

BIS | Department for Business
Innovation & Skills

**EMPLOYEE OWNERSHIP AND
SHARE BUY BACKS**

Consultation on implementation
of Nuttall Review
recommendations

OCTOBER 2012

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Employee ownership and share buy backs

1. The independent Nuttall Review of employee ownership set out the economic and social benefits achieved by employee owned companies. In his review, Graeme Nuttall described the benefits of employee ownership in relation to:
 - improved business performance;
 - increased economic resilience;
 - greater employee engagement and commitment;
 - driving innovation;
 - enhanced employee well-being; and
 - reduced absenteeism.
2. He made recommendations to Government on removing barriers to further uptake of employee ownership in the private sector.
3. Alongside this consultation document the Government is also publishing its formal response to the Nuttall Review. The Government is embarking upon a programme of work to implement the agenda set by the Nuttall Review. This consultation forms one part of that agenda, and is in response to a recommendation made by the Nuttall Review.
4. The Nuttall Review set out two basic models for administering employee ownership. Under the 'trust model' or 'indirect share ownership', an employee trust is established to hold shares in the company on behalf of the employees. Alternatively, under 'direct share ownership' employees hold shares in their company themselves.
5. Companies using this form of share ownership often need a mechanism by which to buy back shares owned by employees who are leaving or who have left the company, in order to re-distribute them to new starters at the company. Otherwise, the company risks becoming over the years predominately owned by ex-employees.
6. Buy back arrangements are discretionary and depend on the shareholder (the seller) mutually agreeing a price and/ or arrangement with the company (the buyer). In some cases a buy back arrangement may be agreed between the company and employee prior to the employee taking shares – for example, the two parties may agree that the employee must offer shares for sale back to the company on his or her leaving. In other cases an ex-employee may be approached by the company with an offer to buy back the ex-employee's shares.
7. Once a buy back has been agreed, companies must comply with a number of Company Law provisions which regulate the process. The Nuttall Review concluded that these

provisions were overly burdensome, and recommended that Government simplified them in order to remove barriers and disincentives to further uptake of direct employee ownership. Specifically, the Review made the following recommendation to Government:

Recommendation V

The Department for Business, Innovation and Skills should consult upon improving the operation of internal share markets to support companies using direct share ownership, including holding private company shares in treasury and facilitating share buy backs.

8. This consultation seeks to take evidence and perspectives on those changes.

Issued: 30 October 2012

Respond by: 16 November 2012

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This consultation is relevant to companies operating employee share plans and their advisers.

This consultation is UK wide. The Northern Ireland administration has agreed that, while company law remains a transferred matter within the legislative competence of the Northern Ireland Assembly, the Companies Act 2006 should apply to the whole of the UK. Consequently any changes to company law resulting from this consultation will apply UK-wide.

The proposals being consulted upon

9. Companies using direct employee share ownership will come across times when they must decide how to manage shares held by employees leaving the company. They may wish to redistribute them to new starters at the company or amongst the existing cohort of employees; and to avoid a scenario in which the company might be majority-owned by ex-employees in the company rather than employee owned.
10. In these circumstances companies often wish to buy back shares. The process of administering share buy backs is regulated by several provisions in Company Law, in order, broadly, to protect the interests of other shareholders and creditors. The Nuttall Review recommended that Government reviewed, with a view to simplification, those provisions.
11. The Government is committed to reducing regulatory burdens upon business, as a means of promoting competitiveness and economic growth. The Government is also embarked upon an agenda – outlined by the Nuttall Review – to promote employee ownership in the private sector. In this context, the Government’s aim through this consultation is to test with stakeholders how the regulatory burden associated with these Company Law provisions can be lightened: to free up the activities of companies and shareholders and to create freer and more competitive markets. In so doing, we also wish to test what simplification is possible whilst also minimising any risk from removing regulatory protection or benefits the original provisions are designed to ensure.
12. The Nuttall Review cited these stages of the buy back process as relevant for simplification: -
 - Authorising a share buy back contract;
 - Financing the purchase of those shares; and
 - Whether those shares, once purchased by the company, may be kept for subsequent re-distribution.
13. The proposals in this consultation follow the Nuttall Review’s recommendations and are divided into each of those three stages.

1) Authorisation of share buy backs

14. Companies may only buy back shares off-market (i.e. not on a regulated investment exchange) if they have a buy back contract authorised by a special resolution of the shareholders (i.e. with 75% agreement, excluding the votes of the seller) (ss.693-695 Companies Act 2006). An ordinary resolution is needed for market purchases.
15. This provision provides protection to existing shareholders by preventing company directors from entering into share buy backs that are not in the company’s or other shareholders’ interests. In addition, there are a number of other regulatory protections which already provide for this: for example, (i) director’s duties, (ii) the ability of

shareholders to (via special resolution) alter a company's Articles of Association to prevent share buy backs, and (iii) the requirement for a company to have a special resolution if the buy back is financed out of capital.

16. On the other hand, administering this process contract by contract through a new procedure adds administrative costs to companies and shareholders – through the time and other costs involved in initiating and running the process.
17. Allowing private companies to arrange share buy backs subject to an ordinary resolution, would bring the legal requirements for off market purchases in line with those of market purchases. **The Government is seeking views on this proposal.**
18. The main benefits of such a de-regulatory measure are that it would, in this respect at least, level the playing field between off market and market purchases and remove some of the administrative costs of organising special authorisation. It would also retain the regulatory protections aimed at allowing shareholders to control or veto a company from purchasing its own shares or pursuing employees' share schemes.

2) Financing buy backs

a) Payment by instalments

19. Limited companies when buying back shares must pay for them in full, on purchase.
20. Following the Nuttall Review recommendations, de-regulating this provision would allow companies seeking to buy back shares more flexibility in paying for buy backs, and in particular to allow them to be paid for in instalments. **The Government is seeking views on this proposal.**
21. This would give companies more flexibility in financing buy backs. This should lower the costs to businesses by allowing them more scope to manage their payments. On the other hand, allowing instalments may put creditors and sellers at a disadvantage if the company becomes insolvent before all instalments of payment have been made. To some extent, this is a risk inherent in all transactions involving instalments two parties agree to and crucially, share buy backs must be agreed by both parties.

b) A greater range of funding options

22. To fund the purchase of its own shares, all companies may use distributable profits, or the proceeds of a fresh issue of shares made for the purpose of financing the share buyback. In addition, private companies may also use its share capital, but to do so is

subject to a number of further restrictions to protect the interests of shareholders and creditors to the company¹.

23. The Nuttall Review recommends revisiting these provisions with a view to increasing the number of options companies have in how they finance share buy backs. **The Government is seeking views on whether the provisions cited above are overly restrictive.**
24. A particular benefit might be to allow start-ups who are not yet in profit – who thus do not have distributable profits – more choices in how they finance buy backs. Other companies require employee shareholders to offer their shares back to the company upon their departure at par value, and views are sought on the feasibility of allowing private companies to finance buy backs by other means.

3) After share buy back

25. When shares have been bought back, they are either cancelled, or held by the company (so called 'treasury shares'). Treasury shares may be disposed of (sold for cash or transferred for an employee share scheme) by the company, but while holding them the company may not exercise any of the rights attached to them (voting, dividend etc.). Crucially, only shares that are listed may be held as treasury shares, so holding shares in this way is not available to private companies, whose shares when bought back must be cancelled.
26. The Nuttall Review recommends that these provisions should be expanded so that private companies may also hold shares in treasury, after they have bought back shares. The Nuttall recommendation is intended to give private companies greater freedom to buy back shares and then hold them until such time they wish to distribute them again (for example when the company wishes to provide shares to new starters in the company). As such they save the costs and burden of buying back shares from leavers, going through the process of cancelling them and then issuing new shares. Other companies will establish an employee benefit trust to serve as a means of holding shares, although to do so carries costs which some companies prefer to avoid.
27. Holding shares in treasury also allows – to some extent – a market in the company's shares to be created, making them more liquid and increasing the ability of employee owners to realise capital gains they make on their share holding.
28. **The Government is seeking views on the proposition that provisions for treasury shares should be extended to private companies.** Provisions ensure that shares held in treasury are apparent in the Register of Members and views are also sought on what transparency and shareholder oversight provisions may be necessary in concert with this proposition.

¹ These include approval by special resolution, requirement to issue a directors' statement, auditor's report and a public notice, and further opportunity for shareholders or creditors to a company to apply for the arrangement to be cancelled.

Consultation questions

A Response Form is provided in the Annex.

General

1. Do you agree that Company Law regulations on share buy backs and treasury shares can act as an impediment to further uptake of employee ownership? If so, to what extent?

Authorisation of share buy backs

2. What estimate do you make of the time or cost of complying with this regulation in your company / the companies you represent; or of operating alternative arrangements such as an employee trust?
3. Do you agree that allowing private companies to arrange share buy backs should be subject to an ordinary resolution rather than a special resolution? Would this change simplify the authorisation process, help remove unnecessary costs, and make employee ownership easier to administer?
4. Do you agree that this proposal provide shareholders with adequate oversight and discretion over the activities of companies in the respect of share buy backs?
5. Are there any potential issues or unintended consequences that could arise from implementing this proposal? Are there more effective alternatives?

Financing buy backs

6. What estimate do you make of the time or cost of complying with this regulation in your company / the companies you represent, or of operating alternative arrangements such as an employee trust?

a) Payment by instalments

7. Do you agree that payments by instalments (a) a useful flexibility for companies, (b) an acceptable risk for general creditors, and (c) an acceptable risk for selling shareholders?
8. Do you agree that the maximum time period over which payments may be made should be solely a matter of negotiation between the buying company and the selling shareholder? Or should a maximum time period be specified in statute?

b) Sources of finance

9. Are the current financing restrictions an unreasonable limitation to companies seeking to buy back shares for the purposes of an employee share scheme?
10. Do you agree that the current restrictions be removed without issues or unintended consequences for the remaining shareholders?

After share buy back

11. Do you agree that private companies should be able to hold shares 'in treasury'?
12. If you agree that it would be helpful for private companies seeking to administer employee ownership to have an ability to hold shares 'in treasury', can you estimate the extent of this benefit?
13. Do you agree that shareholders will have sufficient oversight over private companies if they are able to hold shares in treasury?

What happens next?

29. Within three months of the close of this consultation we will publish on the BIS website a summary of the responses to the consultation, and a Government response to the consultation. This will set out the next steps the Government wishes to take in light of this consultation.
30. An electronic version can be found at www.bis.gov.uk. Other versions of the document in Braille, some other languages or audio-cassette are available on request.

Confidentiality & Data Protection

31. Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

Annex 1: The Consultation Code of Practice Criteria

1. Formal consultation should take place at a stage when there is scope to influence policy outcome.
2. Consultation should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
3. Consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
4. Consultation exercise should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
5. Keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
6. Consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
7. Officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

John Conway,
BIS Consultation Co-ordinator,
1 Victoria Street,
London
SW1H 0ET

Telephone John on 020 7215 6402
or e-mail to: john.conway@bis.gsi.gov.uk

Annex 2: Employee ownership and share buy backs consultation: Response form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

Name:

Organisation (if applicable):

Address:

Telephone:

Fax:

Email:

Please return completed forms to:

Darren Walcott
Business Environment Directorate
1 Victoria Street
London
SW1H 0ET

Or via email: employeeownership@bis.gsi.gov.uk

Please tick a box below that best describes you as a respondent to this consultation:

<input type="checkbox"/>	Business representative organisation/trade body
<input type="checkbox"/>	Central government
<input type="checkbox"/>	Charity or social enterprise
<input type="checkbox"/>	Individual
<input type="checkbox"/>	Large business (over 250 staff)
<input type="checkbox"/>	Legal representative
<input type="checkbox"/>	Local Government
<input type="checkbox"/>	Medium business (50 to 250 staff)
<input type="checkbox"/>	Micro business (up to 9 staff)

	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

Question 1

Do you agree that Company Law regulations on share buy backs and treasury shares can act as an impediment to further uptake of employee ownership? If so, to what extent?

Comments:

Question 2

What estimate do you make of the time or cost of complying with this regulation in your company/ the companies you represent; or of operating alternative arrangements such as an employee trust?

Comments:

Question 3

a) Do you agree that allowing private companies to arrange share buy backs should be subject to an ordinary resolution rather than a special resolution?

Yes

No

Not sure

b) Would this change simplify the authorisation process, help remove unnecessary costs, and make employee ownership easier to administer?

Yes

No

Not sure

Comments:

Question 4

Do you agree that this proposal provide shareholders with adequate oversight and discretion over the activities of companies in the respect of share buy backs?

Yes

No

Not sure

Comments:

Question 5

a) Are there any potential issues or unintended consequences that could arise from implementing this proposal?

Yes

No

Not sure

b) Are there more effective alternatives?

Yes

No

Not sure

Comments:

Question 6

What estimate do you make of the time or cost of complying with this regulation in your company/ the companies you represent, or of operating alternative arrangements such as an employee trust?

Comments:

Question 7

Do you agree that payments by instalments are?

a) a useful flexibility for companies and shareholders

Yes

No

Not sure

b) an acceptable risk for general creditors

Yes

No

Not sure

c) an acceptable risk for selling shareholders

Yes

No

Not sure

Comments:

Question 8

a) Do you agree that the maximum time period over which payments may be made should be solely a matter of negotiation between the buying company and the selling shareholder?

 Yes No Not sure

b) Or should a maximum time period be specified in statute?

 Yes No Not sure

Comments:

Question 9

Are the current financing restrictions an unreasonable limitation to companies seeking to buy back shares for the purposes of an employee share scheme?

 Yes No Not sure

Comments:

Question 10

Do you agree that the current restrictions be removed without issues or unintended consequences for the remaining shareholders?

 Yes No Not sure

Comments:

Question 11

Do you agree that private companies should be able to hold shares 'in treasury'?

 Yes No Not sure

Comments:

Question 12

If you agree that it would be helpful for private companies seeking to administer employee ownership to have an ability to hold shares 'in treasury', can you estimate the extent of this benefit?

 Yes No Not sure

Comments:

Question 13

Do you agree that shareholders will have sufficient oversight over private companies if they are able to hold shares in treasury?

 Yes

 No

 Not sure

Comments:

How useful has this consultation been?

On a scale of 1 to 5, 5 being the highest, grade your overall approval of the consultation.

	5	4	3	2	1
Right problems identified					
Range of options wide enough					
Preferred options well chosen					

Comments:

Do you have any other comments that might aid the consultation process as a whole?

Please use this space for any general comments that you may have, comments on the layout of this consultation would also be welcomed.

Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.

Please acknowledge this reply

At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?

Yes

No

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