EXPLANATORY MEMORANDUM TO

THE COMPANIES ACT 2006 (ALLOTMENT OF SHARES AND RIGHT OF PRE-EMPTION) (AMENDMENT) REGULATIONS 2009

2009 No. 2561

1. 1.1 This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 These Regulations amend the Companies Act 2006 so as to correct errors in the provisions on pre-emption rights and directors' authority to allot shares.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 The instrument is being laid for fewer than 21 days before it takes effect on 1 October 2009. This is because it would have been impossible to make and lay it sooner, and it is essential that it should come into effect on that date, for the reasons explained below.

3.2 Although the defective provisions of the Companies Act 2006 have been on the statute book since November 2006, they are not yet in force and it was only in the second half of August this year that a firm of city solicitors drew the problem to the Department's attention. Having understood the problem, we needed to work urgently with Parliamentary Counsel and stakeholders to agree on the changes necessary.

3.3 The Regulations correct errors in the Companies Act 2006 in provisions that will take effect on 1 October 2009. If the corrections came into effect any later, then there would be a gap in early October when the erroneous provisions applied. This could prevent companies from proceeding with certain transactions, and it could seriously jeopardise any allotments in progress at that time. It is therefore essential that the instrument should come into effect on 1 October 2009.

4. Legislative Context

4.1 The Companies Act 2006 received Royal Assent in November 2006. It contained many provisions (including those on pre-emption rights and directors' authority to allot shares that are being corrected by this instrument) that simply re-stated provisions of the Companies Act 1985 and the Companies (Northern Ireland) Order 1986. While the Act was before Parliament, Ministers made it clear that the intention of such provisions was to restate the old law in more modern terms, but not to change its substantive effect except for two reasons: to ensure consistency with

other provisions in the Bill and to ensure compliance with EC obligations. (See for example Hansard, House of Lords, 2 November 2006, column 432.)

4.2 The Act is being commenced in stages, with the final provisions coming into effect on 1 October 2009.

4.3 The provisions on pre-emption rights currently in the Companies Act 1985 and the Companies (Northern Ireland) Order 1986, so far as they relate to public companies, implement Article 29 of the Second EU Company Law Directive (77/91/EEC). The provisions on directors' authority to allot shares, as they relate to public companies, implement Article 25 of the Directive. Both sets of provisions take advantage of the power to derogate, in relation to employee share schemes, under Article 41 of the Directive.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 Ian Lucas, Minister for Business and Regulatory Reform, has made the following statement regarding Human Rights:

> In my view the provisions of the Companies Act 2006 (Allotment of Shares and Right of Pre-emption) (Amendment) Regulations 2009 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 When a company allots new shares, existing shareholders have pre-emption rights: that is, the company cannot as a rule allot new shares without first having offered them to the existing shareholders pro rata to their holdings. This ensures that the shareholders have the opportunity to maintain the percentage of the company that they own. There are methods by which the rights can be waived. And there are exemptions from the rule for allotments for non-cash consideration, and for allotments in connection with employee share schemes. The exemption relating to employee share schemes takes advantage of the power to derogate under Article 41 of the Second EU Company Law Directive. When shares are allotted in two stages, as a right (eg a convertible bond) followed by allotment of the share, the pre-emption rights apply only to the issue of the right, and never to the subsequent allotment. That is consistent with Article 29(6) of the Directive. The Directive applies only to public companies but the relevant provisions of the Companies Act 1985 and the Companies (Northern Ireland) Order 1986 apply both to public and private companies.

7.2 Sections 560 to 577 of the Companies Act 2006 were intended to continue these rules on pre-emption rights, replacing the corresponding provisions of the Companies Act 1985 and the Companies (Northern Ireland) Order 1986, but they are defective in two ways. First, the exemptions do not apply properly to two-stage

allotments, so that, for example, after properly issuing a convertible bond for non-cash consideration, a company would find that it was not allowed to allot the shares on conversion without having made an offer to other shareholders. In that respect we consider that the provisions, as they relate to public companies, are inconsistent with Article 29(6) of the Second EU Company Law Directive. The second problem is that the exemption for employee share schemes (authorised by Article 41 of the Directive) has been worded more narrowly, and so could fail to exempt schemes where shares are to be held by the employees in their own names.

7.3 The Regulations correct both of these defects and ensure that the relevant provisions of the Companies Act 2006 will have the same effect as the Companies Act 1985 and the Companies (Northern Ireland) Order 1986 when those provisions come into force on 1 October 2009. The corrections apply to the law as it affects both public and private companies. We consider it necessary to maintain consistency between these parallel regimes.

7.4 The Regulations also correct a similar defect in section 549 of the Companies Act 2006. Section 549 imposes conditions on the exercise by company directors of the company's power to allot shares. As it relates to public companies, it forms part of the implementation of Article 25 of the Second EU Council Directive, taking advantage of the power to derogate (in relation to employee share schemes) in Article 41 of the Directive. It is not intended to apply to the allotment of shares in pursuance of an employee share scheme or to the grant of a right to subscribe for, or to convert any security into, shares allotted in pursuance of such a scheme. Such allotments and grants are excluded from the corresponding provisions of the Companies Act 1985 and the Companies (Northern Ireland) Order 1986. However, section 549 is not as clearly drafted as it might be in this respect. The Regulations therefore correct the drafting. The correction affects the law as it applies both to public and private companies. We consider it necessary to maintain consistency.

8. Consultation outcome

8.1 In the time available, we have consulted the lawyers who raised the issue on our proposed resolution, and also members of our advisory group on the implementation of the Companies Act. No-one we consulted disagreed with the proposed corrections.

9. Guidance

9.1 Companies House provides guidance on company law, including pre-emption rights and directors' authority to allot shares, on its website: www.companieshouse.gov.uk.

10. Impact

10.1 By correcting errors in the Companies Act 2006, this instrument will ensure there is no adverse impact on businesses or others of an unplanned change in the law on pre-emption rights and directors' authority to allot shares.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument.

11. Regulating small business

11.1 The legislation applies to all companies, including small businesses. No special provision has been made for small business.

12. Monitoring & review

12.1 This instrument will be reviewed from 2011, as part of the Companies Act 2006 evaluation.

13. Contact

13.1 Richard Grafen at the Department for Business, Innovation and Skills (tel: 020 7215 5323) or email: richard.grafen@bis.gsi.gov.uk can answer any queries regarding the instrument.