributable for the duration of the ownership of these shares.⁴⁰

Directors who use share buy-backs to impact the market price of the company's shares would be guilty of market manipulation. However, if a buy-back is carried out in compliance with the regulatory rules and restrictions, it wouldn't constitute market manipulation.⁴¹ In Kuwait, market manipulation is prohibited under articles 122, 124, and 125 of Law No. 7 of 2010.⁴² Criminal sanctions were stipulated as an outcome of market manipulation practices to protect the market, investors, and shareholders from abusive practices and to guarantee transparency, proper performance of securities markets, and equality in the treatment of investors. As a result, if the share buy-back was intended to manipulate the market,

34 Kuwait Companies Law Executive Bylaws, Article 108.

35 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-6.

36 Michelle R. Clayman et al. *Corporate finance: A practical approach* 243 (John Wiley & Sons 2nd ed. 2012).

37 Kuwait Companies Law of 2016, Article 71.

38 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-7.

39 William D. Dunlap, *The Legal Status of Treasury Stock* 1 Tex. L. & Leg., 305-306 (1947).

40 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-8.

41 Rehana Cassim, *An analysis of market manipulation under the Securities Services Act 36 of 2004 (part 2)* 20 SA Mercantile Law Journal, 187 (2008).

42 Fatemah A. Al Shuraian, *Market manipulation in Kuwait stock exchange: an analysis of the regulation of market manipulation prior and under Law no. 7 of 2010* 164 (PhD diss., University of Leicester 2014).

abuse shareholder rights, or fix the share price, it ought to be void. Kuwaiti law does not regulate void buy-backs in particular leaving it subject to general rules. Thus, void buy-backs in Kuwait are governed by article 187 of the Kuwaiti Civil Code which states that in case of nullification, both contracting parties shall return to their pre-contract condition.⁴³ German law, on the other hand, addressed the matter of void buybacks stating that treasury shares must be sold within a year.⁴⁴ This is a long period in relation to Norwegian law, which requires that it be sold within three months following the acquisition.⁴⁵ The three jurisdictions mentioned vary in terms of time frames for disposing of treasury shares in the case of a void buyback. In Kuwaiti law, a time period is not specified. German law allows more flexibility by granting a longer period for selling treasury shares. This is beneficial for some companies, giving them more time to find suitable conditions for the disposal of the shares. In contrast, Norwegian law's shorter deadline is stricter and necessitates quicker action.

8 Treasury Shares and Capital Structure

A shareholding company can be defined as a company in which one or more persons or commercial enterprises participate and which is liable for its obligations to the extent of the company's assets, and the shareholders are required only to fulfill the duties specified in the articles of association,⁴⁶ or as a company that constitutes a separate legal entity where liability to creditors concerning obligations of the company is limited to the company's assets.⁴⁷ Furthermore, the capital of a shareholding company is the nominal value of the total shares of the company.⁴⁸ It represents the long-term investment that a company's shareholders have placed in it.⁴⁹ Capital also refers to the investment of shareholders and their contribution to the company in exchange for ownership rights and interests represented by their shares such as voting rights and dividend entitlements. The characteristics of such capital are an integral part of corporate structure. Kuwait Companies Law specifies that the company's capital is »divided into equal shares provided that the nominal value per share is no less than one hundred fils. The shares are indivisible.⁵⁰ "Most legislations in other jurisdictions state that capital is divided into shares. Swiss law, as an example, specifies that capital in shareholding companies is a pre-determined capital set out in the articles of association and is divided into shares.⁵¹ Companies Law in Saudi Arabia, on the other hand, states that "capital is divided into tradable shares"⁵². Capital of a shareholding company is formed by

43 Kuwaiti Civil Code of 1980, Article 187.

44 German Stock Corporations Act of 1965, Article 71c.

45 Norwegian Public Limited Liability Companies Act of 1997, Article 9-7.

46 Swiss Civil Code of 1911, Article 620.

47 German Stock Corporations Act of 1965, Article 1.

48 Ahmed Al Melhem, Kuwaiti Commercial Companies Act and Comparative Law, Part Two (Authorship, Translation & Publication Committee, Kuwait University 2nd ed. 2014) 624.

49 John Armour, *Share capital and creditor protection: efficient rules for a modern company law*, 63 *The Modern Law Review*, 12 (2000).

50 Kuwait Companies Law of 2016, Article 150.

51 Andreas Their et al. *Introduction to Swiss law* 346 (Sui Generis Verlag 2022).

52 Saudi Arabian Companies Law of 2022, Article 59.

public subscription if it is a public shareholding company or a limited subscription to its incorporators if it is a closed shareholding company. Initial Public Offering (IPO) is "the process of addressing an invitation to the public to subscribe or purchase securities through various media"⁵³. Swiss law defines a public offer as any offer to purchase or exchange shares, participation or bonus certificates, or any other equity securities that is made publicly to the holders of shares or other equity securities of Swiss companies whose equity securities are, in whole or in part, listed on an exchange in Switzerland.⁵⁴ In light of this, can a company subscribe to its own shares? Companies law in Denmark and Germany forbid companies from subscribing to their own shares.⁵⁵ In return, if an IPO is unfulfilled, Swedish law allows for a company to acquire its own shares for which payment isn't made.⁵⁶ Syrian law follows a similar position, allowing companies to acquire shares in an unfulfilled subscription and registering them as treasury shares subsequent to a resolution from the board of directors.⁵⁷ This could be another route to fulfill a failing subscription rather than repealing the incorporation of the company or reducing the capital, which is the fate of an unfulfilled IPO in Kuwaiti law.⁵⁸

Capital structure is the company's selection of its debt-to-equity ratio and the way it raises capital to pay for the corporation's assets.⁵⁹ Planning an optimal capital structure has become a significant element of corporate governance. Boards have a responsibility to ensure capital stability by choosing the least costly form of funding and allocating the risk of bankruptcy to substantial debt financing. Overall, companies now pursue active and thoughtful strategies when planning their capital structure. As a result, today, financial statements show the accurate value of the company and if it is unable to convince the shareholders that it can invest the capital profitably, capital is returned to shareholders via share buy-backs, reduction of capital, and payment of dividends.⁶⁰

Capital can be restructured by increasing or reducing the issued capital of the company. Reduction of capital is a valuable method for companies to return some of the surplus to shareholders, purchase of own shares, and write off part of lost capital.⁶¹ Treasury share is one of the tools used to reduce the capital. Companies can restructure their capital by reducing it using treasury shares. This is found in Article 170 of Companies Law which regulates the methods of capital reduction which includes repurchasing a number of shares equal to the amount of capital to be reduced.⁶² Cancelling a number

53 Kuwait Capital Markets Law, Article 1.

54 Swiss Federal Act on Stock Exchanges and Securities Trading of 1995, Article 2.

55 Danish Companies Act of 2021, Article 205; German Stock Corporations Act 1965, Article 56.

56 Swedish Companies Act of 2005, Chapter 19, Section. 5.

57 Ziad Mohammed, & Suheir Al Jund, *The legal system of Treasury Shares*, 15 The University of Sharjah Journal of Law Sciences 406, 420 (2018).

58 Kuwait Companies Law of 2016, Article 134.

59 Peter H. Huang, & Michael S. Knoll, *Corporate Finance, Corporate Law and Finance Theory*, 74 S. Cal. L. Rev., 180 (2000).

60 Paul K. Andersen, *Corporate governance in Denmark* 13 (Stockholm Institute for Scandinavian Law 2003).

61 Elliot, & Elliot, *supra* note 18, at 267.

62 Kuwait Companies Law of 2016, Article 170.

of shares is another method to reduce capital.⁶³ Kuwait Capital Markets Law specified that ordinary shares and treasury shares may be canceled in this method.⁶⁴ In this regard, Kuwait's Companies Law requires a resolution by the extraordinary general meeting, based on a reasoned proposal of the board of directors and following approval of the Capital Markets Authority to reduce the company's capital in any of the following cases:⁶⁵

- 1- If the company's capital is found higher than its requirements.
- 2- If the company suffers losses that cannot be covered by its profits.
- 3- Any other cases specified by the executive regulations.

Kuwaiti law, in addition to numerous laws in other jurisdictions, does not place capital reduction under the company's willpower and is subject to the business judgment of the board even if the supervision of the general meeting of shareholders is present. However, cases of capital reduction are provided to avoid any abuse by members of the board and to further protect shareholders and creditors.⁶⁶

9 Other Uses of Treasury Shares

Alongside using treasury shares as a tool for capital structuring, other uses are evident in modern corporate practice. Treasury shares are either held in treasury or canceled upon finalizing the share buyback process.

10 Holding Treasury Shares

Holding treasury shares refers to holding repurchased shares in the company's possession without canceling them immediately, or reissuing them, instead, they are kept in the company's treasury. There is no obligation to sell or cancel treasury shares after a buyback except if the company's shares exceed the threshold of ten percent of the share capital which must as a matter of law be re-sold or canceled using a capital reduction within two years.⁶⁷ Therefore, companies may keep them for several reasons. The advantages of holding treasury shares include having more freedom to respond to investor perceptions of the amount of debt a firm uses to fund its operations in relation to equity capital. Therefore, companies would reissue the shares if the debt is thought to be too high. Additionally, by using shares held in treasury, a corporation has the ability to fulfill employee share options and loan conversions without having to issue additional shares, which would alter the ownership of existing shareholders.⁶⁸ Companies may also resort to holding treasury shares in order to maintain the stability of the share price of the listed company or to reduce the company's capital. Some comparative laws introduced a maximum holding period. While in Kuwait, such a period is not specified. For instance, a maximum

63 *Id.*

64 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 15-14.

65 Kuwait Companies Law of 2016, Article 168.

66 See for example: Danish Companies Act of 2021, Articles. 185-193; Swiss Civil Code of 1911, Articles. 653j-653r.

67 Swiss Civil Code of 1911, Article 659.

68 Elliot, & Elliot, *supra* note 18, at 274.

holding period is specified in Swedish law at three years, or else treasury shares are declared void by the company and a proposal of a reduction of capital by the portion of the share capital represented by such shares is presented to the general meeting.⁶⁹ This means that under Swedish law, a company can hold its own shares in its treasury for up to three years. If the company fails to sell or dispose of its shares within the three-year period, treasury shares are declared void by the company and the company is required to propose a reduction of capital to the general meeting. This reduction of capital is equal to the percentage of the share capital represented by the voided shares. In result, the company's capital structure is adjusted to reflect the removal of these shares. This stance in Swedish law encourages companies to actively manage their treasury shares and prevents them from holding these shares indefinitely. Holding treasury shares for a long period would dilute the ownership interests of other shareholders. On the other hand, this provision also ensures accountability by requiring the approval for the reduction of capital at a general meeting. Meanwhile, in Kuwaiti law, companies holding treasury shares may:⁷⁰

- 1- Resell the purchased shares, as a general rule.
- 2- Reduce the company's paid-up capital.
- 3- Settle the company's account receivables.
- 4- Maintain stability of the company's share price.
- 5- Repay a debt against these shares.
- 6- Repay an existing debt.
- 7- Distribute treasury shares as bonus shares to shareholders without an increase of the capital or the number of Shares issued.
- 8- Use treasury shares in swap deals in cases of mergers and acquisitions of other companies.
- 9- Distribute treasury shares to its employees, subject to the approval of the general assembly.
- 10- Lend or borrow treasury shares for market-making for listed companies.

Furthermore, since treasury shares can be re-sold following a resolution of the board of directors, requirements regarding the reselling have to be met. In this matter, Shareholders must be treated equally by granting an equal right to buy treasury shares, and public disclosure is needed.⁷¹ Legal restrictions also apply to avoid insider trading. Insider trading is using information that is not accessible to the

⁶⁹ Swedish Companies Act of 2005, Chapter 19, Section. 6.

⁷⁰ Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-2.

⁷¹ *Id.*, Article 14-18.

public in the interest of an inside dealer.⁷² Insider trading is prohibited under Kuwait Capital Markets Law and criminal penalties are incurred by any insider who traded security while in control of insider information, or revealed insider information, or gave advice based on insider information to another person. Penalties also apply to any person who traded a security based on insider information attained from an insider, while being aware of the nature of such information, for the purpose of achieving any benefit for himself or others.⁷³ Swiss law, with respect to insider trading, also prohibits the abuse of privileged non-public information.⁷⁴ As a result, regulations introduced a cooling-off period as a new restriction to prevent insider trading. A cooling-off period represents a temporarily waiting period where transactions regarding treasury shares are prohibited to give regulators time to review the transaction. Kuwait's regulations set this period at ten business days before a company discloses its financial statements or any other significant information that may affect the company's shares.⁷⁵ Cooling-off periods imply less information for the insider, resulting in the share price revealing less information and equalizing the risk-sharing opportunities resulting in maximizing shareholders' welfare.⁷⁶ In addition, further supervision is apparent in Kuwait's regulatory rules as the company holding treasury shares is obligated to submit a report to the Capital Markets Authority at the end of each fiscal year explaining the justifications for holding those shares, provided that the report is submitted within ten working days of the end of the fiscal year for which the report is prepared. The company is also obligated to submit a quarterly report to the Authority that includes all transactions carried out on its shares for the period for which the report is submitted, accompanied by a treasury share balance letter certified by the clearing agency, and this report must be submitted within a maximum period of ten working days from the end of the aforementioned period.⁷⁷

11 Cancelling Treasury Shares

Companies that achieve profitability may rush to cancel treasury shares instead of reusing them elsewhere. Canceling treasury shares is the process through which the company cancels its shares that have been repurchased from its issued capital and held in its treasury aiming to reduce the company's capital. Kuwait Capital Markets Law bylaws stipulate that the company's purchase of treasury shares for the purpose of canceling them is one of the ways to reduce the capital.⁷⁸ Comparative law also indicates that capital may be reduced by canceling shares.⁷⁹ One of the most important effects of canceling treasury shares is the reduction of the company's capital, as the company resorts to buying its shares from shareholders to cancel them if it wants to reduce its capital, and thus, withdraws part of its shares

72 Al Shuraian, *supra* note 42, at 60.

73 Kuwait Capital Markets Law of 2010, Article 118.

74 Swiss Penal Code of 1937, Article 161.

75 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-19.

76 Jun Deng et al. *Disclosing and Cooling-Off: An Analysis of Insider Trading Rules 21* (Rotman School of Management Working Paper 2022).

77 Kuwait Capital Markets Law Executive Bylaws, Module Eleven: Dealing in Securities, Article 14-10.

78 *Id.*, Article 15-14.

79 See for example: Swiss Civil Code of 1911, Article 653j; UAE Commercial Companies Law of 2021, Article 205.

by buying part of the traded shares and then canceling them. The cancellation of treasury shares also eliminates the threats posed by rival companies to acquire the company. Many corporations often resort to acquiring other enterprises for economic concentration, expansion, and elimination of competitors in the market. In addition, companies may resort to treasury shares to protect themselves from the acquisition of competitors and disruption of the decision-making mechanism within the company. By canceling treasury shares, the company withdraws and cancels the shares on the market to stop competing companies from buying these shares. Another outcome of treasury shares cancellation is increasing earnings per share as it leads to a reduction of the company's capital and consequently, a reduction of the number of shares. This leads to avoiding dividend payments on these shares and therefore, increases the profitability of the remaining shares and increases their price on the stock market. However, this effect remains until the shares are canceled.⁸⁰ Since treasury shares can only be bought out of surplus, the surplus is permanently reduced by the purchase of treasury shares, and retaining treasury shares has the outcome of freezing or rendering a portion of the surplus equal to the cost of the treasury shares unattainable for dividends or further share purchase. Cancelling treasury shares frees the frozen surplus aforementioned to the extent of the reduction of capital affected by cancellation.⁸¹ Consequently, the cancellation of treasury shares leads to a reduction of capital. Therefore, if a share reacquisition was intended to cancel the reacquired shares, treasury shares only exist in the period prior to that cancellation in accordance with the process of reduction of corporate capital.⁸²

3 Conclusion

This comparative study has provided a comprehensive analysis of the regulatory framework of treasury shares, examining the legal provisions and practical implications in multiple jurisdictions. Throughout the research, significant differences and similarities between various legal systems were noted, shedding light on essential aspects of corporate finance and governance in relation to treasury shares. The findings of this study indicate that while legislations identify treasury shares as a viable tool in corporate finance, they adopt distinct approaches in their regulations and application. Kuwaiti law takes a more conservative and protective position, stressing the need to protect shareholder interests and maintain financial stability. On the other hand, other laws adopt a more liberal and flexible approach, granting companies more freedom to manage their capital structure using treasury shares. The use of treasury shares offers numerous advantages for shareholding companies. Treasury shares offer companies the flexibility to adjust capital structure and allocate resources effectively, adapting to changing circumstances and strategic objectives.

Despite the benefits, this study has also identified potential challenges and risks associated with the use of treasury shares. Misuse or improper handling of treasury shares can lead to over-market

80 Mohammed, & Al Jund, *supra* note 57, at 427-429.

81 Wilber G. Katz, *Review of Capital Surplus and Corporate Net Worth by Raymond P. Marple*, 4 University of Chicago Law Review 350, 351 (1937).

82 Roger H. Hermanson et al. *Accounting Principles: A Business Perspective* 533 (Endeavour International Corporation, Houston, Texas, USA, 2011).

manipulation. Therefore, companies and regulatory bodies must balance between promoting capital efficiency and ensuring transparency and accountability in the management of treasury shares. By analyzing the experiences of Kuwait and other jurisdictions in handling treasury shares, valuable insights that can inform and guide future corporate governance practices and regulatory improvements worldwide are gained. In light of this, many recommendations are essential to promote the efficient, practical, and sensible use of treasury shares in Kuwait including:

- 1- Allowing companies to buy back shares where it is necessary to avoid an imminent detriment to the company without authority from the general meeting providing notification is given to shareholders.
- 2- Regulating on-market and off-market buy-backs with specific provisions for each method.
- 3- Regulating void buy-backs and the fate of treasury shares in that situation.
- 4- Allowing companies to buy part of the issued capital in the case of an unfulfilled IPO.
- 5- Introducing a maximum holding period regarding companies holding treasury shares.

In conclusion, this comparative study highlights the importance of treasury shares as a strategic tool for capital structure in shareholding companies and underscores the significance of tailored legal frameworks that suit the unique characteristics and objectives of each jurisdiction. By fostering transparency, accountability, and investor confidence, companies can effectively leverage treasury shares to optimize their capital structure and create sustainable value for shareholders and stakeholders alike. As legislations continue to refine their corporate governance practices, it is crucial to monitor and adapt to emerging trends in treasury share utilization, ensuring a dynamic and resilient framework that supports the use of treasury shares as an integral part of corporate finance.

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