

# RED TAPE AROUND EMPLOYMENT SHARE SCHEMES STRIPPED BACK

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## Australia Corporate Alert

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The *Treasury Laws Amendment (Cost of Living Support and Other Measures) Act 2022* (the ESS Act), which received royal assent on 31 March 2022, introduces a new Division 1A into Part 7.12 of the *Corporations Act 2001* (Cth). The ESS Act, which takes effect from 1 October 2022, will significantly decrease red tape for companies (especially startups) and registered schemes looking to attract, retain or reward employees through offers to participate in an employee share scheme (ESS).

Specifically, the ESS Act makes it easier for companies and registered schemes to access 'regulatory relief' from the Corporations Act's securities disclosure, licensing, advertising, anti-hawking and on-sale regulatory requirements which would otherwise apply when making offers of interests under an ESS.

## CURRENT LAW

In order to make an offer of shares or options to investors or employees in Australia, the issuing body must comply with the following requirements of the Corporations Act (Disclosure Requirements), all of which take time and attract significant cost:

- The disclosure requirements for the issue, sale and transfer of securities (Parts 6D.2 and 6D.3) and financial products (Part 7.9);
- The restrictions on advertising of offers for the issue, sale and transfer of securities (section 734) or financial products (section 1018A);
- The requirement to make a target market determination for a financial product and distribute financial products in accordance with a target market determination (Part 7.8A);
- The requirement to hold an Australian financial services licence for a financial service provided in relation to the employee share scheme (section 911A);
- The prohibition on the hawking of financial products (section 992A); and
- The restrictions in s707 and 1012C on the on-sale of financial products issued without disclosure within 12 months of their issue.

To avoid the application of the Disclosure Requirements entities have relied largely on the regulatory relief provided by the ASIC Class Orders regime, namely [CO 14/1000] *Employee incentive schemes: Listed bodies* and ASIC Class Order [CO 14/1001] *Employee incentive schemes: Unlisted bodies* (Class Orders).

The ESS Act is set to replace the Class Orders. While the ESS Act will provide very similar regulatory relief as the Class Orders, the requirements to be met in order to qualify for relief are significantly less onerous, particularly for unlisted bodies. The table below outlines the key changes between the ESS Act and the Class Orders.

In addition to the Class Orders, there are also two specific exemptions from the Disclosure Requirements set out in the Corporations Act. These exemptions apply to offers made to 'senior managers' and small-scale offerings (<20 acceptances and <AU\$2 million raised in any one year). These exemptions (which by themselves offer relief in very limited circumstances) will remain in force, and will exist alongside the new ESS Act.

## KEY CHANGES

Issue	Current Position Under the Class Orders	Position from 1 October 2022
<b>General Changes</b>		
<b>Eligible Participants</b>	<ul style="list-style-type: none"> <li>▪ Directors</li> <li>▪ Full-time and part-time employees</li> <li>▪ Casual employees and contractors, provided they work the number of hours that are the pro-rata equivalent of 40% or more of a comparable full-time position with the entity.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Directors</li> <li>▪ Full-time and part-time employees</li> <li>▪ Any service providers to the entity (with no minimum requirement of hours of service provided)</li> <li>▪ Certain 'related persons' to the 'primary participant' above, including a family member, or a corporation or trust controlled by the primary participant.</li> </ul>
<b>ASIC Involvement</b>	A 'Notice of Reliance' must be submitted to ASIC to rely on the Class Order relief.	There are no ASIC lodgement requirements.
<b>On-Sale Relief</b>	Relief is provided from the Corporations Act on-sale provisions for securities issued under the Class Order.	<p>There is no equivalent relief under the ESS Act.</p> <p>The only exception in the ESS Act is where a participant reasonably believes they are only selling their interest to another participant in the same employee share scheme.</p>

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		In all other circumstances where ESS interests are on-sold within 12 months of issue, cleansing notices will need to be issued.
<b>Changes Specific to Listed Bodies</b>		
<b>Issue Cap</b>	The maximum number of ESS interests that can be issued under the Class Order relief over a three-year period is 5% of its share capital.	<p><b>If the offer of ESS interests is for no monetary consideration:</b> There is no limit on the number of such ESS interests that may be issued.</p> <p><b>If the offer of ESS interests is for monetary consideration:</b> The same 5% applies, <i>however</i> entities have the ability to specify a different issue cap in their constitution (there are no limits on what this can be).</p>
<b>Quotation Requirement</b>	An entity's shares must have been quoted for three months before the Class Order relief is available.	Newly listed entities can offer ESS interests under the new regime without any minimum quotation period. This will make it much simpler for newly listed entities to offer ESS interests.
<b>Suspension</b>	For the Class Order relief to be available, the entity's shares must not have been suspended for more than five days over the previous 12 months.	The new regime permits an entity to offer ESS interests regardless of any suspension to the trading of its shares.
<b>Disclosure Requirements</b>	<p>Participants must be given an offer document that includes:</p> <ul style="list-style-type: none"> <li>▪ The terms or a summary of the terms of the ESS;</li> <li>▪ Information relating to special features (e.g., the terms of any loan or contribution plan</li> </ul>	<b>If the offer of ESS interests is for no monetary consideration:</b> No disclosure is required other than that the offer must be expressed to be made under Division 1A of Part 7.12 of the Corporations Act, with the exception of option plans and incentive rights (see below).

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	<p>offered and information on trust arrangements);</p> <ul style="list-style-type: none"> <li>▪ Pricing information; and</li> <li>▪ An advice warning and general product risk warning.</li> </ul>	<p><b>If the offer of ESS interests is for monetary consideration and payment is upfront:</b> Participants must be provided with an ESS offer document which is substantially the same as the offer document required under the Class Order, but with the following additional requirements:</p> <ul style="list-style-type: none"> <li>▪ An offer document must now be provided 14 days before making the offer;</li> <li>▪ A requirement to state the acquisition price (or method of attaining a future acquisition price); and</li> <li>▪ A requirement to draw the participant's attention to relevant disclosure documents produced in the previous 12 months.</li> </ul> <p><b>Offers of option plans and incentive rights:</b></p> <ul style="list-style-type: none"> <li>▪ Option plans and incentive rights require an ESS offer document at the point of offer, regardless of whether acceptance of the offer requires payment or not.</li> </ul>
<b>Changes Specific to Unlisted Bodies</b>		
<b>Issue Cap</b>	The maximum number of ESS interests that can be issued under the Class Order relief over a three-year period is 20% of share capital.	<b>If the offer of ESS interests is for no monetary consideration:</b> There is no limit on the number of such ESS interests that may be issued.

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		<p><b>If the offer of ESS interests is for monetary consideration:</b> The same 20% cap applies, <i>however</i> entities have the ability to specify a different issue cap in their constitution (there are no limits on what this can be).</p>
<p><b>Value of Offer (Value of Underlying ESS Interest)</b></p>	<p>The value of all offers of ESS interests to any person in any 12-month period must not exceed AU\$5,000 (based on the most recent directors' valuation resolution).</p>	<p>No limitations on value – can issue an unlimited amount subject to issue cap (above) and monetary cap (below).</p>
<p><b>Monetary Cap</b></p>	<p>All offers by unlisted bodies and their wholly owned subsidiaries must be made for no more than nominal monetary consideration (token or trivial amount) at the time of the offer.</p> <p>Monetary consideration for options and incentive rights is not required at the time of the offer, so it is excluded from the above cap, however such an offer will only have the benefit of relief if:</p> <ul style="list-style-type: none"> <li>▪ The underlying securities have been quoted for three months and have not been suspended for more than five trading days; or</li> <li>▪ A valuation document is provided to the participant no later than 14 days before exercise or vesting.</li> </ul>	<p>In relation to all ESS interests:</p> <p>A participant cannot pay in any 12 month period more than a monetary cap calculated as:</p> <ul style="list-style-type: none"> <li>▪ AU\$30,000; plus</li> <li>▪ 70% of the sum of the amounts of any distributions on ESS interests and cash bonuses received by the participant in the relevant 12 month period.</li> </ul> <p>In the case where the ESS interests are options or incentive rights, the AU\$30,000 component of the monetary cap (to the extent not utilised by the participant in exercising the options or incentive rights in a 12 month period) can be carried forward for up to a further four years i.e., a maximum of AU\$150,000 cumulative over 5 years.</p> <p>Note: by definition, contribution plans and loan arrangements require a</p>

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		<p>participant to make a monetary contribution to acquire the interest. For this reason they were excluded under the Class Orders (which had a very strict monetary cap). The monetary cap under the ESS Act has been relaxed, meaning unlisted bodies can now use contribution plans and loan arrangements to offer ESS's.</p>
<b>Disclosure Requirements</b>	<p>Participants must be given an offer document that includes the same requirements imposed on listed bodies above, as well as:</p> <ul style="list-style-type: none"> <li>▪ General information about the risks of acquiring and holding shares, options or incentive rights;</li> <li>▪ If the body has a statutory obligation to prepare an audited financial statement – that audited financial statement OR for all other unlisted bodies – a special purpose financial statement for a 12-month period; and</li> <li>▪ A directors' solvency resolution that is made no later than one month before the offer.</li> </ul>	<p><b>If the offer of ESS interests is for no monetary consideration:</b> No disclosure is required other than that the offer must be expressed to be made under Division 1A of Part 7.12 of the Corporations Act, with the exception of option plans and incentive rights (see below).</p> <p><b>If the offer of ESS interests is for monetary consideration and payment is upfront:</b> Participants must be provided with an offer document which is substantially the same as the offer document required under the Class Order but with the following additional requirements:</p> <ul style="list-style-type: none"> <li>▪ A valuation of the interests being offered; and</li> <li>▪ Draw the participants attention to relevant disclosure documents produced in the previous 12 months.</li> </ul> <p><b>Offers of option plans and incentive rights:</b></p> <ul style="list-style-type: none"> <li>▪ Option plans and incentive</li> </ul>

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		<p>rights require an ESS offer document at the point of offer, regardless of whether acceptance of the offer requires payment or not;</p> <ul style="list-style-type: none"> <li>▪ For offers with no monetary consideration, no further disclosure is required; and</li> <li>▪ For offers with monetary consideration, a second offer document (including a valuation) must be provided to the participant 14 days before the point of exercise.</li> </ul>

## ASX LISTING RULES CONSIDERATIONS

The Listing Rules govern the issue (and authorisation or ratification) of equity securities by a company.

Broadly speaking, and subject to a number of exceptions, Listing Rule 7.1 limits the amount of equity securities that a listed company can issue without the approval of its shareholders over any 12-month period to 15% of the fully paid ordinary securities it had on issue at the start of that period.

Issues of equity securities to persons under an ESS would ordinarily reduce a company's available placement capacity under Listing Rule 7.1, i.e., it would eat away at that available 15%.

However, Listing Rule 7.2 exception 13(b) excludes from the placement capacity restrictions in Listing Rule 7.1 an issue of securities under an ESS if within three years before the issue date the holders of the entity's ordinary securities have approved the issue of securities under the scheme as a Listing Rule 7.2 exception.

It follows that in order to avoid ESS offers eating into that 15% yearly placement capacity, companies may wish to arrange for shareholder approval of the maximum number of securities proposed to be issued under the scheme (over a three-year period).

In light of the ESS Act, this maximum number, when represented as a percentage of issued share capital, should ideally match any newly specified issue cap.

With AGM season upon us, it would be wise to include a resolution seeking such shareholder approval at upcoming AGMs.



## NEXT STEPS

For those companies and registered schemes which have existing ESS policies and offer documentation, they will need to update these to ensure the entity is afforded the relief provided by the new regime. Companies may also wish to amend their constitution to increase the issue cap in order to allow them to issue a greater percentage of their share capital under an ESS.

For many unlisted companies, the relaxation of the qualification requirements will mean they can soon implement an ESS where previously they could not, meaning new ESS policies and offer documentation will need drafting from scratch.

For entities making offers under their ESS in the meantime, they will need to continue to comply with the existing law, including relying on the current Class Orders where their conditions can be met.

## KEY CONTACTS



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