DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

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~~Prime Minister~~

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From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London, SW1

PL 8/5

6 May 1980

Dear Geoffrey

PURCHASE OF OWN SHARES

In the context of measures to encourage small businesses and enterprise generally I have been examining the provisions of the Companies Acts that (with certain exceptions) prohibit a company from purchasing its own shares. We have said publicly on a number of occasions that the Government were looking into this with a view to relaxing the present prohibition, and that we would undertake consultations with a view to legislating in the next Companies Bill in the 1980/81 Session.

The Queen's Speech and Future Legislation Committee (QL) decided last week to recommend to the Cabinet that a Companies Bill should be introduced before the end of the year, and the Committee agreed that, subject to the necessary policy approval, the Bill could include legislation on the purchase of own shares.

There has been increasing public interest in this aspect of company law in recent years, particularly in the small business sector, and it was referred to in the Interim Report on the Financing of Small Firms (Cmnd 7503) of the Committee to Review the functioning of Financial Institutions. But the debate so far has been unfocussed and very general. Before we can reach our own decisions, and translate them into legislation, we need to consult widely on both the major policy issues and detailed aspects of the possible ways of proceeding.

I therefore propose to issue a consultative document on this subject
.... and attach a draft text which I intend to publish in early June. (Whether this will be in the form of a Green Paper or of a document issued by my Department I have not yet decided.)

I do not propose to summarise the draft in this letter. I would however emphasise that I attach the highest priority, both economically and politically, to legislating on this matter in the next Companies Bill. The scope and details of that legislation can be decided in the light of the response to the consultative document. The arguments for a change in the law with regard to private businesses are overwhelming. I personally also believe there are very strong arguments for enabling public companies to purchase their own shares - in effect a form of demerging.

As you will see, the bulk of the draft comprises a paper by my Research Adviser on company law, Professor Gower, the eminent authority on company law. In finalising his text Professor Gower has benefitted from discussion of earlier drafts by my Advisory Panel on Company Law, which contains distinguished representatives of the legal and accountancy professions as well as of business interests. This should be borne in mind when any amendments to the text are being considered.

Apart from the company law aspects, there are significant tax questions at issue, as the consultative document makes clear. I very much hope that the Treasury's further consideration of this subject will open the way to a more favourable tax regime for the purchase of own shares as a complement to any liberalisation of the company law regime.

From the Secretary of State

I am copying this letter to members of E Committee and to Sir Robert Armstrong. In view of the need to issue the consultative document as soon as possible, I would be grateful for any comments by 16 May.

Yours ever

John.

JOHN NOTT

THE PURCHASE BY A COMPANY OF ITS OWN SHARES

A CONSULTATIVE DOCUMENT

PART I

INTRODUCTION

1. Broadly speaking company law in the United Kingdom does not permit a limited company to buy its own shares. The main reasons for this have been that such purchases could reduce the capital of the company available for the protection of those who deal with the company and to prevent companies "trafficking" in their shares. However, many other countries permit such purchases and increasing interest has been shown in this country in replacing the present general prohibition with provisions which, whilst providing for the maintenance of the company's capital, would also give companies the opportunity to buy their own shares, to the benefit both of companies and of shareholders.

2. During the Parliamentary debates on the Bill which became the Companies Act 1980, Mr Reginald Eyre, Parliamentary Under Secretary of State, Department of Trade, announced that the Government attached high priority to relaxing the present prohibition and that consultations would be undertaken with a view to bringing forward necessary legislation as part of a Companies Bill which it was hoped to introduce in the 1980/81 Session of Parliament.

3. The purpose of this consultative document is to seek views on the extent to which it is desirable to change company law to enable companies to buy their own shares and on the form that these changes and the consequent safeguards should take. In Part II of this document, Professor L C B Gower, the Research Adviser on Company Law to the Department of Trade, discusses the present law in this country, compares it with the law in other countries, and describes and analyses various ways in which the law could be amended. Part II represents Professor Gower's personal views and not those of the Government: it is published both as a major contribution to the consideration of the issues involved, and as an analytical framework for consultation on this subject. In preparing Part II Professor Gower has had the benefit of the advice of the Advisory Panel on Company Law, established by the Government in February 1980.

4. The Government attaches particular importance to the principal economic arguments in favour of a relaxation of the present law. For private companies, a change should make investment and participation in such companies more attractive, by providing shareholders with a further means of disposing of their shares and by permitting the remaining members to maintain control and ownership of the business. Different considerations apply to companies whose shares are dealt in

on a market. Public companies with surplus cash resources could find it useful to be able to buy their own shares and thus return surplus resources to shareholders, thereby removing the pressure on such companies to employ those surplus resources in uneconomic ways, and enabling shareholders to deploy the resources to better effect.

5. Any changes in the law would need to be accompanied by safeguards for the interests of creditors, shareholders and others interested in the company, who could otherwise be prejudiced if the company was able freely to reduce its capital.

6. So far as public companies are concerned, any relaxations in the law would also have to be consistent with the provisions of the EEC Second Directive on company law. The Companies Act 1980 implemented this Directive, which amongst other matters was concerned with the maintenance of the share capital of public companies. The Directive lays down certain minimum safeguards which must be met if Member States permit public companies to purchase their own shares; the directive does not, however, require Member States to permit such purchases, (this matter is discussed in more detail in Part II).

7. In advance of the present consideration of possible changes in the law, the Companies Act 1980 restates in statute, with certain minor modifications, the prohibition, established by judicial precedent in the nineteenth century, on companies buying their own shares. However, during the passage of that legislation the Government made it clear that this statutory restatement was without prejudice to the further consideration of the whole area.

8. The proposal that companies should be permitted in defined circumstances to buy their own shares will open up one somewhat separate issue. The development in the UK of unit trust schemes, through which investors can spread their investment in equities, is largely the consequence of the rule that a company cannot buy its shares. This has precluded the development of "open-ended" investment trusts of the type which operate in other countries. The question posed in this paper will therefore raise two further questions: first, whether it would be advantageous to permit the development of open-ended investment trust companies in the UK, and secondly whether special statutory safeguards would be required for investors in such companies, bearing in mind the provisions in the Prevention of Fraud (Investments) Act for the protection of investors in unit trusts.

/TAX - PASSAGE UNDER DISCUSSION WITH REVENUE/

The Government invites comments on the issues raised in this consultative document, in particular on:

i) the strength of the case in principle for a change in the law to enable (a) private companies and (b) public companies, to purchase their own shares;

ii) the safeguards for members, creditors, employees and other interested parties that should be attached to any provisions enabling (a) private and (b) public companies to purchase their own shares;

iii) whether, if private companies were permitted to purchase their own shares, this should be in defined circumstances only (eg on the death or retirement of a member);

iv) whether for private companies, the present requirements for the formal reduction of share capital should be eased, to permit simpler and cheaper reductions;

v) whether, in the case of public companies, any power to repurchase should be restricted eg to unlisted shares or to companies of a defined size;

vi) whether if repurchase of own shares were permitted, it should be stipulated that such shares should be cancelled, rather than treated as "treasury shares";

vii) whether the Companies Acts should be amended to permit companies to issue redeemable equity shares;

viii) whether private companies operating employee share schemes otherwise than through trustees should be permitted to buy their own shares, and to finance such schemes as a further exception to the general prohibition in section 54 of the Companies Act 1948.

ix) the implications of according to investment companies a power to repurchase their shares.

It is suggested that Professor Gower's analysis in Part II would provide a convenient framework for observations on these points.

Representations on the issues raised in this Consultative Document should be sent to

Department of Trade
Companies Division
Room 509
Sanctuary Buildings
16-20 Great Smith Street
London
SW1P 3DB

and should reach the Department by 30 September 1980.

PART II

PURCHASE OF OWN SHARES

PURCHASE BY A COMPANY OF ITS OWN SHARES

THE PRESENT POSITION

1 It was established by the case of Trevor v Whitworth (1887) 12 App Cas 409, H.L. that a limited company may not buy its own shares because this would amount to an unauthorised reduction of capital. This basic principle has now been codified in the Companies Act 1980 and applied to any acquisition by a limited company of its own shares "whether by purchase, subscription or otherwise": S. 35(1). Certain exceptions are recognised. A Company limited by shares may acquire its fully paid shares otherwise than for valuable consideration and any company may acquire its own shares "in a reduction of capital duly made": S. 35(2). Companies may also redeem redeemable preference shares, purchase shares in pursuance of an order of the Court under Section 11 or 75 of the 1980 Act or 5 of the 1948 Act and may forfeit shares or accept a surrender in lieu for non-payment of calls: S. 35(4). Where partly-paid shares are acquired by a nominee of the company, Section 36 of the 1980 Act makes the nominee personally liable and, by Section 37, where any shares of a public company are acquired by it or its nominee they must be disposed of or cancelled within a prescribed time and, in the meantime, cannot be voted. Further, a public company is, in general, prohibited from taking a charge over its own shares: S. 38.

2 The rule that a company may not buy its own shares does not apply to an unlimited company. But prohibitions have been extended to other transactions which, though technically they do not reduce capital, are thought to be subject to equal or greater objections. Thus, in general, a subsidiary company may not become a member of its holding company (Companies Act 1948, S. 27) nor may a company provide financial assistance for the purchase or subscription of its shares or those of its holding company (ibid S. 54) - and these two sections apply equally to unlimited companies.

3 Of the exceptions listed in paragraph 1 to the general principle, that relating to redeemable preference shares is by far the most important and also the most interesting in the present context. It shows that it is possible to provide for the re-purchase of shares in a way which does not impair capital to the detriment of creditors. Under Section 58 of the Companies Act 1948, replacing the provision of the 1929 Act which first legitimated the issue of such shares by registered companies, a company if so authorised by its articles may issue preference shares which are, or at the option of the company are liable, to be redeemed. But they may be redeemed only if fully paid, and only out of profits which would otherwise be available for dividend or out of the proceeds of a fresh issue made for the purpose of the redemption. In either event, any premium payable on redemption must be provided for out of profits (and, under the amendment in the 1980 Act expressly "profits which would otherwise be available for dividend") or out of the share premium account. Moreover if redeemed out of profits an amount equivalent to the nominal amount of the shares redeemed must be transferred to an undistributable reserve, rather unhappily named "the capital redemption reserve <u>fund</u>" unless and until it is subsequently converted to share capital on an issue of bonus shares. In other words, capital is not reduced[1] but is replaced and maintained either by the new share capital or by the capital redemption reserve fund. Hence, insofar as capital is a protection to creditors against depletion of the company's resources by subsequent distributions (and under the dividend

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1 But see paragraph 22, below

rules introduced by Part III of the 1980 Act the protection will become substantial in the case of public companies) that protection is not impaired.

4 The main reason for restricting the power to issue redeemable shares to preference shares was, no doubt, that the possibilities of abuse are less in this case since they do not normally afford voting control of the company or fluctuate in value to the same extent as equity shares. But since there is no definition of "preference shares" for the purpose of Section 58 it would appear to cover any which afford a preference either as regards dividends or capital. Hence it could be used to issue redeemable shares which because of their rights to further participation in either or both of income and capital confer a considerable slice of equity (and, indeed, of the votes). If the section is intended to limit redeemable shares to non-equity shares it has achieved its purpose only because advantage has not in practice been taken of it in relation to equity shares. The only worthwhile purpose that the word "preference" seems to serve is that it ensures that the company has other, non-redeemable, shares and therefore helps to avoid the complications which occur when a company finds itself without any shareholders.

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5 So much for the present position in the United Kingdom. In the USA the common law developed differently and it was held in most States that a company could buy back its own shares so long as it did so out of profits and without impairing capital. The practice is now regulated by statute in most States and is generally permitted subject to various limitations and conditions.[2] A distinction is drawn between shares issued as redeemable,

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2 And is now spreading to other common law countries: see, for example, Canada Business Corporations Act 1974-75, S. 32

which is generally impermissible in the case of common stock, and shares not liable to be redeemed and cancelled but which can be re-purchased by the company, becoming "treasury shares" until resold. The latter is permitted in the case of all types of share, including common stock, but, again, subject to limitations and condition. While the shares are held in the company's treasury they are not entitled to dividends or votes.

6 Similarly in the other EEC countries companies were generally permitted to repurchase their shares, though the practice now is normally regulated by statutes which are in process of amendment to comply with the provisions of the Second EEC Directive on Company Law referred to in paragraph 7 below. The conditions under which the practice was permitted differed widely. In Germany, for example, the amount of share capital that a public company (Aktiengesellschaft) could re-purchase was normally limited to 10% and the acquisitions had to be for certain specified reasons. One of these was "if the acquisition is necessary to avert serious damage to the company" - a formula (reflected in art. 19.2 of the Second Directive) which was treated as justifying use of the power pretty freely. In France the provisions were more complicated and restrictive. Purchases were allowed for the purposes of (a) cancellation on a resolution to reduce capital, (b) employee share schemes, and, (c) in the case of listed companies, maintaining the quoted price of the shares or to facilitate mergers. But acquisitions were subject to various conditions and the total acquired under (b) and (c) could not exceed 10% of the shares of any class. In the Netherlands, on the other hand, the provisions were few and normally fully paid shares could be acquired up to 50% of the share capital. As in the USA, the general position was that the company could not exercise or enjoy any rights in respect of the shares held by it. Generally speaking too (though the reverse was true in Denmark) greater freedom was permitted

in the case of the types of company corresponding to our private companies. The position in the other EEC countries also differed from that in the UK in that capital could be reduced with less formality so long as the minimum capital requirements (a long-established feature of European company laws) were not infringed. And France recognised the (to us) strange concept of "reimbursed shares" (actions de jouissance) under which the shareholder had his proprietary interest redeemed but remained a member of the company in other aspects.

7 One of the objects of the Second EEC Directive on Company Law is to harmonise the provisions relating to purchase and redemption of shares. The more important of the relevant articles are set out in Appendix A to this Paper. As will be seen, they are lengthy and complicated but their general effect can be summarised by saying that they forbid the purchase or redemption of shares except that, to accommodate to some extent the divergent practices of the various Member States, they permit their laws to allow purchases, withdrawals and redemption of shares subject to compliance with certain conditions which are generally more stringent than those hitherto prevailing in the Continental systems. The Directive, which we have implemented by the 1980 Act, permits us to maintain the existing exceptions to the Trevor v Whitworth rule but does not require us to extend them. It would, however, allow us to widen these exceptions subject, in the case of public limited companies, to laying down stringent conditions. The Directive does not apply to our private companies (though the 1980 Act has extended some of its provisions to them) and so far as they are concerned we are free to widen the exceptions to any extent we wish.

8 The main conditions which would normally have to be present if public limited companies were to be permitted to purchase their shares are:

(a) the shares must be fully paid

(b) authorisation must be given by the general meeting,

(c) the total acquired and held must not exceed 10%,

(d) the effect of the purchase must not be to reduce the net assets below the amount of the subscribed capital plus undistributable reserves,

(e) voting rights must be suspended so long as the shares are held by the company, and

(f) purchases and the reasons for them must be set out in the "annual" report.

Somewhat different conditions are laid down in respect of redeemable or withdrawable shares; articles 35-37 being designed to accommodate the various Continental practices (art. 35 relating to the French actions de jouissance referred to above) and art. 39 to accommodate the UK practice. It will be noted that this article does not prescribe that the redeemable shares must be preference shares.

THE CASE FOR CONSIDERING EXTENSION OF THE POWER TO ACQUIRE THE COMPANY'S SHARES

9 Until recently there has been little public interest in the possibility of a further extension of the power for a company to acquire its own shares. The Jenkins Committee, having taken evidence from America that "the power enjoyed by companies in the United States has not led to abuse and is useful for a number of purposes" (Cmnd 1749 of 1962, para 167) nevertheless reported as follows:

"168. In our view, if the Companies Act were amended to give a limited company a general power to buy its own shares it would be necessary to introduce stringent safeguards to protect both creditors and shareholders. We think it would be possible to devise effective safeguards and we do not think they need to be unduly complicated. On the other hand, we have received no evidence that British companies need this power and the relatively few witnesses who offered any evidence on this matter were almost unanimous in opposing the introduction of a general power for companies to buy their own shares. The power might occasionally be useful when a minority of the members of a small company whose shares were not readily marketable wished to retire from the company and the other members were unable or unwilling to buy their shares at a fair price; we doubt if such a power would often be exercised for this purpose since it would usually give rise to a surtax assessment in respect of past profits of the company still undistributed and, in cases where tax difficulties can be overcome, a quasi-purchase of the shares of the company can be, and in practice is, carried out by the machinery of a reduction of capital by repaying those shares at a premium. We have therefore reached the conclusion that there is no justification for the general abrogation of the familiar rule that a limited company may not buy its own shares; indeed, we think that the rule should be expressly stated in the Act.

169. We have considered whether a special exception should be provided for companies which operate profit-sharing schemes involving the issue of shares to their employees. The value of such shares will to a great extent depend upon their being freely marketable. The employee, if the shares are not quoted or if his holding is small,

may find it difficult to sell them. In such circumstances, it is argued, the company should be empowered to provide a market in the shares. We received no evidence that this problem presented insuperable difficulties and on the evidence presented to us we do not think that the proposed exception would be justified. For the same reason, we do not accept the suggestion that Section 27, which prohibits a subsidiary from acquiring shares in its holding company, should be modified in favour of profit-sharing companies."

In other words an extension was rejected not on the ground that it would be unduly difficult or lead to abuse but rather on the ground that nearly everybody was happy with the status quo.

10 This attitude has continued to prevail until very recently when there has been some pressure for a wider power. For example, the Committee under the Chairmanship of Sir Harold Wilson which is reviewing the working of the City's Financial Institutions, has in an Interim Report on The Financing of Small Firms (Cmnd 7503 of 1979) advocated that consideration should be given to permitting such firms to issue redeemable equity shares as a means of enabling them to raise needed capital without parting permanently with family control: page 12, para 17. The Association of Independent Businesses, in a well-argued Memorandum to the Department of Trade, has pointed out that a shareholder needing to sell all or part of his equity in a small unlisted company may be unable to find a buyer other, perhaps, than a financial institution or public company and that this is one of the factors leading to excessive concentration of industry and commerce. The Association argues that if a company were permitted to buy its own shares a greater number of unlisted independent companies would be able to continue in separate existence and that additional investment in

them would be encouraged. Others have suggested that larger companies with surplus liquid assets might more usefully employ them in informal reductions of capital by buying up their shares rather than by looking round for outlets for further diversification.

11. The main advantages which have been claimed for allowing companies to buy their own shares are the following:

(a) It may enable the company to buy out a dissident shareholder.

(b) It facilitates the retention of family control.

(c) It provides a means whereby a shareholder, or the estate of a deceased shareholder, in a company whose shares are not listed can find a buyer.

(d) It is particularly useful in relation to employee share schemes in enabling the shares of employees to be repurchased on their ceasing to be employed by the company.

(e) It may help with the marketing of shares by enabling the company to give a subscriber an option to re-sell to the company.

(f) It enables companies to purchase their shares for use later in stock option plans or acquisition programmes, or to increase their earnings per share and thereby make the remaining shares a more attractive investment.

(g) If redeemable shares are quoted at below the redemption price it enables the company to save money by buying up in advance of the redemption date (a practice which our Companies can, and do, adopt in the case of debentures but cannot in the case of redeemable preference shares).

(h) It permits the evolution of the open-ended investment company or mutual fund instead of having to operate through the device of a unit trust.

(i) It provides a company with surplus cash with a further means of using it advantageously.

(j) It can be used to support the market for the shares if this is thought to be unduly depressed, thus preserving for the shareholders the value of their shares as marketable securities.

(k) If the company not only buys its shares but trades in the treasury shares thus acquired it may make money thereby.

12. It is not suggested that all the above advantages are necessarily desirabl (j), in particular, may be regarded as objectionable as leading to market-rigging and (k), trafficking in its own shares, is not self-evidently a desirable corporate activity. But some - particularly (b), (c) and (d) clearly are valuable, especially in the case of closely-held companies and it is in relation to such companies that the power is mainly used in the USA. Even in these cases, however, the power is clearly capable of abuse; for example by enabling the management to maintain its own control or to gain control and to use the company's money in doing so.

13. Some of the objectives of the transactions listed in paragraph 11 above, can already be achieved by other means. It is common, for example, for the articles of association of private companies to provide that a member wishing to dispose of his shares will first offer them to the other shareholder, or to the directors. Thereby the objectives of (b) and (c) may be achieved. But they will not be achieved if the other members are unable or unwilling to buy. And, if the right of first refusal is coupled with an absolute discretion to the directors to refuse to register transfers (as it almost invariably is) the shareholder, or the estate of the deceased shareholder, may be locked in the company with little prospect of receiving dividends (since profits will probably be re-invested or distributed as directors' remuneration) or may ultimately be forced to sell to the members or directors at a gross undervalue. One of the main reasons for the enactment of section 210 of the 1948 Act (now replaced by Section 75 of the 1980 Act)

was to provide some remedy for this.

Moreover if, as is sometimes the case, the articles provide that the offer shall be to the directors (as opposed to all the members) it provides a ready means whereby directors, in breach of the spirit, but not the letter, of their fiduciary duties, can maintain and enhance their control of the company. These possibilities of abuse would be reduced if the company itself could be the purchaser. And clearly there would be many cases where the other members would be happy for the company to buy although they were unable to raise the money to do so themselves. They might well be unable to raise the necessary money themselves by borrowing on the security of their shares because shares in private companies are not an attractive security to outside sources of finance and the company itself is precluded by section 54 of the 1948 Act from lending for the purpose of enabling its shares to be acquired.[3]

14. Similarly, it is possible to institute employee share schemes whereby employees are enabled or obliged to re-sell on leaving employment. But this has to be done by operating the scheme through trustees, although, thanks to the exceptions to section 54, the needful finance can be provided by the company.[4] This necessity to establish a trust is not a serious snag in the case of large public companies. But those running small private ones undoubtedly regard it as an unnecessary and incomprehensible complication which is a serious disincentive to the establishment of such schemes.

15. For these reasons there is a case for consideration, at least, of an extension of the power of a private company to repurchase its own shares. If, however, an extension is to be of practical value perhaps the most serious problem that will have to be solved is one of tax law rather than

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3. S.38 of the 1980 Act, generally prohibiting a company from taking a charge on its own shares, applies only to public companies.

4. But, as a result of an amendment made by the 1980 Act, in the case of public companies only out of profits available for dividend: 1980 Act Schd 3, para 10.

company law. It was, indeed, the tax implications that led the Jenkins Committee to conclude that a power to buy their own shares would be of little value to private companies. The tax position has changed substantially in recent years and will alter radically when the proposals relating to "close companies" announced in the 1980 Budget Speech are enacted. In the case of trading companies the Revenue's present power to apportion undistributed income (above certain limits) among the participators, taxing them at their personal rates will be abolished, thereby making it easier for such companies to accumulate profits out of which their shares could be re-purchased. But a major problem will remain - and this applies equally to non-close companies - the shareholders whose shares are to be re-purchased will not be willing to sell unless any profit they make is liable only to capital gains tax and not treated as income. Yet if this is conceded there is a possibility of using the power as a tax avoidance device by extracting income in the form of capital.

It is understood that the present practice of the Revenue when shares are re-purchased by an unlimited company is to treat any part of the purchase price in excess of the capital paid up on the shares as taxable income of the seller. Moreover, if the shares are re-purchased out of the company's profits the company is deemed to have made a "distribution" with consequent liability forthwith to pay advanced corporation tax. If this practice were maintained a sale to the company, rather than to a third party, would be highly disadvantageous to the selling shareholder and detrimental to the company itself unless it was liable to full corporation tax payable almost immediately. Nevertheless if it is thought desirable in the interests of small businesses to permit them to buy their own shares the needed changes in company law should precede, and not wait upon, changes in tax law and practice which will not be made in respect of transactions which are legally impossible.

16. The case for an extension in relation to public companies is of a different character. Advantages (a) to (d) are either of no or of lesser moment, (e) seems undesirable in the case of listed securities and (j) and (k) are probably actually or potentially objectionable. The only seemingly unobjectionable advantages appear to be (f) to (i). It is, however, doubtful how far use would be made of (f), (h) or (i). If public companies want to have shares available for stock options or acquisitions they seem to experience no difficulty in persuading their members to authorise the creation of further share capital for this purpose. If they want to reduce, rather than increase, capital they can do so under a formal reduction scheme which, in the case of larger companies, is a relatively simple and inexpensive operation. The argument that, if companies could spend surplus cash on informal reductions by buying their shares, they would do so rather than engage in possibly dangerous expansion and diversification seems distinctly dubious in view of the many surveys which have concluded that the main motivation of company managements is a desire to expand their empires. It is difficult to see how a power to purchase the company's own shares could be directly used to facilitate "de-mergers". At the most it might provide an outlet for surplus cash alternative to further take-overs and, when a company had hived-off part of its undertaking by a sale, provide it with an alternative method of distributing the proceeds of sale to its shareholders. As for (h) (the possibility of operating through Mutual Fund companies rather than Unit Trusts) at the time of the Jenkins Committee the unit trust industry showed a marked lack of interest and enthusiasm for any such innovation. If this is still the view of the industry there seems little point in introducing a possibility of which use is unlikely to be made.

17. The tax problems adverted to in paragraph 15, above, would arise equally in relation to public companies. While the present tax law and practice remains, using a power to re-purchase shares would normally be

disadvantageous both to the shareholders and the company whether the purchases were a means of distributing surplus cash, rather than paying increased dividends over a number of years, or a means of providing a market for shareholders wishing to sell. But, as with private companies, if it is thought that the power is needed, company law should be amended to confer the power without waiting for changes of tax law.

THE EXTENSIONS WORTHY OF CONSIDERATION

18. In deciding what extensions are worthy of consideration and subject to what conditions, the following assumptions are made:

a. That there should be no breach of our international obligations under the EEC Second and Fourth Directives;

b. That, even in the case of private companies to which the Second Directive need not be applied, we should not substantially reduce the additional protection afforded to creditors and members by the stricter rules embodied in the 1980 Act in respect of authorisation of issues of further capital, raising and maintaining capital, distributions to shareholders, and pre-emptive rights.

19. Even within the constraints imposed by these assumptions, the possible extensions are many, but it is thought that those set out below are those worthy of serious consideration. They are set out from the narrowest possible to the widest with, in each case, a summary of the problems involved and the suggested solutions and the conditions which might need to be imposed. Possible extensions in relation to private companies are dealt with first. In this connection what is meant by "private companies" is private companies which are not, at the time when the shares are re-purchased, subsidiaries of public companies. If the view is taken that extensions should not be made in relation to public companies it seems clear that their subsidiaries should be treated in the same way.

PRIVATE COMPANIES

POSSIBILITY A

Expressly permit private companies to issue redeemable equity shares

20. This would meet one particular point raised by the Wilson Committee: see paragraph 10 above. And it could be simply achieved; essentially all that would be necessary would be to delete the word "preference" from section 58 of the 1948 Act. As a matter of strict law this would achieve little. As pointed out in paragraph 4 above, that section already permits the issue of redeemable equity shares so long as they confer some preferential rights in respect of dividends or capital repayment. Nevertheless, there seems no reason why it should not be done and the section is misleading as at present worded.

21. Two other amendments would, however, be desirable. The first, a minor one, would be designed to ensure that the company, as a result of redemptions, did not end up without any members. The 1948 Act provides two sanctions when a company continues to trade with fewer than the prescribed minimum number of members - as a result of the 1980 Act, two in respect of both public and private companies. Section 31, as amended by the 1980 Act, makes the remaining members personally liable for the company's debts contracting while they know it is so trading. This is totally ineffective if there are no remaining members. The other sanction is liability to be wound up under section 222(d). But if the company was solvent it is unlikely that anyone would petition to wind it up. It is suggested therefore that section 58 should be amended to provide that the power to issue redeemable shares should not be exercised unless the company has another class of (irredeemable) shares.

22. The other desirable amendment is of greater importance. Anomalously, section 58 at present permits a premium payable on redemption to be provided

either out of profits or out of the share premium account (as docs s.56(2)) and the capital redemption reserve fund which has to be established consists only of "a sum equal to the nominal amount of the shares redeemed". The result is that "capital", in the sense of share capital plus share premium account need not be fully maintained on redemption. If 1,000 redeemable preference shares of £1 each are issued at £1.10, share capital plus share premium account will equal £1,100. If later the shares are redeemed at £1.20 out of profits and the share premium account all that will replace the £1,100 is a capital redemption reserve fund of £1,000. This anomaly may not matter much in the case of preference shares in the strict sense, where the premiums are likely to be small. But in relation to redeemable equity shares the premiums might well be many times the nominal value, resulting in a substantial reduction of capital on redemption. It is therefore suggested that sections 56 and 58 should be amended so as to prevent redeemable shares from being redeemed otherwise than out of profits or an issue of new capital without any use of share premium account which would be left intact.

23. The point raised in the previous paragraph regarding redemption premiums draws attention to a difficulty that would arise in relation to the redemption of equity shares, that of finding a formula which will ensure that the amount repaid in redemption fairly represents the security's stake in the equity at that date. It can be done (approximately) in the case of listed securities by the use of the so-called "Spens formula" whereby the redemption price is based on recent quotations. In the case of unlisted securities in private companies the nearest approach would be to adopt the formula common when other shareholders are given pre-emptive rights, ie "at a fair price to be determined in default of agreement by the auditors of the company"-a formula which can (and has) produced widely different answers since the valuation of shares in private companies is notoriously difficult.

24. While this Possibility seems unobjectionable, it is not what private companies really seek. Their lack is not the ability to issue equity securities expressly created as redeemable, but the ability to buy out members or the estates of deceased members (ie Possibility C below).

POSSIBILITY B

Permit private companies to buy shares issued under an employees share scheme

25. Having regard to the present state of our law it is difficult to see what objections there could be to this further extension other than purely doctrinal ones. The exceptions to section 54[5] of the 1948 Act already permit "the provision by a company, in accordance with an employee share scheme ..... of money for the purchase of, or subscription for, fully paid shares in the company or its holding company .... " Under this, companies can, and do, finance such schemes and the shares can be issued to employees and re-purchased out of the finance provided by the company. In the case of private companies[6] this can be done without the finance having to be provided out of profits. At present it can be done only by vesting the shares in trustees, a complication which, as pointed out in paragraph 14 above, is a disincentive to the establishment of such schemes by small companies.

26. It is therefore suggested for consideration that proviso (b) to section 54(1) should be amended in relation to private companies (other than subsidiaries of public ones) by deleting the requirement that the purchase or subscription must be by trustees and that a further exception should be added to the prohibition on purchasing or subscribing by the company of its own shares (section 35 of the 1980 Act), namely the acquisition by a company of

5. As amended by 1980 Act, Schd 3, para 10.

6. But, as a result of the 1980 Act, not public companies

fully-paid shares included in an employee share scheme. In addition an amendment would be necessary to section 27 of the 1948 Act permitting a similar exception to the rule that a company must not become a member of its holding company.

27. If this were done the only other provisions which would appear to be desirable are:

(a) that as in the case of redeemed shares they should on re-purchase be cancelled[7] and replaced by a capital redemption reserve fund;

(b) that the company should not repurchase employee shares unless, thereafter, it will still be in a position to pay its debts as they fall due.

28. Provision (a) would alter the position which now obtains when employee shares are vested in trustees. Where, as is commonly the case, the trustees are closely allied to the management this can be used as a means of enchancing their own control. This danger would be increased if votes could be exercised on shares vested in the company, for then it would be the management which would control the exercise of the votes. Cancellation would avoid this danger and also solve the problems which may arise if a solvent company goes into liquidation while employee shares are held by the trustees - even if this possibility has been foreseen and provided for, it may give rise to unexpected tax and other consequences[8]. As regards provision (b), it would clearly be improper for a company to provide further finance to a trustee-operated scheme if the result would be to make it insolvent in the sense that it could not pay its debts as they fall due. The same should apply if the company itself were permitted to operate a scheme.

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7. But with power to issue a like amount without liability to further capital duty: see para 37.

8. See Rutter v Charles Sharpe & Co Ltd/1979/I W.L.R. 1429

29. Hence from a purely company law standpoint, this extension could be achieved very simply. Present tax legislation, however, restricts the use likely to be made of it. In most cases the company will probably wish to set up the scheme so that the employees receive the tax concessions conferred on "approved profit sharing schemes" under Chapter III of the Finance Act 1978[9] Employee share schemes can secure approval under the present terms of that Act only when shares are initially vested in trustees and retained by them subject to various restrictions for a prescribed period or until earlier cessation of employment by reason of redundancy, death, injury, or disability or reaching pensionable age. It would be possible to achieve the same result by instead making it a condition of approval that the shares should be of a separate class which would be subject to similar restrictions. But even if the Revenue regarded it as essential to maintain the need for trustees for these approved schemes it does not follow that the suggested extension would not be worthwhile. Companies may still wish to operateemployee share schemes which are free from the restrictive conditions laid down for approved profit sharing schemes - but which may nevertheless confer tax advantages on the employees under section 79 of the Finance Act 1972. To force them to set up trusts in such circumstances seems pointless.

POSSIBILITY C

Additionally[10] permit private companies to repurchase their shares

30. If practicable, this solution would confer on private companies all the advantages which are sought by them. It would, however, raise greater problems than Possibility A or B. Before discussing these, however, it is necessary to consider whether, in fact, private companies would find it

9. The 1980 Budget Speech announced further concessions in respect of such schemes.

10. It would, of course, be possible to adopt this in lieu of B which would then, to some extent, be subsumed within C but it is thought that it would be preferable to treat employee shares separately.

possible, in the light of the tax law and the need to maintain the capital of limited companies, to take advantage of the power.

i. Practicability

31. It would clearly be wrong to allow companies to redeem shares not expressly issued as redeemable with safeguards against reducing capital to the detriment of creditors less stringent than those applicable to redeemable preference shares. Assuming therefore that the safeguards in section 58 are not reduced (a question discussed below in paragraphs 50-55) it follows that shares could not be repurchased unless -

(a) they were fully paid,

(b) they were repurchased out of the proceeds of a fresh issue or out of profits, and

(c) if purchased out of profits, the share-capital which they represent was replaced by an undistributable reserve - the capital redemption reserve fund.

It can be argued that these rules - or rather (b) and its corollary (c) - would in practice prevent private companies from exercising the power since they rarely accumulate sufficient profits to buy out in one lump sum a member who has, say, one-quarter or more of the equity.

32. However, one of the reasons why they do not accumulate profits - the power of the Revenue to apportion short-falls in distributions by close companies - will, as pointed out in paragraph 15, above, be removed in the case of trading companies when the 1980 Budget proposals are enacted. And partnership firms commonly buy the shares of a deceased or retired partner by instalments out of future years' profits. If this was permissible in the case of companies (and there seems to be no reason why not) the lack of accumulated profits would be unimportant. If partnership firms (which are

treated just as strictly for tax purposes) find it practicable to buy partners out[11] it would seem to be equally practicable for private companies (most of which are incorporated partnerships) to do likewise if they were allowed to. The only difference would be that whereas unincorporated partnerships (or unlimited companies) can use capital as well as profits, limited companies could not.

33. Doubtless therefore there would be some cases where, without resort to capital, it would not be possible for a private company to buy out a major shareholder, even if the price were paid by instalments. But the mere fact that private companies would not always be able to use the power to repurchase is not a reason for refusing to confer the power for use in those cases where it would be practicable to do so.

34. There is, however, a further tax problem which would have to be solved if the power was to be of practical value. The shareholder or his personal representatives will not wish to sell to the company unless the net price after tax is as much as it would be if the sale was to a third party. In other words he or they will want any profit to be taxed as a capital gain only and not as income. But, if this were conceded in all cases where a company buys its shares, it would afford an easy way of extracting income in the form of capital. A company instead of distributing its profits by way of dividend or directors' salaries could instead carry out a pro-rata informal reduction of capital by repurchasing a proportion of each member's shares. Clearly this would, and should, be treated as payment of dividend. In the USA, where tax questions have been one of the major problems arising from the power to buy shares, the Internal Revenue tries to distinguish between those transactions which are in reality distributions of dividends and those which are *bona fide* purchases. A distribution to a shareholder in a complete

11. Though it is now less common for large payments to be made for the share of goodwill.

redemption of his holding is treated as a sale or exchange. Proportionate redemptions from all shareholders are treated as dividends. For transactions in between, the basic principle is that a purchase by a company of its own shares is treated as a dividend unless it is established in the particular circumstances of each case that it is not essentially equivalent to one. In principle this seems to be sound but it affords a greater measure of uncertainty and administrative discretion than might be regarded as acceptable in this country. However, so long as it was conceded that a purchase of the whole of a member's shares would be treated as a sale, giving rise only to such tax liability as would arise on a sale to a third party, the main need would be met. Without this concession the position of the retiring shareholder would be even worse than it is at present, for the directors, if they had absolute power to refuse transfers, would probably say "The company is prepared to buy your shares at a fair price but not to permit a transfer to an outsider". Without more evidence of badfaith their decision could hardly be attacked. Yet the effect would be that the price payable by the only available purchaser would be unfairly disadvantageous to the seller.

35. Another problem would be the determination of what is a fair price. In the absence of any other provision in the company's articles this would depend on free bargaining between the company and the shareholder and the purchase would not take place unless both were satisfied. Many private companies would doubtless insert in their articles a provision that if any shareholder wished to dispose of his shares the company would be entitled to buy them at a fair price to be determined in default of agreement by the company's auditor. But as already pointed out (paragraph 23, above) the subjective judgment of the auditor would not necessarily ensure that the price was objectively correct. It has to be faced that there is no cast-iron way of ensuring that the price paid is not excessive (thus reducing the

value of the remaining shares) or (what is more likely because of the restricted market and the probably unfettered discretion to refuse transfers) too small (thus increasing the value of the remaining shares). Safeguards against these dangers and against the danger that purchases will be used by the directors to enhance their own control or otherwise unfairly, are discussed in paragraphs 41-48 below and can, it is thought, be provided.

36 It seems, therefore, that there are no insuperable difficulties and that, subject to some further relaxation of the tax rules, the power would be useful sufficiently often to make it worthwhile.

ii. Questions arising

37. The first question is to decide whether shares repurchased should be cancelled or whether they should be treated as "treasury shares" which the company could re-sell. In relation to private companies it seems clear that there is no case for courting the accounting and other problems which dealings in treasury shares would involve. Shares purchased should be cancelled but there should be the same concessions relating to capital duty as apply to issues of further capital following redemption of redeemable shares (see Companies Act 1948 Section 58(4) as amended by Finance Act 1973, sched. 19, para 14). This, in effect, would enable the company to bring in a new shareholder in place of the one bought out without payment of further duty. It would also preserve the protection to the members afforded by Sections 14 and 17 of the 1980 Act.

38. If companies were permitted to buy their own shares it would follow, in the absence of express prohibition, that they could enter into executory contracts, or obtain options, to do so. There seems to be no grounds for

prohibition; indeed for reasons stated in paragraph 32, executory contracts appear to be vital if the aim is to be achieved. Performance of such contracts would necessarily be conditional on its being lawful for the company to pay for the shares at the time when the contract is completed, ie on the assumption that payment could lawfully be made out of profits only, on the company's having profits available at the time or times of performance. What should happen, however, if the contract has been partly performed? Suppose, for example, that the company has 900 issued shares owned equally by three shareholders. One dies and the company agrees to buy his 300 shares for £30,000, payable by equal instalments out of the profits for the next 3 years. The first year's payment is made but in the second year insufficient profits are available. If this eventuality has been foreseen and dealt with in the contract all may be well. But what if it has not? It is tempting to say that the purchase of the first 100 shares for £10,000 should be completed butthat the contract should be cancelled as regards the balance. But that would be to make a different contract for the parties and, probably, one that would not be satisfactory to either. The estate wants to get out of the company and not to be left with 200 (probably unsaleable) shares. The company has agreed the price on the basis that it is buying a holding which, through the power to block a special resolution, conferred a measure of negative control. An alternative solution (though clearly not one wholly satisfactory to the estate) would be to say that in the absence of agreement to the contrary the whole transaction should be cancelled. This might occasionally present difficulties if the personal representatives had distributed the £10,000 or if the 100 shares had already been transferred to the company and cancelled. Neither solution is ideal. But all that seems to be necessary is to provide some rule which, in the absence of express agreement, would provide a workable solution if not a perfect one.

iii. Safeguards

39. As with issues of redeemable shares, companies should be permitted to repurchase their shares only if authorised by their articles. But this alone would not provide adequate publicity. If companies were permitted to enter into executory contracts or to obtain options to buy their shares it would be necessary to ensure that publicity was given to the fact that the shares were subject to the contract or option. When shares are issued as redeemable this is ensured because the articles have to state the terms and manner of redemption and because the relevant share certificates will describe them as redeemable. In such cases the right or obligation to redeem will be an incident of the shares and will run with them into the hands of any holder. This would not be so in the case of other types of share.[12] The contract or option to buy would be personal to the shareholder and a purchaser, without notice, from him would obtain a good title but for the fact that if the directors have power to refuse transfers, as in practice they will, they would obviously refuse to register him. Hence he ought to be able to find out that the shares are under contract or option; and so should anyone dealing with the company - especially anyone minded to become a shareholder - for the contract may materially affect the true net worth of the company. Provision would obviously need to be made requiring notice to be given to the Companies Registry whenever a company acquired any of its own shares. But in addition it is suggested that whenever it entered into a contract or acquired an option to do so it should also give such notice. It is also suggested that the company should be required to maintain at its registered office a register (analogous to the register of directors'

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12 It would be possible to provide that a note of the contract or option should be endorsed on the relative share certificates but it is doubtful if this would be much of a safeguard.

holdings and dealings required under Section 29 of the 1967 Act) of all acquisitions, contracts, or options which would show, inter alia, the price paid, and that the register (and perhaps copies of the contracts themselves?) should be available for inspection at least by any member or debenture holder. This would be a valuable additional protection against improper or improvident behaviour by the directors and would help to some extent in the determination of a fair price since it would be possible to obtain details of any past purchases. Unless, in the case of private companies, it would be thought an undue invasion of privacy any member of the public might be permitted to inspect these documents and any member or debenture holder to inspect the contracts themselves.

40. Some minor amendments to Schedule 8 of the Companies Act 1948 would also be necessary to ensure that the annual accounts gave adequate particulars of shares repurchased. When a company had entered into a contract to acquire shares, paras 11(5) and 12(1)(d) should be made applicable. The EEC Fourth Directive (which applies to private as well as public companies) requires separate details to be given of holdings of the company's own shares, but only "to the extent that national law permits their being shown in the balance sheet" as assets. If the foregoing suggestions were adopted they would clearly not be so shown since they would have been cancelled.

41. The final question is whether the present law would provide adequate safeguards against the undoubted opportunities for abuse that an extension of the power to repurchase shares would provide. Purchases could be used to enhance the directors' control or to increase the value of their shares using the company's money to do so. If made in advance of a likely take-over bid they could be highly prejudicial to the holders of the shares bought.

Since the company would rarely be in a position to buy out every member if a number wished to sell within a short period, it could be used to favour one member rather than another. These abuses can take place at present - except that the directors or other "insiders" have to use their own money when they buy and not that of the company. The power to use the company's money might increase the likelihood of these abuses and introduce others since, as already pointed out, if the company pays too much for the shares its creditors and remaining members are prejudiced, and if it pays too little its remaining members gain unfairly.

42. In the case of dealings in shares in private companies it is unrealistic to place reliance on the extra-legal restraints imposed by the Codes of Conduct promulgated by The Stock Exchange, and the Council for the Securities Industry or on the City Code on Take-Overs and Mergers. Nor will the new statutory rules regarding insider-dealing have relevance to dealings in shares of private companies. Hence, unless additional protections were provided, the safeguards would consist of (a) the directors' duties of care, skill and good faith and (b) the protection of minorities afforded by a winding-up order on the ground that it is just and equitable or the alternative remedy under the Section 75 of the Companies Act 1980. These rules would provide remedies if the directors were negligent in the exercise of the company's power or used it for an improper purpose or to benefit themselves or if the power was exercised in a way which was unfairly prejudicial to some part of the members. Hence they would go some way to provide the needed safeguards if only shareholders could be relied upon to invoke them. Unfortunately, but understandably in the light of the expense of corporate litigation, this cannot be relied on. Nor would the resources of the Department of Trade be adequate to enable abuses to be effectively prevented or remedied by the exercise of the Secretary of State's powers

to appoint Inspectors and to take legal action in the light of the Inspectors' Reports.

43. It therefore appears that further safeguards are needed. It is accordingly suggested that any contract to repurchase shares should require ratification by the company in general meeting. This would ensure that all shareholders learnt of the proposed repurchase in advance and that they, and not merely the directors, had to pass judgment upon its desirability. If, however, the shareholder who wished to be bought out, had a majority of votes, this alone would not be an adequate safeguard. It would be somewhat more effective if an extraordinary or a special resolution, requiring a three-quarters majority, were prescribed, but, even so, in some cases the affirming resolution would be passed only as a result of the votes of the self-interested shareholder.

44. It is therefore suggested for consideration that on any such affirming resolution the shares which were to be purchased should not be voted. It is appreciated that this would be to introduce into English Company Law a somewhat novel concept since at general meetings, as opposed to directors' meetings, members are generally permitted to vote in their own selfish interests. But in the not-wholly dissimilar situation when the general meeting has been asked to ratify the issue of shares allegedly allotted improperly the court have directed that such shares shall not be voted: Hogg v Cramphorn Ltd. [1967] Ch. 254; Bamford v Bamford [1970] Ch. 212, C.A. Moreover, if it is conceded that what is sought to be achieved is that the power should be exercised only when that is in the interests of the company as a whole and if, as the case-law establishes, that means in the long-term interests of members present and future, it seems logical that the decision should be taken by members who will remain in the company rather than by

those who are seeking to leave it. It should also be borne in mind that where the shares are those of a deceased (or bankrupt) member it would not always be possible for his shares to be voted because his personal representatives (or trustee in bankruptcy) had not been registered as a member (Table A. art. 32).

45. An alternative to the safeguard suggested in the foregoing paragraph would be to allow all members (including the one being bought out) to vote on the resolution but to entitle a dissenting minority to petition the court to set aside the resolution. Experience with other circumstances in which such a safeguard is already provided (for example under Sections 72 and 209 of the 1948 Act) does not suggest that it would be particularly effective in view of the courts' reluctance to interfere with the business judgment of directors and majority shareholders and any safeguard dependent on the willingness to incur the expenses of litigation is better avoided except as a last resort, especially in the case of small companies.

46 Since the new statutory insider dealing rules (1980 Act, Part V) do not apply to transactions in the securities of private companies it would be desirable to provide protection against the increased opportunities for abuse of inside information that would arise if the company itself could buy its shares. It could be argued that since most private companies are essentially incorporated partnerships the transactions should be treated as contracts *uberrimae fidei* demanding disclosure of all material facts. But since an issue of shares is not a contract *uberrimae fidei* in the full sense it would be illogical to go so far with a contract to repurchase. It would seem better to draw on the analogy of the provisions of the 1980 Act and to prohibit a repurchase when either the buying company or the selling shareholder (in the case of a private company the latter might have information unknown to the company) had "unpublished price sensitive information"

as defined[13] in Section 73(2) of the Act. But in contrast with the Act's provisions relating to dealings, normally on The Stock Exchange, it is suggested that the sanctions for breach should not be limited to criminal penalties against individuals but that, in addition, the transaction should be voidable at the instance of the innocent party.

47. The foregoing safeguards would not be needed if repurchases were pro-rata from all shareholders. This however is unlikely to occur in the case of private companies without a formal scheme of capital reduction because it seems inconceivable that the Revenue would ever countenance a relaxation of the tax rules treating it as an income distribution - it would provide obvious opportunities for tax avoidance.

48. It is not thought that specific provisions would be needed regulating the insertion in the company's articles of a power to repurchase shares at an arbitrary price. It could not be successfully argued that such a power or its exercise was necessarily effective as "in the interests of the company as a whole" for in this context that does not mean the company as a corporate entity.[14]

iv. <u>A narrower alternative</u>

49. It should be pointed out, in conclusion of the discussion of this Possibility, that instead of conferring power to repurchase in any

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13 The definition might need verbal amendment to make it appropriate to dealings in securities of private companies.

14 <u>Greenhalgh</u> v <u>Arderne Cinemas</u> /1951/ Ch. 286, C.A., at 291

circumstances if profits permitted, private companies might be permitted to do so in defined circumstances only. In that event the circumstances might be:

(a) in redemption of redeemable shares in advance of the redemption date,

(b) repurchase of the whole of a member's holding on his death or his retirement from gainful occupation as a result of disability, redundancy or attainment of pensionable age.

There seems to be a strong case in any event for allowing repurchase in case (a). It might reduce the temptation to redeem under a formal reduction scheme when, because of changes in interest rates, such shares have become detrimental to the company and might enable the shareholders to avoid being redeemed under such schemes on terms which they regard as unfair.[15] Case (b) reflects the type of special circumstances in which it might be conceded that the purchase price should not be treated as an income distribution for tax purposes.[16] But so far as company law is concerned it is

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15 Scottish Insurance Corpn v Wilsons & Clyde Coal Co [1949] A.C. 462, H.L; Prudential Assurance v Chatterly Whitfield Collieries, [1949] A.C. 512, H.L; Re Saltdean Estate Co [1968] 1 W.L.R. 1844. The objections of The Stock Exchange and Institutional investors to premature purchases for cancellation of listed redeemable securities could hardly apply to freely negotiated repurchases of unlisted shares where the alternative of a reduction scheme may operate harshly in the necessary absence of the protection of the Spens formula: see Re Saltdean Estate Co.

16 the conditions for approved profit sharing schemes referred to in paragraph 29, above.

suggested that the power to repurchase, if conferred at all, should be exercisable generally and not restricted to those circumstances in which, for tax reasons, it is most likely to be used. It would, however, be possible to restrict the use of the power to specific types of private companies, for example to "proprietary companies" or to middle-tier private companies as defined in the recent Green Paper, Company Accounting and Disclosure (Cmnd 7654).

CAPITAL MAINTENANCE

50. Before leaving private companies there is one further question which needs to be discussed. As has been pointed out, if redemption or purchase of shares is permitted only out of profits, some private companies will find themselves unable to avail themselves of the power. Is it practicable, without substantially reducing the protection afforded to creditors present and future, to relax the present rules? This could be done in one (or both) of two ways. The first would be to enable private companies to redeem or purchase shares without having to comply with all the present restrictions in section 58; the second could be to make it easier for them to reduce capital and thus to effect a purchase by that route. In considering the feasibility of either it needs to be borne in mind that (a) under-capitalisation is a major cause of failure of private companies, often with grievous loss to their creditors, and (b) the capital maintenance and dividend rules have now been strengthened by the provisions of the 1980 Act. Hence any weakening of the protection is something that needs to be looked at very critically.

51. Under the present Section 58 shares cannot be redeemed

(a) unless they are fully paid,

(b) except out of profits available for dividend or the proceeds of a fresh issue,

and

(c) unless, on redemption out of profits, an undistributable reserve (the capital redemption reserve fund) replaces the nominal amount of the shares redeemed.

52. It has long been accepted that only fully paid shares can be redeemed and it seems clear that a relaxation of (a) could not be contemplated.[17] Uncalled capital, in the rare cases in which it exists, is in reality a valuable asset to which creditors can turn and on which they are entitled to rely. To permit the uncalled liability to be wiped out, except on a formal reduction of capital, seems unthinkable. It has been argued that no harm would be done to creditor protection so long as the uncalled liability was replaced by capital redemption reserve fund. But a reserve is not as effective a protection as an "asset", particularly in relation to private companies to which Section 40 of the 1980 Act does not apply. Similarly there would be a grave weakening of the present protection if a company could buy back shares out of capital. At first sight, however, it might be thought that this could adequately be prevented by maintaining (a) and (b) alone. This, however, is not so, for (c) is, in effect a necessary corollary of (b). This can be illustrated by the following simplified example:

> Company A has issued £10,000 Ordinary Shares and £10,000 Redeemable Preference Shares at par. It has made realised profits of £10,000 and now has net assets of £30,000, represented by £20,000 share capital and £10,000 free

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17 The EEC Second Directive takes the same view: see arts. 19.1.d and 39.b.

reserves. It uses the £10,000 to redeem the Preference Shares. Its share capital is now £10,000 and its net assets £20,000. But for the need to establish a capital redemption reserve fund it would still have free reserves of £10,000 available for dividend, and would, in effect, have redeemed the Preference Shares out of capital.

It seems clear, therefore, that (c), the need to replace the shares redeemed by an undistributable reserve, is vital if creditor protection is not to be substantially reduced, both in the case of redeemable preference shares and re-purchase of shares.

53. The second way of meeting the difficulties of private companies, ie by permitting simpler and cheaper formal reductions of capital, seems more promising. If, however, the need to obtain the approval of the court were maintained it seems doubtful whether the procedure could be simplified and cheapened (even if the jurisdiction of the county court was extended) sufficiently to make it attractive to small private companies. The real protection afforded to creditors and members by the need for court approval is not so much that reduction schemes are liable to be rejected by the court (it is difficult indeed to find cases of such rejection when the formal requirements have been complied with) but rather the fact that the need to go before the court involves the collaboration of barristers, solicitors and accountants who for the sake of their reputations, will not support reduction schemes unless they are satisfied that they are fair and justified. It is their professional charges rather than court fees which account for the expense. But any legal procedure which dispensed with their collaboration would result in a grave weakening of the protection afforded.

54. However, as already pointed out (paragraph 6) we are exceptionally strict in our present requirement that a formal reduction of capital always involves confirmation by the court. It is for consideration whether adequate safeguards to creditors and members could not be secured without involving the court - an involvement which in the case of small companies imposes a heavy burden. In a Report to the Finance and Economics Committee of the States of Jersey[18] the Commercial Relations Department has suggested a procedure which draws on Continental experience and provides pretty stringent safeguards. The relevant clauses of the Draft Bill (article 50(1), relating to redeemable shares and article 51, relating to reductions of capital generally) are set out in Appendix B to this paper. The precise solution recommended would not be practicable here for we have no officer equivalent to the Commercial Relations Officer and the Companies Division of the Department of Trade does not have the resources needed to undertake the task of confirming in place of the court. Nor do our private companies need to have a minimum capital. But is is for consideration whether a modified version of the proposals, on the following lines, would not afford adequate protection.

55. A private company might be permitted to redeem or re-purchase shares out of capital and to reduce capital accordingly, in the following manner:

(a) Passing a special resolution ratifying the redemption or purchase and approving the reduction of capital.

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18 Report on Company Law Reform with Draft Company Law, October 1975

(b) Delivering to the Registrar of Companies a copy of the resolution together with

i a statutory declaration by all the directors certifying that the company was and, after the redemption or purchase, would be able to pay its debts as they fell due and that it had adequate capital facilities for the conduct of its business without resort to the capital employed in the redemption or purchase;

and

ii a report by the company's auditor stating that he had examined the books and accounts of the company and that in his opinion the company would be able to pay its debts as they fell due without regard to the capital resolved to be returned to the shareholders.

(c) The Registrar would cause a notice of the proposed purchase or redemption and reduction of capital to be published in the Gazette and in at least one national newspaper and one local newspaper circulating in the locality where the company had its principal place or places of business.

(d) Unless within a prescribed time from the publication of the notice any creditor or member applied to the court to prohibit the redemption or purchase and reduction the resolution would become effective at the expiration of that time.

(e) If application were made to the court the resolution would not take effect except to the extent that, and subject to such conditions as, the court ordered.

(f) Stringent penalties would be prescribed for statements made without reasonable grounds and if the company were wound up, and proved to be insolvent, within, say 12 months or 3 months after the publication of its next accounts (whichever was the longer) it would be presumed until the contrary was shown that the directors did not have reasonable grounds for their declaration (cf Section 283 of the 1948 Act).[19]

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PUBLIC COMPANIES

PRELIMINARY CONSIDERATIONS

56. In discussing whether public companies and their subsidiaries should be given powers to re-purchase their own shares, five preliminary considerations need to be stressed.

(a) The case for doing so is of a different character from that of private companies: see paragraph 16 above.

(b) In relation to public companies (though not their private subsidiaries) any extension would have to comply with the stringent conditions imposed by the EEC Second Directive: see paragraphs 7 and 8 above and Appendix A.

(c) The EEC Second Directive, art. 39, does not prescribe that redeemable shares must be preference shares.

(d) The present need to operate employee-share schemes through trustees does not impose an excessive burden on public companies

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19 A possible additional safeguard would be to provide that if winding up took place within the prescribed period the shareholders should be liable to return the capital repaid. This, however, would prevent the personal representatives of a deceased shareholder from completing administration of the estate until after the expiration of the period.

and to dispense with trustees and yet comply with the provisions of the Second Directive would make for needless complications.

(e) The EEC Second Directive envisages that companies having power to re-purchase their shares might then re-sell them. This would, in effect, introduce a practice alien to British notions (though common in the USA) namely that of public companies keeping their shares "on tap" indefinitely. In none of the recent discussions on this subject has there been any advocacy of allowing companies to traffic in their shares and if they were empowered to do so it would lead to a number of complicated problems regarding accounting for dealings and the tax treatment of the company in respect of profits or losses on such deals. If, as proposed in the case of private companies, public companies were merely empowered to buy their shares for cancellation, these complications would be avoided, as would some of the constraints which would otherwise be required by the Second Directive.

Having regard to these considerations the only questions that it seems necessary to discuss are whether powers analogous to Possibilities A and C should be extended to public companies (and their private subsidiaries) and, if so, what modifications of the suggestions made in relation to private companies would be desirable, or necessary, in order to comply with the Second Directive.

POSSIBILITY D

Expressly permit public companies and their subsidiaries to issue redeemable equity shares

57. All that has been said about Possibility A in relation to private companies is equally applicable here. In practice the power might prove more useful to public companies since the problem of fixing a meaningful redemption price could be solved in the case of listed shares by the use of the *Spens* formula: see paragraph 23 above. Whether such shares would prove popular with investors (or The Stock Exchange) is another matter but the fact that they might not is not an adequate reason for not openly recognising what is already legally possible. But in relation to public companies it would be even more desirable to make the amendments to sections 56 and 58 of the 1948 Act suggested in paragraph 22 above[20].

POSSIBILITY E

Permit public companies and their private subsidiaries to re-purchase and cancel their shares

58. The principal advantage of this proposal is thought to be that it would make it easier for companies to "go public" without obtaining a Stock Exchange listing, for the company would provide an alternative market. The expenses of listing and the minimum size of issues that The Stock Exchange will list are undoubtedly grave handicaps in the way of small concerns wishing to market their shares. On the other hand, it can be argued that the initial scrutiny and subsequent vigilance of The Stock Exchange is the most potent protection which investors enjoy, and certainly the track records of many of the (relatively few) companies which have made public issues without a listing do not suggest that such issues should be encouraged. Moreover the proposals of The Stock Exchange to introduce an Unlisted Securities Market (in addition to dealings under the present rule 163(2)) may solve the problems of small public companies in this regard.

20. The present position seems inconsistent with the spirit, if not the letter, of the EEC Second Directive.

59. If, nevertheless, it was thought desirable to adopt this Possibility, much of what has been said in relation to Possibility C is equally applicable here and need not be repeated. The public company would be permitted to re-purchase shares only if authorised by its articles and if the shares were fully paid and only out of profits available for dividends or the proceeds of a fresh issue. On repurchase the shares would be cancelled but with a similar concession to that under section 58(4) as amended (see paragraph 37) on an issue of further capital (to which the provisions of sections 14, 17 and 18 of the 1980 Act would apply). The capital of shares re-purchased out of profits would be replaced by a capital redemption reserve fund - particularly important in the case of public companies in view of section 40 of the 1980 Act. Public companies would not face the same difficulties as private ones in complying with these conditions and it is not suggested that in their case any less formal provisions for reduction of capital should be contemplated. Additional extra-legal protections against abuses would be likely to operate because The Stock Exchange, the C.S.I., and the Take-over Panel would doubtless evolve additional rules to deal with this new situation. Where the shares purchased were listed there would be recent quotations which would help in ensuring that a fair price was paid and if they were bought on The Stock Exchange the new insider dealing rules would operate[21].

60. Certain modifications of the proposals made in relation to Possibility C would however be necessary; for example it would obviously be impracticable to require each individual re-purchase to be ratified in general meeting. Others would be needed to comply with the Second Directive.

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21. Other common-law countries on introducing power for a company to buy its own shares have thought it necessary to provide expressly that the company is then an "insider": see Canada Business Corporations Act 1974-75, s.125(1)(b). Since the rules in our 1980 Act impose liability only on individuals it might be desirable to clarify precisely who would be liable when the purchase was by the company itself.

61. It is accordingly suggested that the power should be exercised as follows:

(a) Authorisation should be given in general meeting and should lapse unless renewed at each succeeding annual general meeting. The authorisation should determine the maximum number of shares of each class that might be re-purchased and the maximum and minimum price which might be paid (thus complying with art.19 1a of the Second Directive).

(b) Notice of all acquisitions, contracts and options should be given to the Registrar of Companies and the company should also be required to maintain a register of all acquisitions, contracts or options which should be open to public inspection (cf paragraph 39 above).

(c) The directors' report or notes to the accounts should state the reasons for acquisitions during the relative accounting period, the number, class and nominal value of the shares acquired, the proportion they represent of the issued share capital at the beginning of that period and the total price paid (thus complying with art.22.2 of the Second Directive).

(d) Shares could be lawfully re-purchased only if fully paid and only out of the proceeds of a fresh issue, or out of profits which, consistently with sections 39-45 of the 1980 Act, the company could have distributed by way of dividend (thus complying with art.19.1c and d of the Second Directive).

(e) Re-purchased shares would be cancelled forthwith and, unless re-purchased out of the proceeds of a fresh issue, replaced by an undistributable reserve.

(f) No re-purchase could be made by a public company if the cancellation of the shares concerned would have the effect of reducing the nominal value of the company's issued share capital below "the authorised minimum" as defined in section 85 of the 1980 Act (thus complying with art.34 of the Second Directive).

62. Since the shares re-purchased would not be held by the company, but cancelled, no other conditions seem to be necessary in order to comply fully with the Second (or Fourth) EEC Directive. It is for consideration, however, whether, by analogy with art. 19.1b of the Second Directive, some limit (additional to that resulting from paragraph 61(f)) should be imposed on the proportion of the share capital which a company might acquire - art.19.1b prescribes a limit on shares acquired <u>and held</u> of 10%. Since the members in general meeting would have to determine the maximum number which could be acquired (see paragraph 61(a) above) and since creditors would be protected because there would be no reduction of the capital yard-stick (see paragraph 61(d) and (e) above) the case for imposing any such limit does not seem to be strong. The only obvious purpose which it would serve would be to restrict the extent to which re-purchases might be used by the directors to enhance their own control or increase the value of their own shares. That, however, would be achieved only if the limit was a proportion of the shares of each class (as well as of the total subscribed capital) and, further, was a proportion of the capital originally subscribed (a percentage of the currently subscribed capital would allow the capital to be reduced gradually). Having regard to the conditions suggested in paragraph 61 and to the legal and extra-legal restraints on self-dealing it hardly seems necessary to prescribe a limit. The limit resulting from condition (f) in paragraph 61 would operate only in the case of public companies and not in relation to their private subsidiaries. It would therefore provide a means of buying out a minority alternative to a purchase by the parent company. That, however, appears to be unobjectionable.

63. One further article of the Second Directive is relevant, however. Article 42 prescribes that "For the purposes of the implementation of this Directive the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position". The danger that a power to re-purchase might be used to discriminate unfairly as between one shareholder and another has already been adverted to (paragraph 41 above) and doubtless the draftsmen of the Directive had this in mind. Although the risk of such discrimination is probably less in the case of public companies (certainly the larger ones) and is taken care of by the legal and extra-legal constraints to which they are subject, the article may have important implications in the present context. Where the company's shares are listed it is not thought that there would be any breach of the article if a company wishing to buy its shares did so by instructing its stockbroker to acquire them on The Stock Exchange. But so long as the present tax rules (see paragraph 15, above) are maintained this type of re-purchase would presumably have to be banned because it would be impossible for the Revenue (or the company) to tell which shareholders selling on the Exchange should be deemed to have sold to the company and which to third parties[22]. And in any case it would be grossly inequitable to tax some as if the price received was income and others as if it was capital liable only to capital gains tax. In practice, the company would have to circulate an invitation to its shareholders, in which event offers might be received of more shares than the company was prepared to buy. The company ought then to treat each shareholder alike by scaling down each offer pro rata. That, however, would mean that only a proportion - and perhaps a small one - of each member's holding would be bought, with the result that the Revenue would be more likely to insist that the purchases should be treated for tax purposes as a distribution (see paragraph 34 above).

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22. In both cases transfers would be through SEPON.

The circumstances in which the power to re-purchase would be most valuable to a shareholder are where the shares are not listed and he needs to sell. This seems to be the most likely case for a relaxation of the present tax rules. And it is not thought that it would conflict with article 42 of the Second Directive so long as the company adopted a consistent policy towards approaches from shareholders.

64. If the power to re-purchase was extended to investment companies it would enable unit trusts to operate instead as open-ended investment companies or mutual funds. This, as pointed out in paragraph 16 above, they seemingly do not wish to do - though some investment trust companies might welcome the opportunity. It would also necessitate the dismantling of the present regulation of unit trusts and the erection of an entirely new method of control. Although there may in the long term be a case for a new system - as the Jenkins Committee thought (Cmnd 1749 paras 311-324) - neither the Department nor, it is thought, the industry, would wish to face this task at the present time. Hence it is suggested that investment companies should be expressly excluded if this Possibility were adopted.

65. As in the case of private companies (see paragraph 49 above) it would be possible to adopt a more restricted power than that so far considered. For example, the power to re-purchase might be limited to shares which are not listed - the situation in which it would be most needed by shareholders because there was no other market on which they could sell. Or, adopting the three-fold classification proposed in the Green Paper <u>Company Accounting and Disclosure</u> (Cmnd 7654), it could be restricted to companies not in the top tier. Alternatively (or additionally) it could be limited to the purchase and cancellation of redeemable shares prior to the date of redemption. This power might well be conceded in any event. Though it is understood that the re-purchase of listed debenture stock is not popular among

institutional investors and is a practice which The Stock Exchange seeks to regulate and control, there seems no valid reason to continue to draw a distinction in this respect between one type of redeemable security and another. Company law, it is suggested, should permit it in the case of all types and The Stock Exchange be left to regulate its exercise in relation to listed securities.

COMPANIES ACT 1948, SECTION 54

66. One final question is whether, if any of these Possibilities were adopted, section 54 of the 1948 Act, which subject to certain exceptions prohibits a company from providing finance to another person for the purchase of its shares, should be repealed or amended. On the face of it, it may seem anomalous that companies should be given power to purchase their shares themselves but prohibited from providing finance to others for such purchases. This, however, is not the view taken by the Second Directive (see art.23). And it is thought that that view is correct. The abuses that can flow from the latter practices are, as many Inspectors' Reports have shown, both prevalent and likely to be more dangerous than an open purchase by the company itself. This is not to suggest that the section is not inneed of clarification and amendment. The Jenkins Report (Cmnd 1749, paras 170-186) was critical of it - though its suggested amendments are no longer practicable in the light of the Second Directive. But, it is thought, implementation of any of the possibilities canvassed in this paper, would not of itself demand any amendment of section 54 other than that referred to in paragraph 26 above, if Possibility B were adopted.

CONCLUSIONS

67. To sum up:

i. Little purpose would be served merely by expressly permitting companies to issue redeemable equity shares but it should be allowed subject to certain amendments to sections 56 and 58 of 1948 Act: paragraphs 20-24 and 57.

ii. Consideration should be given to the possibility of:

(a) Permitting private companies to operate employee share schemes otherwise than through trustees and, in relation to such schemes, to buy their own shares: paragraphs 25-29.

(b) Permitting private companies to re-purchase their own shares for cancellation: paragraphs 30-49.

(c) In conjunction with (b) or on redemption of redeemable preference shares, providing a less formal means of reducing capital: paragraphs 50-55.

(d) Permitting public companies to re-purchase their own shares for cancellation: paragraphs 58-65

iii. Without substantial changes in the law and practice of corporate taxation little use is likely to be made of these powers but that is not a valid reason for not introducing them. If they are thought to be desirable reforms of company law they should not await changes in tax law: paragraphs 15, 17, 29, 34, 63.

Appendix A
Relevant Articles of the 2nd Directive

3. Paragraphs 1 and 2 shall not affect the provisions of the Member States as regards increases in subscribed capital by capitalization of reserves.

4. The laws of a Member State may provide for derogations from paragraph 1 (a) in the case of investment companies with fixed capital.

The expression 'investment company with fixed capital', within the meaning of this paragraph means only those companies:

— the exclusive object of which is to invest their funds in various stocks and shares, land or other assets with the sole aim of spreading investment risks and giving their shareholders the benefit of the results of the management of their assets, and

— which offer their own shares for subscription by the public.

In so far as the laws of Member States make use of this option they shall:

(a) require such companies to include the expression 'investment company' in all documents indicated in Article 4 of Directive 68/151/EEC;

(b) not permit any such company whose net assets fall below the amount specified in paragraph 1 (a) to make a distribution to shareholders when on the closing date of the last financial year the company's total assets as set out in the annual accounts are, or following such distribution would become, less than one-and-a-half times the amount of the company's total liabilities to creditors as set out in the annual accounts;

(c) require any such company which makes a distribution when its net assets fall below the amount specified in paragraph 1 (a) to include in its annual accounts a note to that effect.

Article 16

Any distribution made contrary to Article 15 must be returned by shareholders who have received it if the company proves that these shareholders knew of the irregularity of the distributions made to them, or could not in view of the circumstances have been unaware of it.

Article 17

1. In the case of a serious loss of the subscribed capital, a general meeting of shareholders must be called within the period laid down by the laws of the Member States, to consider whether the company should be wound up or any other measures taken.

2. The amount of a loss deemed to be serious within the meaning of paragraph 1 may not be set by the laws of Member States at a figure higher than half the subscribed capital.

Article 18

1. The shares of a company may not be subscribed for by the company itself.

2. If the shares of a company have been subscribed for by a person acting in his own name, but on behalf of the company, the subscriber shall be deemed to have subscribed for them for his own account.

3. The persons or companies or firms referred to in Article 3 (i) or, in cases of an increase in subscribed capital, the members of the administrative or management body shall be liable to pay for shares subscribed in contravention of this Article.

However, the laws of a Member State may provide that any such person may be released from his obligation if he proves that no fault is attributable to him personally.

Article 19

1. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make such acquisitions subject to at least the following conditions:

(a) authorization shall be given by the general meeting, which shall determine the terms and conditions of such acquisitions, and in particular the maximum number of shares to be acquired, the duration of the period for which the authorization is given and which may not exceed 18 months, and, in the case of acquisition for value, the maximum and minimum consideration. Members of the administrative or management body shall be required to satisfy themselves that at the time when each authorized acquisition is effected the conditions referred to in subparagraphs (b), (c) and (d) are respected;

(b) the nominal value or, in the absence thereof, the accountable par of the acquired shares, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, may not exceed 10 % of the subscribed capital;

(c) the acquisitions may not have the effect of reducing the net assets below the amount mentioned in Article 15 (1) (a);

(d) only fully paid-up shares may be included in the transaction.

2. The laws of a Member State may provide for derogations from the first sentence of paragraph 1 (a) where the acquisition of a company's own shares is necessary to prevent serious and imminent harm to the company. In such a case, the next general meeting must be informed by the administrative or management body of the reasons for and nature of the acquisitions effected, of the number and nominal value or, in the absence of a nominal value, the accountable par, of the shares acquired, of the proportion of the subscribed capital which they represent, and of the consideration for these shares.

3. Member States may decide not to apply the first sentence of paragraph 1 (a) to shares acquired by either the company itself or by a person acting in his own name but on the company's behalf, for distribution to that company's employees or to the employees of an associate company. Such shares must be distributed within 12 months of their acquisition.

Article 20

1. Member States may decide not to apply Article 19 to:

(a) shares acquired in carrying out a decision to reduce capital, or in the circumstances referred to in Article 39;

(b) shares acquired as a result of a universal transfer of assets;

(c) fully paid-up shares acquired free of charge or by banks and other financial institutions as purchasing commission;

(d) shares acquired by virtue of a legal obligation or resulting from a court ruling for the protection of minority shareholders in the event, particularly, of a merger, a change in the company's object or form, transfer abroad of the registered office, or the introduction of restrictions on the transfer of shares;

(e) shares acquired from a shareholder in the event of failure to pay them up;

(f) shares acquired in order to indemnify minority shareholders in associated companies;

(g) fully paid-up shares acquired under a sale enforced by a court order for the payment of a debt owed to the company by the owner of the shares;

(h) fully paid-up shares issued by an investment company with fixed capital, as defined in the second subparagraph of Article 15 (4), and acquired at the investor's request by that company or by an associate company. Article 15 (4) (a) shall apply. These acquisitions may not have the effect of reducing the net assets below the amount of the subscribed capital plus any reserves the distribution of which is forbidden by law.

2. Shares acquired in the cases listed in paragraph 1 (b) to (g) above must, however, be disposed of within not more than three years of their acquisition unless the nominal value or, in the absence of a nominal value, the accountable par of the shares acquired, including shares which the company may have acquired through a person acting in his own name but on the company's behalf, does not exceed 10 % of the subscribed capital.

3. If the shares are not disposed of within the period laid down in paragraph 2, they must be cancelled. The laws of a Member State may make this cancellation subject to a corresponding reduction in the subscribed capital. Such a reduction must be prescribed where the acquisition of shares to be cancelled results in the net assets having fallen below the amount specified in Article 15 (1) (a).

Article 21

Shares acquired in contravention of Articles 19 and 20 shall be disposed of within one year of their acquisition. Should they not be disposed of within that period, Article 20 (3) shall apply.

Article 22

1. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall make the holding of these shares at all times subject to at least the following conditions:

(a) among the rights attaching to the shares, the right to vote attaching to the company's own shares shall in any event be suspended;

(b) if the shares are included among the assets shown in the balance sheet, a reserve of the same amount, unavailable for distribution, shall be included among the liabilities.

2. Where the laws of a Member State permit a company to acquire its own shares, either itself or through a person acting in his own name but on the company's behalf, they shall require the annual report to state at least:

(a) the reasons for acquisitions made during the financial year;

(b) the number and nominal value or, in the absence of a nominal value, the accountable par of the shares acquired and disposed of during the financial year and the proportion of the subscribed capital which they represent;

(c) in the case of acquisition or disposal for a value, the consideration for the shares;

(d) the number and nominal value or, in the absence of a nominal value, the accountable par of all the shares acquired and held by the company and the proportion of the subscribed capital which they represent.

Article 23

1. A company may not advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party.

2. Paragraph 1 shall not apply to transactions concluded by banks and other financial institutions in the normal course of business, nor to transactions effected with a view to the acquisition of shares by or for the company's employees or the employees of an associate company. However, these transactions may not have the effect of reducing the net assets below the amount specified in Article 15 (1) (a).

3. Paragraph 1 shall not apply to transactions effected with a view to acquisition of shares as described in Article 20 (1) (h).

Article 24

1. The acceptance of the company's own shares as security, either by the company itself or through a person acting in his own name but on the company's behalf, shall be treated as an acquisition for the purposes of Articles 19, 20 (1), 22 and 23.

2. The Member States may decide not to apply paragraph 1 to transactions concluded by banks and other financial institutions in the normal course of business.

Article 25

1. Any increase in capital must be decided upon by the general meeting. Both this decision and the increase in the subscribed capital shall be published in the manner laid down by the laws of each Member State, in accordance with Article 3 of Directive 68/151/EEC.

2. Nevertheless, the statutes or instrument of incorporation or the general meeting, the decision of which must be published in accordance with the rules referred to in paragraph 1, may authorize an increase in the subscribed capital up to a maximum amount which they shall fix with due regard for any maximum amount provided for by law. Where appropriate, the increase in the subscribed capital shall be decided on within the limits of the amount fixed, by the company body empowered to do so. The power of such body in this respect shall be for a maximum period of five years and may be renewed one or more times by the general meeting, each time for a period not exceeding five years.

3. Where there are several classes of shares, the decision by the general meeting concerning the increase in capital referred to in paragraph 1 or the authorization to increase the capital referred to in paragraph 2, shall be subject to a separate vote at least for each class of shareholder whose rights are affected by the transaction.

4. This Article shall apply to the issue of all securities which are convertible into shares or which carry the right to subscribe for shares, but not to the conversion of such securities, nor to the exercise of the right to subscribe.

Article 26

Shares issued for a consideration, in the course of an increase in subscribed capital, must be paid up to at least 25% of their nominal value or, in the absence of a nominal value, of their accountable par. Where provision is made for an issue premium, it must be paid in full.

Article 27

1. Where shares are issued for a consideration other than in cash in the course of an increase in the subscribed capital the consideration must be transferred in full within a period of five years from the decision to increase the subscribed capital.

2. The consideration referred to in paragraph 1 shall be the subject of a report drawn up before the increase in capital is made by one or more experts who are independent of the company and appointed or approved by an administrative or judicial authority. Such experts may be natural persons as well as legal persons and companies and firms under the laws of each Member State.

Article 10 (2) and (3) shall apply.

3. Member States may decide not to apply paragraph 2 in the event of an increase in subscribed capital made in order to give effect to a merger or a public offer for the purchase or exchange of shares and to pay the shareholders of the company which is being absorbed or which is the object of the public offer for the purchase or exchange of shares.

4. Member States may decide not to apply paragraph 2 if all the shares issued in the course of an increase in subscribed capital are issued for a consideration other than in cash to one or more companies, on condition that all the shareholders in the company which receive the consideration have agreed not to have an experts' report drawn up and that the requirements of Article 10 (4) (b) to (f) are met.

Article 28

Where an increase in capital is not fully subscribed, the capital will be increased by the amount of the subscriptions received only if the conditions of the issue so provide.

Article 29

1. Whenever the capital is increased by consideration in cash, the shares must be offered on a pre-emptive basis to shareholders in proportion to the capital represented by their shares.

2. The laws of a Member State:

(a) need not apply paragraph 1 above to shares which carry a limited right to participate in distributions within the meaning of Article 15 and/or in the company's assets in the event of liquidation; or

(b) may permit, where the subscribed capital of a company having several classes of shares carrying different rights with regard to voting, or participation in distributions within the meaning of Article 15 or in assets in the event of liquidation, is increased by issuing new shares in only one of these classes, the right of pre-emption of shareholders of the other classes to be exercised only after the exercise of this right by the shareholders of the class in which the new shares are being issued.

3. Any offer of subscription on a pre-emptive basis and the period within which this right must be exercised shall be published in the national gazette appointed in accordance with Directive 68/151/EEC. However, the laws of a Member State need not provide for such publication where all a company's shares are registered. In such case, all the company's shareholders must be informed in writing. The right of pre-emption must be exercised within a period which shall not be less than 14 days from the date of publication of the offer or from the date of dispatch of the letters to the shareholders.

4. The right of pre-emption may not be restricted or withdrawn by the statutes or instrument of incorporation. This may, however, be done by decision of the general meeting. The administrative or management body shall be required to present to such a meeting a written report indicating the reasons for restriction or withdrawal of the right of pre-emption, and justifying the proposed issue price. The general meeting shall act in accordance with the rules for a quorum and a majority laid down in Article 40. Its decision shall be published in the manner laid down by the laws of each Member State, in accordance with Article 3 of Directive 68/151/EEC.

5. The laws of a Member State may provide that the statutes, the instrument of incorporation or the general meeting, acting in accordance with the rules for a quorum, a majority and publication set out in paragraph 4, may give the power to restrict or

withdraw the right of pre-emption to the company body which is empowered to decide on an increase in subscribed capital within the limits of the authorized capital. This power may not be granted for a longer period than the power for which provision is made in Article 25 (2).

6. Paragraphs 1 to 5 shall apply to the issue of all securities which are convertible into shares or which carry the right to subscribe for shares, but not to the conversion of such securities, nor to the exercice of the right to subscribe.

7. The right of pre-emption is not excluded for the purposes of paragraphs 4 and 5 where, in accordance with the decision to increase the subscribed capital, shares are issued to banks or other financial institutions with a view to their being offered to shareholders of the company in accordance with paragraphs 1 and 3.

Article 30

Any reduction in the subscribed capital, except under a court order, must be subject at least to a decision of the general meeting acting in accordance with the rules for a quorum and a majority laid down in Article 40 without prejudice to Articles 36 and 37. Such decision shall be published in the manner laid down by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC.

The notice convening the meeting must specify at least the purpose of the reduction and the way in which it is to be carried out.

Article 31

Where there are several classes of shares, the decision by the general meeting concerning a reduction in the subscribed capital shall be subject to a separate vote, at least for each class of shareholders whose rights are affected by the transaction.

Article 32

1. In the event of a reduction in the subscribed capital, at least the creditors whose claims antedate the publication of the decision to make the reduction shall be entitled at least to have the right to obtain security for claims which have not fallen due by the date of that publication. The laws of a Member State shall lay down the conditions for the exercise of this right. They may not set aside such right unless the creditor has adequate safeguards, or unless the latter are not necessary in view of the assets of the company.

2. The laws of the Member States shall also stipulate at least that the reduction shall be void or that no payment may be made for the benefit of the shareholders, until the creditors have obtained satisfaction or a court has decided that their application should not be acceded to.

3. This Article shall apply where the reduction in the subscribed capital is brought about by the total or partial waiving of the payment of the balance of the shareholders' contributions.

Article 33

1. Member States need not apply Article 32 to a reduction in the subscribed capital whose purpose is to offset losses incurred or to include sums of money in a reserve provided that, following this operation, the amount of such reserve is not more than 10% of the reduced subscribed capital. Except in the event of a reduction in the subscribed capital, this reserve may not be distributed to shareholders; it may be used only for offsetting losses incurred or for increasing the subscribed capital by the capitalization of such reserve, in so far as the Member States permit such an operation.

2. In the cases referred to in paragraph 1 the laws of the Member States must at least provide for the measures necessary to ensure that the amounts deriving from the reduction of subscribed capital may not be used for making payments or distributions to shareholders or discharging shareholders from the obligation to make their contributions.

Article 34

The subscribed capital may not be reduced to an amount less than the minimum capital laid down in accordance with Article 6. However, Member States may permit such a reduction if they also provide that the decision to reduce the subscribed capital may take effect only when the subscribed capital is increased to an amount at least equal to the prescribed minimum.

Article 35

Where the laws of a Member State authorize total or partial redemption of the subscribed capital without

* ie 25,000 u.a.

reduction of the latter, they shall at least require that the following conditions are observed:

(a) where the statutes or instrument of incorporation provide for redemption, the latter shall be decided on by the general meeting voting at least under the usual conditions of quorum and majority. Where the statutes or instrument of incorporation do not provide for redemption, the latter shall be decided upon by the general meeting acting at least under the conditions of quorum and majority laid down in Article 40. The decision must be published in the manner prescribed by the laws of each Member State, in accordance with Article 3 of Directive 68/151/EEC;

(b) only sums which are available for distribution within the meaning of Article 15 (1) may be used for redemption purposes;

(c) shareholders whose shares are redeemed shall retain their rights in the company, with the exception of their rights to the repayment of their investment and participation in the distribution of an initial dividend on unredeemed shares.

Article 36

1. Where the laws of a Member State may allow companies to reduce their subscribed capital by compulsory withdrawal of shares, they shall require that at least the following conditions are observed:

(a) compulsory withdrawal must be prescribed or authorized by the statutes or instrument of incorporation before subscription of the shares which are to be withdrawn are subscribed for;

(b) where the compulsory withdrawal is merely authorized by the statutes or instrument of incorporation, it shall be decided upon by the general meeting unless it has been unanimously approved by the shareholders concerned;

(c) the company body deciding on the compulsory withdrawal shall fix the terms and manner thereof, where they have not already been fixed by the statutes or instrument of incorporation;

(d) Article 32 shall apply except in the case of fully paid-up shares which are made available to the company free of charge or are withdrawn using sums available for distribution in accordance with Article 15 (1); in these cases, an amount equal to the nominal value or, in the absence thereof, to the accountable par of all the withdrawn shares must be included in a reserve. Except in the event of a reduction in the subscribed capital this reserve may not be distributed to shareholders. It can be used only for offsetting losses incurred or for increasing the subscribed capital by the capitalization of such reserve, in so far as Member States permit such an operation;

(e) the decision on compulsory withdrawal shall be published in the manner laid down by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC.

2. Articles 30 (1), 31, 33 and 40 shall not apply to the cases to which paragraph 1 refers.

Article 37

1. In the case of a reduction in the subscribed capital by the withdrawal of shares acquired by the company itself or by a person acting in his own name but on behalf of the company, the withdrawal must always be decided on by the general meeting.

2. Article 32 shall apply unless the shares are fully paid up and are acquired free of charge or using sums available for distribution in accordance with Article 15 (1); in these cases an amount equal to the nominal value or, in the absence thereof, to the accountable par of all the shares withdrawn must be included in a reserve. Except in the event of a reduction in the subscribed capital, this reserve may not be distributed to shareholders. It may be used only for offsetting losses incurred or for increasing the subscribed capital by the capitalization of such reserve, in so far as the Member States permit such an operation.

3. Articles 31, 33 and 40 shall not apply to the cases to which paragraph 1 refers.

Article 38

In the cases covered by Articles 35, 36 (1) (b) and 37 (1), when there are several classes of shares, the decision by the general meeting concerning redemption of the subscribed capital or its reduction by withdrawal of shares shall be subject to a separate vote, at least for each class of shareholders whose rights are affected by the transaction.

Article 39

Where the laws of a Member State authorize companies to issue redeemable shares, they shall require that the following conditions, at least, are complied with for the redemption of such shares:

(a) redemption must be authorized by the company's statutes or instrument of incorporation before the redeemable shares are subscribed for;

(b) the shares must be fully paid up;

(c) the terms and the manner of redemption must be laid down in the company's statutes or instrument of incorporation;

(d) redemption can be only effected by using sums available for distribution in accordance with Article 15 (1) or the proceeds of a new issue made with a view to effecting such redemption;

(e) an amount equal to the nominal value or, in the absence thereof, to the accountable par of all the redeemed shares must be included in a reserve which cannot be distributed to the shareholders, except in the event of a reduction in the subscribed capital; it may be used only for the purpose of increasing the subscribed capital by the capitalization of reserves;

(f) subparagraph (e) shall not apply to redemption using the proceeds of a new issue made with a view to effecting such redemption;

(g) where provision is made for the payment of a premium to shareholders in consequence of a redemption, the premium may be paid only from sums available for distribution in accordance with Article 15 (1), or from a reserve other than that referred to in (e) which may not be distributed to shareholders except in the event of a reduction in the subscribed capital; this reserve may be used only for the purposes of increasing the subscribed capital by the capitalization of reserves or for covering the costs referred to in Article 3 (j) or the cost of issuing shares or debentures or for the payment of a premium to holders of redeemable shares or debentures;

(h) notification of redemption shall be published in the manner laid down by the laws of each Member State in accordance with Article 3 of Directive 68/151/EEC.

Article 40

1. The laws of the Member States shall provide that the decisions referred to in Articles 29 (4) and (5), 30, 31, 35 and 38 must be taken at least by a majority of not less than two-thirds of the votes attaching to the securities or the subscribed capital represented.

2. The laws of the Member States may, however, lay down that a simple majority of the votes specified in paragraph 1 is sufficient when at least half the subscribed capital is represented.

Article 41

1. Member States may derogate from Article 9 (1), Article 19 (1) (a), first sentence, and (b) and from Articles 25, 26 and 29 to the extent that such derogations are necessary for the adoption or application of provisions designed to encourage the participation of employees, or other groups of persons defined by national law, in the capital of undertakings.

2. Member States may decide not to apply Article 19 (1) (a), first sentence, and Articles 30, 31, 36, 37, 38 and 39 to companies incorporated under a special law which issue both capital shares and workers' shares, the latter being issued to the company's employees as a body, who are represented at general meetings of shareholders by delegates having the right to vote.

Article 42

For the purposes of the implementation of this Directive, the laws of the Member States shall ensure equal treatment to all shareholders who are in the same position.

Article 43

1. Member States shall bring into force the laws, regulations and administrative provisions needed in order to comply with this Directive within two years of its notification. They shall forthwith inform the Commission thereof.

2. Member States may decide not to apply Article 3 (g), (i), (j) and (k) to companies already in existence at the date of entry into force of the provisions referred to in paragraph 1.

Appendix B
Draft Company Laws of Jersey

Redeemable Shares

50 (1) Subject to the maintenance by the company of its minimum paid up capital, a company may by its Articles designate any of its shares as Redeemable Shares and any shares so designated shall be available for issue by the company on such terms as to redemption as the Articles shall specify: Provided that

(a) no such share shall be redeemed unless there shall have been delivered to the Commercial Relations Officer not more than fourteen days previous to the date on which redemption is to be effected a statement specifying the shares to be redeemed and a certificate signed by a majority of the directors confirming that at the date of such certificate the company is not insolvent and that its minimum paid up capital has not been diminished and will not be diminished as a result of the proposed redemption and that the company will not be made insolvent if the redemption is completed and that the company has adequate capital facilities for the conduct of its business without resort to the capital to be redeemed and such certificate shall be counter-signed by the auditor (if any) of the company; and

(b) any amount paid on redemption in excess of the issue price of the shares to be redeemed shall be paid out of the Share Premium Account or out of the Revenue Surplus Account or out of the proceeds of a fresh issue of shares made for purposes of the redemption as provided in Paragraph (4) of this Article.

(2) If a company shall fail to redeem any Redeemable Share on the terms specified in its Articles the holder of any Redeemable Share in respect of which default has been made shall be deemed to be a creditor of the company for the purpose of presentation of an Insolvency Petition against the company without such holder being required to institute formal proceedings against the company by reason of the default.

(3) Where a company has designated any part of its Share Capital as Redeemable Shares in any statement which the company causes to make public as to its Share Capital the company shall disclose in conspicuous terms the amount of its Share Capital so designated and where the terms of redemption provides a fixed term or period during which redemption is to or can take place the relevant year date or dates shall also be stated.

(4) For the purpose of capital duty if any share capital is created by the company for the specific purpose so declared in the requisite resolution of providing monies towards the redemption of Redeemable Shares and the Redeemable Shares are redeemed within one month of the new shares being created the Share Capital shall not be deemed to have been increased except to the extent that such Share Capital exceeds the nominal capital represented by the shares which have been redeemed.

(5) Whenever a company redeems any of its shares under the provisions of this Article it shall give notice in writing to each holder of the shares redeemed reminding such holder of the provisions of Article 38 of the Insolvency (Jersey) Law, 197 , whereby the amount paid on redemption may be recoverable by the Insolvency Commissioner.

Reduction of Capital

51 (1) A limited company may, subject to confirmation by the Commercial Relations Officer, by Special Resolution reduce its share capital in any manner: Provided that no such reduction shall be effective to the extent that it diminishes the prescribed minimum paid up capital.

(2) Within fourteen days after the passing of a Special Resolution to reduce capital the company shall deliver to the Commercial Relations Officer a certified copy of the Special Resolution and where the reduction involves repayment of capital to any member of the company together with a certificate in similar terms to the certificate referred to in Paragraph (1) of Article 50 of this Law and, unless the company has no creditors or all the creditors have signified their consent in writing to the proposed reduction of capital, there shall also be furnished to the Commercial Relations Officer a guarantee by a bank, or other financial institution acceptable to the Commercial Relations Officer, providing security for payment of creditors to such amount as the Commercial Relations Officer shall think in all the circumstances proper or evidence satisfactory to the Commercial Relations Officer that claims of creditors are adequately secured.

(3) On receipt of the documents and particulars referred to in the last preceding paragraph of this Article the Commercial Relations Officer may in any particular case, at the expense of the company, cause a notice to be published in the Jersey Gazette, and in any newspaper published outside the Island if the Commercial Relations Officer so determines having regard to the nature of the company's business, giving details of the proposed reduction, and, unless objection is made in writing to the Commercial Relations Officer pursuant to Paragraph (4) of this Article within fourteen days of such notice appearing or the Commercial Relations Officer determines to dispense with such advertisement, the Commercial Relations Officer shall confirm the reduction and register details thereof in the file of the company at the Companies Registry and issue a certificate of confirmation which shall specify the details of the share capital of the company so reduced.

(4) Where any such advertisement is published as provided in Paragraph (3) of this Article, any creditor of the company who at the date of the passing of the Special Resolution is entitled to any debt or claim against the company, whether such debt or claim be present or future, certain or contingent, ascertained or sounding

only in damages, shall be entitled to object to the reduction by notice in writing specifying his objection and the extent and nature of his claim against the company, such notice to be delivered to the Commercial Relations Officer (and a copy served on the company) within the period of fourteen days specified in Paragraph (3) of this Article.

(5) Where any objection is made pursuant to Paragraph (4) of this Article the Commercial Relations Officer shall within seven days of the objection being made consider the reason for the objection and any representations made by the objector and the company and may refuse to confirm the Resolution for the reduction or may confirm the resolution for reduction absolutely or subject to such conditions as he may impose relating to the company providing security for such creditor, and for this purpose the Commercial Relations Officer may modify the resolution which shall then be registered as so modified.

(6) A special resolution for a reduction shall take effect on and not before the issue by the Commercial Relations Officer of his certificate of confirmation and a copy of the said certificate shall accompany every copy of the Article of the company issued by the company after the date of such certificate.

(7) If any officer of the company:

(a) wilfully conceals the name of any creditor entitled to oppose the confirmation; or

(b) wilfully misrepresents to the Commercial Relations Officer the nature or amount of the debt or claim of any creditor; or

(c) aids, or abets or is privy to any such concealment or misrepresentation.

he shall be personally liable to pay to such creditor the amount of his debt or claim to the extent to which it is not paid by the company and shall be guilty of an offence and liable on conviction to imprisonment for a term not exceeding two years or to a fine not exceeding £1,000 or both.

(8) If any resolution for reduction in capital shall vary the rights attached to any class of shares the company shall satisfy the Commercial Relations Officer that all necessary consents to the reduction shall have been obtained pursuant to Article 38 of this Law.

(9) An Unlimited Company may reduce its share capital in any manner by unanimous resolution without confirmation by the Commercial Relations Officer.

(10) An Investors Unlimited Company may only reduce its Investors Share Capital by following the procedure prescribed in this Law as to reduction of share capital or redemption of shares and such a company may not reduce its unlimited share capital except with the class consent of the holders of its Investors Share Capital.

(11) Whenever a company reduces its share capital by repayment to any member under the provisions of this Article it shall give notice in writing to each such member reminding him of the provisions of Article 38 of the Insolvency (Jersey) Law 197 whereby the amount repaid may be recoverable by the Insolvency Commissioner.

Share Warrants to Bearer or Bearer Shares

52 (1) A public company may issue bearer share certificates only if the Commercial Relations Officer grants it permission to do so and in granting such permission the Commercial Relations Officer may impose such conditions as he considers proper.

(2) Bearer share certificates are negotiable instruments transferable by delivery and a purchaser for money or money's worth of shares represented by a bearer share certificate who has no knowledge of any defect in the title of the person from whom he acquires them obtains ownership of the shares free from the title of and any claim by any former holder.

(3) A company which issues a bearer share certificate shall provide for the payment of dividends by the issue of coupons to bearer and such coupons shall also be negotiable instruments and shall be governed by Paragraph (2) of this Article.

(4) Regulations under this Law may be made for the purpose of altering the rights of public companies generally, or of any public company specifically, to issue bearer share certificates or limiting the time during which such certificates may be valid and providing for the holders to become registered members of the company within a prescribed period on such terms as the regulations may prescribe or for providing that such certificates shall be deposited with an Authorised Depositary resident in the Island.

(5) The holder of a bearer share certificate may exercise the voting rights attached to the shares comprised in his certificate only through an Authorised Depositary resident in Jersey.

(6) Where any voting rights are exercised pursuant to Paragraph (5) of this Article the company shall accept a certificate duly signed by the Authorised Depositary as sufficient evidence to admit the bearer shares to vote.

Ind PS.

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

R

Mike Pattison Esq
Private Secretary
10 Downing Street
London, SW1

30 June 1980

Dear Mike,

PURCHASE OF OWN SHARES

My Secretary of State sent to colleagues on 6 May a draft text of the consultative document on the purchase by a company of its own shares. I now attach an administrative copy of the Green Paper, which my Secretary of State will be presenting to the Press at a conference tomorrow.

I am copying this letter to the Private Secretaries to the Members of E Committee and to David Wright (Cabinet Office).

Yours ever,

Nicholas McInnes

N McInnes
Private Secretary

Ind Pol

MINISTER OF STATE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

N McInnes Esq
Private Secretary to Secretary of State
Department of Trade
1 Victoria Street
LONDON
SW1H OET

27 June, 1980

Dear Nick

INDUSTRIAL STRUCTURE

Thank you for sending Martin Hall a copy of your letter of 26 June to Mike Pattison, enclosing a copy of a draft speech for your Secretary of State to make next Tuesday, when he publishes his Green Paper on the Government's proposals to enable companies to purchase their own shares.

The reference in page 7 to the proposals in the current Finance Bill is not quite right. In particular, it is of the essence of the current proposals that they provide (on certain conditions) for a company to distribute to its shareholders the shares in a subsidiary trading company - but <u>not</u> to distribute other assets. The distribution of other assets is something that we shall consider as part of the next stage of this exercise. Mr Rees suggests that this passage could perhaps be revised on the following lines:

> ".... and indeed the Finance Bill Committee are debating today a Government New Clause and Schedule, which represent a significant step towards a more neutral tax policy, as between mergers and demergers. The objective is to enable 2 or more traders, now grouped together under a single company umbrella, to be split up and pursue their own separate ways under independent management. For this purpose, and subject to certain conditions designed to prevent tax avoidance, a trading company will (for example) be able to distribute direct to its shareholders the shares in one or more of its trading subsidiaries".

I am sending copies of this letter to Mike Pattison (No 10), Ian Ellison (Industry), Murdo Maclean (Chief Whip's Office), Petra Laidlaw (Chancellor of the Duchy's Office), Richard Prescott (Paymaster General's Office) and to David Wright (Cabinet Office).

Yours ever,

Roy Warden

R WARDEN
Private Secretary

Ind PSI.

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/13824/80

Your ref:

30 May 1980

R 3/5

Dear John

PURCHASE OF OWN SHARES

Thank you for sending me your draft Consultative Document. It raises important issues, which need a full and proper public airing. I, therefore, welcome your proposal to issue it soon.

A copy of this goes to other members of E Committee and to Sir Robert Armstrong.

Yours ever

Michael

MICHAEL HESELTINE

The Rt Hon John Nott MP

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

16 May 1980

The Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1

R 20/5

Dear John,

PURCHASE OF OWN SHARES

Thank you for sending me a copy of your letter of 6 May to Geoffrey Howe, together with a copy of the draft consultative document.

I welcome the proposals in the document which should significantly benefit many small companies. As you note, significant tax questions remain unresolved and I echo your hope that the Treasury will give further sympathetic consideration to a liberalisation of tax law.

Copies go to members of E Committee and Sir Robert Armstrong.

Ever,

Keith