EXPLANATORY MEMORANDUM TO

THE COMPANIES (SHARE CAPITAL AND ACQUISITION BY COMPANY OF ITS OWN SHARES) REGULATIONS 2009

SI 2009 No. [XXXX]

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

2. Purpose of the Instrument

2.1 The Regulations change 3 elements of the Companies Act 2006 to:

- reduce the minimum pre-emption rights issue subscription period set out in section 562(5) of the Act from 21 days to 14 days. This amendment will align UK and EU Company law (Directive 77/91/EEC) in this area.
- introduce a requirement in section 646 of the Act so that, when creditors object to a reduction in a company's capital, they should demonstrate that their claim is at risk and that the company has not provided adequate safeguards. A mandatory requirement arising from EC Directive 2006/68.
- repeal section 725 of the Act to remove the 10% limit on companies holding shares in treasury, they also amend sections 694, 697, 700 and 701 to extend the period for which authorisation may be given for the purchase by a company of its own shares from 18 months to 5 years. An option arising from EC Directive 2006/68.

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

3.1 None.

4. Legislative Context

4.1 Section 562 (5) of the Companies Act 2006 sets the minimum period for which pre-emptive offers must be open to existing shareholders when companies issue new shares. These regulations change that period from 21 days to 14 days in line with the minimum requirement set out in Article 29(3) of Council Directive 77/91/EEC (the Second Company Law Directive).

4.2 Sections 645 to 653 of the Companies Act 2006 deal with court-approved capital reductions by limited companies. These Regulations implement the changes made by Article 1(9) of Directive 2006/68/EC to Article 32(1) of Council Directive 77/91/EEC (the Second Company Law Directive), and make the same changes to the law applying to private companies (the Directives only apply to public companies). A Transposition Note is attached at Annex A.

4.3 The Regulations implement changes made by Article 1(4) of Directive 2006/68/EC to Article 19 of Directive of Council Directive 77/91/EEC (the Second Company Law Directive) by repealing section 725 of the Companies Act 2006 to remove the maximum holding of shares in Treasury; and by amending the

authorisation period for purchases which is set out in sections 694 and 697 of the Act in the case of off market purchases of shares and section 701 in the case of the authorisation period for market purchases. A transposition note is attached at Annex A.

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 (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 are compatible with the Convention rights.

7. Policy background

7.1 **Pre-emption rights issue subscription period:** Rights issues are a common capital raising technique for companies in the United Kingdom. When making a rights issue, companies can depending on circumstances choose to use a statutory route where, shares must be offered to existing shareholders in proportion to their existing holdings (pre-emption rights) in accordance with provisions in the Companies Act 2006. Or they can with the agreement of shareholders choose to take a "non-statutory" route which may disapply some or all of the shareholders' pre-emption rights in the Companies Act 2006. At present a rights issue can take at least 39 days from the date of being formally launched and can take considerably longer.

7.2 In June 2008, a high level Group of senior practitioners and experts was established to examine aspects of current market practices concerning equity capital raising by public companies admitted to trading on UK markets and their interaction with company law, and regulatory requirements. The Rights Issue Review Group (RIRG) reported back to the Chancellor in November 2008. One of the recommendations of the Group was to reduce the rights issue subscription period. Together with other recommendations made by the group this measure could contribute to a significant reduction in the period when a company (and its reputation) is at risk and its share price open to potential abuse.

7.3 **Creditor Protection**: Article 1(9) of Directive 2006/68/EC is intended to enhance standardised creditor protection in all European Members States by ensuring that creditors under certain conditions can resort to judicial or administrative proceedings where their claims are at stake as a consequence of a reduction the capital of a public limited liability company. The conditions are that they can credibly demonstrate that their claim is at stake and that adequate safeguards have not been obtained from the company. SI 2008/719 implemented this requirement in the Companies Act 1985 from 6 April 2008. Previously in the UK all creditors could object to a reduction in a company's capital regardless of whether their claim was at stake. The amendment introduced by the Regulations clarifies the requirement for creditors to demonstrate that their claims are at risk when objecting to a reduction in a company's capital under the Companies Act 2006.

7.4 **Acquisition of Shares**: The purpose of Article 1(4) of Directive 2006/68 is to enhance flexibility and reduce the administrative burden for companies which have to react promptly to developments affecting the prices of their shares by allowing public limited liability companies to acquire their own share up to the limit of the company's distributable reserves. The removal of the limit on companies holding shares and the extension of the period of authorisation for purchases from 18 months to 5 years will provide companies with additional flexibility to manage their capital without adding burdens or costs to companies. Protection of shareholders' rights would be achieved - through the requirement to seek shareholder consent to purchases and their use including arrangements to sell.The sale of shares held in treasury will be subject to pre-emption rights and should be offered to existing shareholders first unless they agree to waive their rights.

8. Consultation Outcome

8.1 **Pre-emption rights issue subscription period**: In June 2008, a high level Group of senior practitioners and experts was established to examine aspects of current market practices concerning equity capital raising by public companies admitted to trading on UK markets and their interaction with company law, and regulatory requirements. The role of the Group was to examine and report on whether there are measures which could be taken to make equity capital raising more efficient and orderly, while continuing to take proper account of the rights of shareholders and the need to promote financial stability. The findings and recommendations of the Group were published as part of the Government's pre-budget report on 24 November 2008. In reaching its recommendations the Group met with 50 consultees.

8.2 **Creditor Protection and Acquisition of Shares**: The proposed Directive was subject to consultation in the UK during March to June 2005. Small stakeholder groups and roundtables were also established to consider the proposals in the Directive. The government response and a summary of responses to the consultation were published in September 2005. Most respondents were in favour of the proposals in the Directive. Of those responding on the acquisition of shares, most suggested that companies should be able to purchase and hold shares to the limit of distributable reserves rather than proposing a new/higher cap. Further consultation on proposals for implementing Directive 2006/68/EC took place in February 2007. The consultation closed on 1 June 2007. The consultation was published on the Department's website and an email alert sent to over 700 individuals and organisations. The response though small supported implementing the standardised creditor protection arrangements and the removal of the cap on companies holding their own shares. The government response to the consultation was published on the BERR website in July 2007. Draft Companies (Reduction of Capital) (Creditor Protection) Regulations were published on the department's website in October 2007 for comment. Although a number of changes were suggested to the creditor protection arrangements those responding supported the change but suggested a number of changes to simplify proposals which were reflected in the final Regulations.

8.3 Draft Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 were published on the BERR website for comment during March 2009, and an email alert was sent to over 700 individuals and organisations. There was a small response to the draft regulations and the majority of those responding were in favour of the changes. The government response will be published on the BIS website.

9. Guidance

9.1 Guidance on Share Capital is available in the Companies House 'Life of a Company – Part 2 - Event Driven Filings 'guide which will be updated to reflect changes made by the Regulations.

10. Impact

10.1 Impact Assessments for each of the changes made by these Regulations are attached to this memorandum at Annex B.

10.2 These Regulations have no impact on the public sector.

11. Regulating small business

11.1 The legislation applies to small companies with share capital but does not impose new requirements on them.

12. Monitoring and review

12.1 These measures are due to be reviewed in 2014, 5 years after implementation.

13. Contact

13.1 Julie Ford at the Department for Business, Innovation and Skills, Telephone: 020 7215 2162 or e-mail: Julie.Ford@berr.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Interventions & Options		
Department / Agency: The Department for Business, Innovation and skills (BIS)	**Title:** The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: Rights Issues	
Stage: implementation	**Version:** One	**Date:** June 2009
Related Publications: A Report to the Chancellor of the Exchequer by the Rights Issue Review Group http://www.hm-treasury.gov.uk/d/pbr08_rightsissue_3050.pdf		
Contact for enquires: Julie Ford	**Telephone :** 020 7215 2162	

What is the problem under consideration? Why is government intervention necessary?

At present a rights issue can take at least 39 days from the date of being formally launched. This could make share prices open to potential abuse and hinder market efficiency. The Government intervention is necessary to speed up the rights issue process and increase the speed of access to equity capital, and help the market to function more effectively.

What are the policy objectives and the intended effects?

To make equity raising more efficient and orderly by reducing the time required by companies to raise equity and reduce exposure by companies raising capital to market volatility and abuse by implementing a recommendation from the Rights Issue Review Group that FSA and BIS should consult on reducing the rights issue subscription period from 21 to 14 days.

What policy options have been considered? Please justify any preferred option.

1. Amend the Companies Act 2006 to reduce the subscription period for pre-emption rights issues from 21 days to 14 days.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Five years after implementation – 2014.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Mr Ian Lucas .....Date: 16 June 2009

…….

Summary: Analysis & Evidence

Policy Option: 1	Description: **Amend the Companies Act to reduce the period of notice for pre-emption rights issues from 21day to 14 days.**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	There are no specific monetary costs associated with this measure.
£ 0.00	**0**	
Average Annual Cost (excluding one-off)		
£ 0.00		**Total Cost** (PV) **£ 0.00**

Other **key non-monetised costs** by 'main affected groups' The reduction in the period of notice may have an impact on shareholders' decision making ability but may be offset by electronic communication, it may stop companies using other means of raising capital that may dilute their holding or pre-emption rights.

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups'
One-off	**Yrs**	
£ 0.00	**0**	
Average Annual Benefit (excluding one-off)		
£ 0.00		**Total Benefit** (PV) **£ 0.00**

Other **key non-monetised benefits** by 'main affected groups' The option to reduce the time taken to undertake a Pre-emptive Rights Issue will speed up access to capital and reduce exposure to market volatility and abuse.

Key Assumptions/Sensitivities/Risks

This is an optional flexibility for public companies trying to raise capital they can continue to apply a 21 day period of notice if it suits their requirements.

Price Base Year 0	Time Period Years 0	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			01 October 2009	
Which organisation(s) will enforce the policy?			BERR	
What is the total annual cost of enforcement for these organisations?			£ not known	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)
Increase of	£ 0	Decrease £ 0	**Net**	**£** 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: Rights Issues

PROPOSAL

1. To reduce the period of notice for pre-emption rights issues in section 562 (5) of the Companies Act 2006, from 21 to 14 days in line with the minimum period of notice permissible under Article 29 (3) of the Second Company Law Directive (77/91/EEC) [1], as recommended by the Rights Issue Review Group (RIRG) in November 2008[2].

OBJECTIVE

2. The objective of the proposed change is to help make equity raising more efficient and orderly by reducing time required by companies to raise equity and reduce exposure by companies raising capital to market volatility and abuse.

BACKGROUND

3. The spring and summer of 2008 saw an unusually busy period of capital raising. Companies raised some £23 billion through rights issues, which was a considerable achievement in the market conditions, but it also highlighted a number of vulnerabilities in the process in terms of exposure to market volatility and abuse. Increasing the efficiency of pre-emptive rights can benefit the market, companies and shareholders by helping to ensure that this model of capital raising retains its place in the UK market.

4. In light of the concerns expressed regarding the UK rights issues the Chancellor of the Exchequer set up the Rights Issue Review Group (RIRG) to examine and report to him on measures which could be taken to make equity raising more efficient and orderly.

5. Rights issues are a common capital raising technique for companies in the United Kingdom. Many of the problems that emerged with the financial sector capital raisings were caused or exacerbated by the duration of the rights issues process. For example, potentially abusive trading strategies are aided by the longer period from announcement to completion; and significant market movements that erode discounts are more likely over a longer time spell.

6. At present a rights issue can take at least 39 days from the date of being formally launched. The process can take considerably longer – for example HBOS took 83 days and Bradford & Bingley 96 days.

7. The statutory minimum subscription period for a pre-emptive rights issue is currently set at 21 days under section 562 (5) of the Companies Act 2006. In its report the RIRG recommended that the FSA and the department should consult on

[1] A copy of Directive 77/9//EEC is available from the following link: http://europa.eu.int/eur-lex/en/consleg/pdf/1977/en_1977L0091_do_001.pdf

[2] A copy of the report is available from: http://www.hm-treasury.gov.uk/d/pbr08_rightsissue_3050.pdf

reducing the rights issue subscription period from 21 to 14 days. The Second Company Law Directive which sets the framework for capital maintenance at EU level sets the minimum subscription period required in the case of pre-emptive rights issues at 14 days. Section 562 (6) of the Companies Act 2006 provides the Secretary of State with powers to reduce (to no less than 14 days) or increase the subscription period.

8. Doing nothing is not a viable option if it puts companies at risk due to market volatility or abuse. A shorter period of notice would help to reduce the time required to undertake a Rights Issue. Providing companies with the option to reduce the period of notice to 14 days will not compel them to undertake all rights issues in the shortest possible time. It will however provide them with the option to speed up the process to suit market conditions. The current minimum period of notice for statutory pre-emptive rights issue is 21 days but we have an option to reduce the subscription period to 14 days the minimum period permissible under EU law.

9. Together with other recommendations made by the RIRG reducing the period of notice could lead to a significant improvement in the time required to undertake a rights issue. It would increase speed of access to capital and help to reduce the period when a company (and its reputation) is at risk and its share price open to potential abuse. At present the minimum statutory period of notice is set at 21 days however Article 29 (3) of the Second Company Law Directive (77/91/EC) provides the UK with the option to reduce the minimum period to 14 days.

COSTS AND BENEFITS

10. There would be no direct costs or benefits if UK legislation is left unchanged. However, if the statutory period of notice remains at 21 days, arrangements in the UK may expose companies to increased risk of market volatility and abuse when using statutory or pre-emptive rights issues to raise capital. UK companies would bear the impact of such exposure.

Costs

11. A shorter subscription period should not lead to additional costs.

Benefits

12. The proposed reduction in the pre-emptive rights subscription period would give issuers the opportunity to speed up the rights issue process (by one week). The benefits of this include:

> **Increase speed of access to equity capital**: issuers would be able to complete rights issues seven days earlier than they can now. This would help issuers in need of raising equity capital quickly.

Market and financial risk: if issuers choose to complete rights issues seven days earlier than is currently possible, this would reduce the risk of changes in market and financial conditions.

Market abuse: recent experience suggests that firms are more vulnerable to market abuse when undertaking rights issues than at other times. A reduction in the rights issue subscription period should reduce the risk of market abuse during rights issues. This is because certain market abuse strategies – e.g. spreading rumours – are easier to implement if more time is available.

RISKS

13 A possible consequence of reducing time available to undertake a rights issue - shareholders may not have sufficient time for decision making. However the use and accessibility of electronic communication has increased since this legislation was introduced and this should help offset some of the time lost. There is a danger that if we do not introduce this change then the statutory pre-emptive method of raising capital, which offers investors maximum protection, will become increasingly less attractive than other methods that the company can adopt.

WHO WILL BE AFFECTED?

14. This change will affect all companies other than those private companies which have excluded the provisions of section 562 of the Companies Act 2006 by their articles. In March 2009 there were 1,109 companies UK companies listed on Main Market and 1,680 listed on AIM (UK and International)[3].

ISSUES OF EQUITY AND FAIRNESS

15. We have considered the three mandatory impact tests (gender, race, disability) and the recommended option is unlikely to have any discriminatory effects

SMALL FIRMS IMPACT TEST

16. There is no change in nature or number of the overall population of companies affected by these provisions.

ENFORCEMENT AND SANCTIONS

[3] London Stock Exchange Main Market Statistics are available from: http://www.londonstockexchange.com/NR/rdonlyres/B7841B80-F917-41CE-AC7D-2B3667F91777/0/MainMarketStatistics0903.pdf

17. If shareholders' pre-emption rights under the Companies Act 2006 are contravened, they have a statutory right to compensation from the company and any directors or other officers who were involved in contravening the rights. This will remain the case.

CONSULTATION

18. The RIRG held meetings with over 50 consultees in reaching its recommendations. On 12 January 2009 the Financial Services Authority published a Consultation Paper (CP09/4) covering another recommendation of the RIRG, to reduce the Listing Rules' requirement for the minimum duration of non-statutory rights issue subscription periods, which has since been implemented. There was a small response to this consultation; however the majority of those responding were in favour of the proposed reduction in the statutory subscription period.

COMPETITION ASSESSMENT

19. The competition filter has been applied. It is considered that the proposed change will not give rise to disproportionate costs of entry or administrative costs for either small or large business. The change is not expected to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services

Specific Impact Tests: Checklist

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Y	N
Small Firms Impact Test	Y	N
Legal Aid	N/A	N
Sustainable Development	N/A	N
Carbon Assessment	N/A	N
Other Environment	N/A	N
Health Impact Assessment	N/A	N
Race Equality	Y	N
Disability Equality	Y	N
Gender Equality	Y	N
Human Rights	N/A	N
Rural Proofing	N/A	N

Summary: Intervention & Options

Department /Agency:	Title: **The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: creditor protection on the reduction of a company's share capital**	
The Department for Business, Innovation and Skills (BIS)		
Stage: Implementation	**Version:** One	**Date:** June 2009

Related Publications: **Implementation of Companies Act 2006 Consultative Document February 2007 Available to view or download at:** http://www.berr.gov.uk/consultations/page37980.html

European Company Law and Corporate Governance: Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company and response available to view or download at: http://www.berr.gov.uk/consultations/page14583.html

Contact for enquiries: Julie Ford	**Telephone:** 020 7215 2162

What is the problem under consideration? Why is government intervention necessary?

To implement a requirement introduced by Directive 2006/68/EC that the creditors of a public company can only object to a reduction in the company's share capital if they can demonstrate that their claims are at stake as a result of the proposed reduction

What are the policy objectives and the intended effects?

To improve the efficiency and competitiveness of companies by making it easier for them to react more promptly and at less cost to developments in the markets without reducing the protection offered to shareholders and creditors.

What policy options have been considered? Please justify any preferred option.

Reflect the requirement for creditors to be able to credibly demonstrate that their claims are at stake if they object to a reduction of capital

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Five years after implementation – 2014

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Mr Ian Lucas Date: 16 June 2009.....

Summary: Analysis & Evidence

Policy Option: 1	**Description: Reflect the requirement for creditors to be able to credibly demonstrate that their claims are at stake if they object to a reduction of capital**

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) **Yrs**	
£ 0.00	
Average Annual Cost (excluding one-off)	
£ 0.00	**Total Cost** (PV) **£ 0.00**

Other **key non-monetised costs** by 'main affected groups' The requirement that creditors can only object to a reduction in a company's capital, if they can show that their claim is at stake or has not been adequately safeguarded (rather than all creditors)- may shift costs to creditors. However as it is unlikely that the that the courts would process a claim without evidence - these provisions should not result in additional costs for either party.

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off **Yrs**	
£ 0.00	
Average Annual Benefit (excluding one-off)	
£ 0.00	**Total Benefit** (PV) **£ 0.00**

Other **key non-monetised benefits** by 'main affected groups' In theory the provisions should reduce burdens for companies - if only those creditors that can prove their claim is at stake and has not been adequately safeguarded (rather than all creditors) can object to a reduction in capital. However in practice it is unlikely that the courts would have processed a claim unless there was some evidence that it was at stake so it is unlikely to reduce the level of claims made against companies.

Key Assumptions/Sensitivities/Risks The regulations will apply to public and private limited liability companies

Price Base Year 0	Time Period Years 0	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			01 October 2009	
Which organisation(s) will enforce the policy?			The courts	
What is the total annual cost of enforcement for these organisations?			£ not known	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large

Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ 0	Decrease £ 0	**Net**	**£** 0

Key:	**Annual costs and benefits: Constant Prices**		**(Net) Present Value**

Evidence Base (for summary sheets)

The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: Creditor Protection

PROPOSAL

1. On 29 October 2004 the European Commission published its proposal for a directive of the European Parliament and of the Council to amend Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (The Second Company Law Directive). The amending Directive (2006/68/EC) was published on 25 September 2006. Member states were required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 15 April 2008. This mandatory element has already been implemented in the Companies Act 1985.

OBJECTIVE

2. The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations re-implement a provision required by Directive 2006/68/EC to be in UK law. The Regulations are required because of the replacement of the Companies Act 1985 by the Companies Act 2006. The requirement is for creditors to demonstrate that their claim is at risk and that the company has not taken adequate safeguards when objecting to a reduction in a company's capital. The Directive sought to simplify capital maintenance provisions across the EU, and to improve the efficiency and competitiveness of companies by making it easier for them to react more promptly and at less cost to developments in the markets without reducing the protection offered to shareholders and creditors.

BACKGROUND

3. Under UK law a limited company may reduce its share capital with the approval of the court, and a private company can also reduce its share capital by special resolution supported by a solvency statement. Directive 2006/68/EC requires creditors be given the right to seek relief in respect of a capital reduction scheme "where they can credibly demonstrate that due to the reduction in subscribed capital the satisfaction of their claim is at stake".

4. Even without such express provision in UK law, it is difficult to conceive of circumstances in which a significant creditor could not object if it could credibly demonstrate to the court that its claim was at stake due to a reduction in capital. The notion of capital maintenance holds that capital is a reserve that underpins the security of the claims of creditors. If the company reducing capital is concerned that a creditor cannot demonstrate that a reduction would affect the satisfaction of its claim, it can ask the court to take this factor into consideration.

5. The Department for Business, Enterprise and Regulatory Reform (BERR) published a consultation on implementation of the provisions in Directive 2006/68/EC in February 2006, the consultation closed on 31st May 2007. There was a small response to the consultation. However respondents indicated that, for purposes of clarity, the department should amend the requirement in respect of safeguards for creditors to reflect the shift in the burden of proof from the company to the creditor when objecting to a reduction of capital.

6. Therefore in the interests of clarity the Companies Act 1985 was amended by SI 2008/719, The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008 to introduce this requirement from 6 April 2008. The current proposal is to introduce a similar amendment to the Companies Act 2006 from 1 October 2009.

7. The aim is to provide the clarity that stakeholders required and ensure compliance with the provision in the Directive. Although there will be a shift in the burden of proof from the company to the creditor, creditor safeguards will be maintained for those creditors entitled to object. There may also be a small reduction in administrative burdens for companies involved in such cases.

COSTS AND BENEFITS

8 There would be no change in costs and benefits if UK legislation is left unchanged. However, if UK legislation is left unchanged there is risk of non-compliance and infraction proceedings may lead to UK being fined for infraction.

RISKS

9. UK law already permits creditors to object to capital reduction schemes through the courts. However, once the Companies Act 1985 is repealed, there will be no express requirement that the creditor must demonstrate that its claim is at risk, as the amending Directive requires. If the Companies Act 2006 is not amended lack of clarity may lead to non compliance.

WHO WILL BE AFFECTED?

10. These provisions will apply to all public limited companies that wish to reduce their capital, and private companies that choose to use the court order procedure for capital reduction. Companies House received notification of approximately 500 applications and 200 court orders confirming capital reductions during 2007.

ISSUES OF EQUITY AND FAIRNESS

11. We have considered the three mandatory impact tests (gender, race, disability) and the recommended option is unlikely to have any discriminatory effects.

SMALL FIRMS IMPACT TEST

12. There is no change in nature or number of the overall population of companies affected by these provisions. The shift of the burden of proof from the company to its creditor in the case of a reduction of capital should not adversely affect small companies.

ENFORCEMENT AND SANCTIONS

13. Existing Companies Act provisions apply.

CONSULTATION

14. The consultation on the implementation of the amendments to the 2nd Company Law Directive (Simplification of the Capital Maintenance Rules) was published on 28th February 2007. It formed part of Chapter 6 of the consultation on "Implementation of the Companies Act 2006" the consultation process closed on 31 May 2007 the government response is available from BIS website at: http://www.berr.gov.uk/bbf/eu-company-law/directives/page19528.html. There was a small but favourable response to the publication of the draft regulations.

COMPETITION ASSESSMENT

15. The competition filter has been applied. It is considered that the proposed change will not give rise to disproportionate costs of entry or administrative costs for either small or large business. The proposal is not expected to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services

Specific Impact Tests: Checklist

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Sustainable Development	N/A	N
Carbon Assessment	N/A	N
Other Environment	N/A	N
Health Impact Assessment	N/A	N
Race Equality	Y	N
Disability Equality	Y	N
Gender Equality	Y	N
Human Rights	N/A	N
Rural Proofing	N/A	N

Summary: Intervention & Options

Department /Agency: The Department for Business Innovation and Skills (BIS)	**Title:** The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: Acquisition by company of its own shares	
Stage: **Implementation**	Version: **One**	Date: **June 2009**

Related Publications: **Related Publications:** Implementation of Companies Act 2006 Consultative Document February 2007 Available to view or download at: http://www.berr.gov.uk/consultations/page37980.html

European Company Law and Corporate Governance: Directive Proposals on Company Reporting, Capital Maintenance and Transfer of the Registered Office of a Company and response available to view or download at: http://www.berr.gov.uk/consultations/page14583.html

Contact for enquiries: Julie Ford **Telephone:** 020 7215 2162

What is the problem under consideration? Why is government intervention necessary?

To remove the statutory limit on the percentage of a company's shares that it is allowed to hold as treasury shares.

What are the policy objectives and the intended effects?

To enhance flexibility and reduce the administrative burden for companies which have to react promptly to market developments affecting the price of their shares.

What policy options have been considered? Please justify any preferred option.

1. Remove the 10% cap on companies holding their own shares and extend the period for which authorisation for the purchase of shares may be given from 18 months to 5 years.

2. To set a cap at a specific level above 10%, and a period of authorisation within 5 years for all companies with qualifying shares.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Five years after implementation – 2014

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Mr Ian Lucas Date: 16 June 2009…….

Summary: Analysis & Evidence

Policy Option: 1	**Description:** Remove the 10% cap on companies holding their own shares and extend the period for which authorisation for the purchase of shares may be given from 18 months to 5 years**.**

COSTS

ANNUAL COSTS	Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition) **Yrs**	
£ 0.00	There should not be any additional costs for companies eligible to take up the increased flexibilities.
Average Annual Cost (excluding one-off)	
£ 0.00	**Total Cost** (PV) **£ 0.00**
Other **key non-monetised costs** by 'main affected groups	

BENEFITS

ANNUAL BENEFITS	Description and scale of **key monetised benefits** by 'main affected groups'
One-off **Yrs**	.
£ 0.00	
Average Annual Benefit (excluding one-off)	
£ 0.00	**Total Benefit** (PV) **£ 0.00**
Other **key non-monetised benefits** by 'main affected groups' The additional flexibility should provide more options for companies when restructuring their capital.	

Key Assumptions/Sensitivities/Risks

Price Base Year 0	Time Period Years 0	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			01 October 2009	
Which organisation(s) will enforce the policy?			The courts	
What is the total annual cost of enforcement for these organisations?			£ not known	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			No	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ 0	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of £ 0	Decrease £ 0	**Net Impact** **£** 0	

Kev: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009: Treasury Shares

PROPOSAL

1. On 29 October 2004 the European Commission published its proposal for a directive of the European Parliament and of the Council to amend Council directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital (The Second Company Law Directive). The amending Directive (2006/68/EC) was published on 25 September 2006. Member states are required to bring into force the laws, regulations and administrative provisions necessary to comply with the Directive by 15 April 2008, the provision under consideration is optional.

2. This impact assessment covers our intention to implement an option provided in EC Directive 2006/68 to remove the 10% cap on companies holding their own shares and to extend the period for which authorisation for the purchase of shares may be given from 18 months to 5 years. We aim to implement this measure from 1 October 2009.

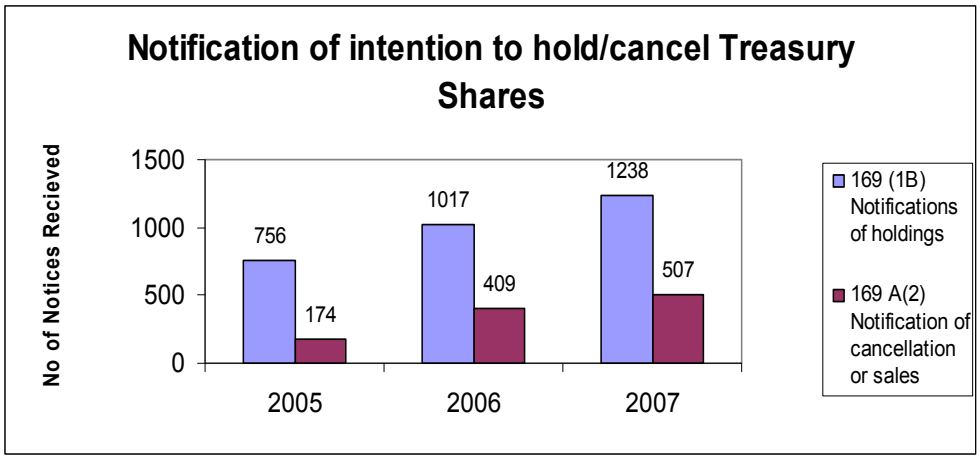
OBJECTIVE

3. The aim of this provision is to enhance flexibility and reduce the administrative burden for companies which have to react promptly to market developments affecting the price of their shares.

BACKGROUND

4. At present in the UK Companies can with shareholder authorisation, hold up to 10% of any shares that they purchase in Treasury, and for purchases to be authorised for a period of 18 months. For the purposes of company law, shares held as treasury shares are generally treated as if they had been cancelled, in the sense that they do not receive dividends and cannot be voted. And any sale of treasury shares is generally treated in the same way as a new an issue of shares. The ability to hold treasury shares provides companies with additional options when managing levels of capital and in balancing debt and equity.

5 Only "qualifying shares" as defined in section 724 of the 2006 Act can be held as treasury shares. Broadly speaking, "qualifying shares" are shares listed on the Official List, officially listed in an EEA state or traded on AIM or a regulated market of another EEA state. The number of notifications of companies' intentions to hold and cancel shares, received by the registrar since 2005, is shown below:



Options for implementing the Companies (Reduction of Capital) Regulations 2009: Treasury Shares

6. The provision in the directive is optional and the UK does not have to take it up. However it offers companies greater flexibility to respond to market pressures.

OPTION 1: Remove the 10% cap on companies holding their own shares and extend the period for which authorisation for the purchase of shares may be given from 18 months to 5 years.

7. The option to hold shares in treasury will provide companies with the flexibility to adjust their share capital to achieve optimum levels of debt and equity without the costs of issuing new shares and might therefore lead to a reduction in companies' overall cost of capital. Companies will have the option of to sell treasury shares through the market at the full market price. At present if companies purchase more than 10% of their shares the amount in excess of 10% must be disposed of, or cancelled within 12 months of the contravention. If the cap were removed there would be more time to dispose of shares and they would only be cancelled for business reasons.

OPTION 2: To set a cap at a specific level above 10%, and a period of authorisation within 5 years for all companies with qualifying shares

8. Rather than remove the 10% limit on holding treasury shares altogether, it would be possible to maintain a limit at a higher level. During previous consultations the majority of respondents suggested that not only was the option to raise the cap considered deregulatory, but that companies should be permitted to purchase their own shares up to the limit of distributable reserves and hold them rather than to the level of another arbitrary cap. As the circumstances which lead to the purchase and holding of shares will vary from company to company, the maximum flexibility should ensure that all possible circumstances are covered. Companies, shareholders and the markets would determine actual take up in each case. Therefore we are proposing to adopt option 1.

COSTS AND BENEFITS

9. No direct costs or benefits accrue from maintaining the status quo and to do so may put UK companies at a disadvantage should other Member States adopt the provisions in Directive 2006/68.

Costs

10. The ability to purchase larger numbers of shares for a longer period of time should not result in additional costs.

Benefits

11. The company will be able to purchase a greater number of its shares if it wishes and thereby take even more advantage of the flexibility offered by Treasury shares when managing levels of capital and balancing debt and equity. There should be time and cost savings if a company does not have to seek authorisation for a purchase within a 5 year period rather than the current 18 months, can purchase a greater number of shares and there is less reason to cancel them.

RISKS

12. There is a risk that companies could use the purchase and sale of shares to erode shareholder rights and dilute their holdings in some way. However, shareholders will be able to protect their interests by limiting the authority they give to directors to purchase the company's own shares, and by limiting the directors' ability to sell the shares without offering them to existing shareholders. On balance, we believe that as a matter of better regulation we should not maintain an arbitrary limit on holdings of treasury shares when there is no compelling reason to do so. In addition companies are also required to comply with the insider dealing regime under the Criminal Justice Act and the market abuse regime under the Financial Services and Markets Act 2000 (FSMA) and requirements under the Listing Rules and the City Code on Takeovers and Mergers.

WHO WILL BE AFFECTED?

13. The flexibility to purchase and hold shares to the limit of distributable profit will apply only to public companies with shares that are quoted on the London Stock Exchange's main market or the Alternative Investment Market, and a small number of public companies with shares that are not quoted on either of these two markets but are quoted on an equivalent of them in another EEA State. In March 2009 there were 1,109 companies UK companies listed on Main Market and 1,680 listed on AIM (UK and International)[4].

14. The extended period of authorisation will apply to private and public limited companies.

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[4] London Stock Exchange Main Market Statistics are available from: http://www.londonstockexchange.com/NR/rdonlyres/B7841B80-F917-41CE-AC7D-2B3667F91777/0/MainMarketStatistics0903.pdf

ISSUES OF EQUITY AND FAIRNESS

15. We have considered the three mandatory impact tests (gender, race, disability) and the recommended option is unlikely to have any discriminatory effects.

SMALL FIRMS IMPACT TEST

16. There is no change in nature or number of the overall population of companies affected by these provisions.

ENFORCEMENT AND SANCTIONS

17. Enforcement of the current provisions in the Companies Act 2006 – which are subject to criminal penalties for non-compliance – is the responsibility of the Department for Business, Innovation and Skills. The Department will be responsible for enforcing the amended law.

CONSULTATION

18. The consultation on the Directive 2006/68 formed Chapter 6 of the consultation on the implementation of the Companies Act 2006[5]. Most of those responding indicated that the government should take up this particular flexibility. Respondents to the earlier consultation on the proposed directive also supported the take up of this flexibility[6]

COMPETITION ASSESSMENT

19. The competition filter has been applied. It is considered that the Directive will not give rise to disproportionate costs of entry or administrative costs for either small or large business. The Directive is not anticipated to restrict innovation in sectors characterised by rapid technological change and would not impair freedom to provide services

[5] The consultation on the implementation of the Companies Act 2006 can be found together, with the government response at: http://www.berr.gov.uk/consultations/page37980.html

[6] **European Company Law and Corporate Governance:**
http://www.berr.gov.uk/consultations/page14583.html

Specific Impact Tests: Checklist

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	Y	N
Small Firms Impact Test	Y	N
Legal Aid	N/A	N
Sustainable Development	N/A	N
Carbon Assessment	N/A	N
Other Environment	N/A	N
Health Impact Assessment	N/A	N
Race Equality	Y	N
Disability Equality	Y	N
Gender Equality	Y	N
Human Rights	N/A	N
Rural Proofing	N/A	N

TRANSPOSITION NOTE

DIRECTIVE 2006/68/EC AMENDING COUNCIL DIRECTIVE 77/91/EEC AS REGARDS THE FORMATION OF PUBLIC LIMITED LIABILITY COMPANIES AND THE MAINTENANCE AND ALTERATION OF THEIR CAPITAL

1. The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 implement articles 1(4) and 1(9) of Directive 2006/68/EC which amends Council Directive 77/91/EEC as regards the formation of public limited liability companies and the maintenance and alteration of their capital – in the Companies Act 2006. Article 1(4) amends provision in Article 19 of Directive 77/91/EEC which covers arrangements for companies to acquire their own shares, and Article 1(9) of the Directive 2006/68/EC amends the creditor protection provisions set out in Article 32 of Directive 77/91/EEC.

2. The amendment relating to standardised creditor protection is mandatory and to be implemented by 15 April 2008. The Companies (Reduction of Capital) (Creditor Protection) Regulations 2008 which came into force on 6 April 2008 implement Article 1(9) of Directive 2006/68/EC in respect of the Companies Act 1985.

3. **The mandatory provisions of Directive 2006/68/EC are dealt with as follows:**

Article in Directive	**Purpose**	**Implementation**
1 (4)	To enhance flexibility and reduce the administrative burden for companies which have to react promptly to developments affecting the prices of their shares by allowing public limited liability companies to acquire their own shares up to the limit of the company's distributable reserves.	Regulation 4(1) of the Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 – amends section 694 of the Companies Act 2006 to increase the period of authorisation for off market purchases of shares from 18 months to 5 years. Regulation 4(2) of the Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 – amends section 701 of the Companies Act 2006 to increase the period of authorisation for market purchases of shares from 18 months to 5 years. Regulation 5 of the Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009 – repeals section 725 of the Companies Act 2006 to remove the limit of 10% of

Article in Directive	Purpose	Implementation
		nominal value of issued share capital on companies holding of their own shares
1 (9)	To standardise creditor protection so that creditors under certain conditions are able to resort to judicial or administrative proceedings where their claims are at stake as a consequence of a reduction in the capital of a public limited liability company. The conditions in such cases are that the creditor can credibly demonstrate that their claim is at stake and that adequate safeguards have not been provided by the company	**Until 1 October 2009:** Sections 136 and 137 of the Companies Act 1985 and Articles 146 and 147 of the Companies (Northern Ireland) Order 1986, as amended by the Companies (Reduction of Capital) (Creditor Protection) Regulations 2008. Regulation 2 inserts section 136(3)(b) into the Companies Act 1985 preventing creditors from being in a position to object to a capital reduction unless they can show that there is a real likelihood that the reduction would result in company being unable to discharge their debts or claims when they fell due. In deciding whether to disapply section 136(3)(b) under section 136(6), the courts will be able to disregard the interests of creditors who would not be entitled to object. Regulation 3 makes an equivalent amendment for Northern Ireland. **From 1 October 2009:** Section 646 of the Companies Act 2006 as amended by regulation 3 of The Companies (Share Capital and Acquisition by Company of its Own Shares) Regulations 2009. Regulation 3 amends section 646 (Creditors entitled to object) of the Companies Act 2006 so that creditors entitled to object to a capital reduction are only those able to demonstrate that their claim is at stake and that the company has not provided adequate safeguards.

6. Responsibility for the measures described in this transposition note taken to implement the amendments made by Directive 2006/68/EC lies with the Secretary of State for Business, Innovation and Skills.