



Department
for Business
Innovation & Skills

**MOVING TO EMPLOYEE
OWNERSHIP**

Guidance on model
documentation

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Contents

Contents	2
Guidance on Model Documentation for moving to Employee Ownership	3
Introduction	4
What is meant by employee ownership?	5
Who is the model documentation aimed at?	5
Co-operative models of employee ownership	6
Options to consider before using the model documentation:	6
1) Direct and indirect employee ownership	6
2) Individual or Corporate Trustees.....	7
3) The Trustee Company	7
4) An Employees Council.....	7
Significant options in the model documentation:.....	8
1) Having a Constitution, Principles and Values for the Company.....	8
2) Having an Employee Director	8
3) Numbers and mix of Trustee Directors	8
4) Profit-sharing to employees	9
Other issues to consider:	9
1) Share transfers and valuation	9
2) Bad Leaver provisions	9
Annex	10
Annex A: Benefits of direct and indirect employee ownership	10
Annex B: Further sources of information.....	11

Guidance on Model Documentation for moving to Employee Ownership

The 2012 Nuttall Review into employee ownership in the UK¹ made a number of recommendations aimed at making a move to employee ownership less complicated. The Government accepted or supported in whole or in part all of these recommendations.

The model documentation² that has been produced for the Department for Business, Innovation and Skills (BIS) by Pett, Franklin and Co. LLP. is a significant step towards meeting a key recommendation to develop “off-the-shelf” toolkits for businesses wishing to move to employee ownership. BIS is extremely grateful for the legal expertise offered pro bono by Pett, Franklin and Co. LLP³.

The model documentation, and this guidance, is provided for information purposes only. They are not intended to constitute legal advice, and should not be relied on or treated as a substitute for specific advice relevant to particular circumstances. Neither BIS nor Pett, Franklin and Co. LLP shall accept responsibility for any errors or omissions, or for any loss which may arise from reliance upon these materials.

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¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31706/12-933-sharing-success-nuttall-review-employee-ownership.pdf

² <https://www.gov.uk/government/publications/employee-ownership-model-documentation>

³ <http://www.pettfranklin.com/>

⁴ <http://www.nationalarchives.gov.uk/doc/open-government-licence/>

Introduction

The model documentation is designed to be used by business owners and those who advise them. They include a description of an example employee ownership structure. However it needs to be recognised that employee ownership can take many different forms. The model documentation is not intended to be prescriptive but rather to present just one approach (and some related options) based on that has been found to work by some real-life businesses. The approach presented will need to be tailored to fit the particular needs/desires of a business and this is likely to need input from professional advisors.

The model documentation contains some provisions that are not expected to be used very often but are included to ensure difficulties do not arise in the case, for example, of a take-over of the Company.

In the model documentation square brackets and italics are used to indicate optional text. In general italicised text indicates options that do not relate to any legal requirement or consequence.

This rest of this document explains some of the choices that have been made in preparing the model documentation and some of the key options for users.

Note that the law relating to trusts is different under Scots law as compared to the law of England & Wales. It is important therefore that the model trust deed, which is governed by the law of England & Wales, is adapted where appropriate in the circumstances. Co-operative Development Scotland (see Annex B for details) can help provide signposting to legal advisers specialising in this field.

Employee ownership as described in this guide should not be confused with the employee shareholder employment status, which was included in the 2013 Growth and Infrastructure Act⁵. Although the employee shareholder employment status does represent an opportunity to increase employee shareholdings within companies it is not primarily designed as an employee ownership initiative. Employees can become part-owners of their business without changing their employment status.

Companies should not assume that employees' ownership of shares will necessarily fall to be accounted for as simple share subscriptions and subsequent dividend payments. Rather, the employee ownership arrangement may fall to be accounted for as an employee remuneration arrangement. Professional advice should be sought in the usual way.

HMRC have also issued guidance on the use of the model documentation which can be accessed via their share scheme website⁶ by following the link to Employee Ownership.

⁵ <http://www.legislation.gov.uk/ukpga/2013/27/section/31/enacted>

⁶ <http://www.hmrc.gov.uk/shareschemes/>

What is meant by employee ownership?

For the purposes of this guidance and the model documentation employee ownership means a significant and meaningful stake in a business for all its employees – this is the approach taken in the Nuttall Review.

What is meaningful is not confined to financial participation. Irrespective of any financial participation, employees must have access to organisational structures that ensure employee engagement. Where financial participation takes place there is no set rule on what percentage of issued share capital is a significant and meaningful stake.

Who is the model documentation aimed at?

The model documentation is designed to help an existing business move to employee ownership by describing a particular employee ownership structure and the legal documentation that would be needed to support it. However, the model documentation could be tailored for use in establishing a new incorporated business with employee ownership.

If using for a new business consideration must be given to the manner in which the initial share capital is to be raised.

Given the diversity of employee ownership models it is not possible to list all of the options available and judgement (based on practical experience) has been exercised in designing the ownership structure illustrated by the model documentation. The next section explains these more fully. These choices may not be appropriate for all businesses and guidance from professional advisors should always be sought.

The model documentation is flexible enough to enable whatever level of employee ownership a business desires. Although the model documentation is not specifically designed for businesses that wish to give employees a controlling interest, they could be readily adapted for this purpose.

The model documentation is not necessarily suitable for those seeking to create a Public Service Mutual. Anyone with an interest in Public Service Mutuals should seek guidance from the Mutuals Support Programme which is building a library of resources, templates and toolkits to be used by fledgling Public Service Mutuals⁷. These various resources have been designed to act as useful aids to transfer knowledge and lessons learned to other developing Public Service Mutuals, including template business plans, financial models and plain English guides to legal documentation. A majority of the content contained within the resource library has been produced by various Suppliers who have bid for and won contracts through the Mutuals Support Programme.

⁷ <http://mutuals.cabinetoffice.gov.uk/documents>

Co-operative models of employee ownership

This model documentation does not offer full compliance with the requirements of a democratic organisation that is the hallmark of co-operative enterprises, here and abroad. A co-operative business may be formed under any legal form, including companies, societies or partnerships, but when employee-owned will have the following key elements:

- A minimum of 51% of the ownership should be held by the employees, directly or indirectly via an employee benefit trust
- A majority of the board directors should be employees
- An employee council should be included with clear and defined role, that allows for employee engagement at all levels

These elements help to ensure that a business is not just owned but also ultimately controlled by employees, rather than ownership being held merely on their behalf. This offers a line of democratic accountability that adds value to the formula of employee ownership.

The model documentation can be adapted to include these elements. Alternatively, for a legal template that is automatically compliant with international co-operative best practice, contact Co-operatives UK (see Annex B).

Options to consider before using the model documentation:

1) Direct and indirect employee ownership

Employee ownership can be direct or indirect. Employees may hold shares in their business directly (perhaps through a tax advantaged share plan) or shares are held collectively on behalf of employees, normally through an employees' share trust. The latter is known as indirect share ownership or the Trust Model. Some businesses combine the benefits of both direct and indirect ownership, with the Trust buying back shares from those who leave or wish to sell and making shares available to employees by way of a gift or sale. Further guidance on these different approaches can be obtained from the Employee Ownership Association or, for co-operative models, Co-operatives UK (see Annex B).

Some of the benefits of these different approaches can be found in Annex A to this guidance. In addition, it is worth noting that the Government announced at Budget 2013 that it will introduce a capital gains tax relief on the sale of a controlling interest in a business into an employee ownership structure, and is also looking at further incentives which could include measures targeted at employees. A consultation on implementing the Budget 2013 announcements is expected in summer 2013 with changes expected to be introduced from April 2014.

The model documentation presents the Trust Model of employee ownership, as was recommended by the 2012 Nuttall Review, alongside allowing direct share ownership by others and/or by employees. The model documentation would therefore be suitable for

businesses looking to combine indirect and direct employee ownership or to only use indirect ownership.

2) Individual or Corporate Trustees

When creating an employees' share trust a decision is needed about whether to appoint Individual Trustees or a Corporate Trustee.

The model documentation assumes the use of a Corporate Trustee as this protects against the risks of potential unlimited personal liability which (in theory at least) attach to individuals acting as trustees. The model documentation could easily be adapted to use Individual Trustees.

3) The Trustee Company

Corporate Trustees can either be an 'in-house' corporate trustee (typically a subsidiary company) or an independent trustee services company (engaged at a fee). The role of the Trustee is to protect the interests of the employees as shareholders. The model documentation provides for the Corporate Trustee to be a company limited by guarantee (as recommended in the Nuttall Review).

The model documentation further provides for this Trustee Company to be a directly wholly-owned subsidiary of the Company.

Whichever model is chosen, maintaining true independence between the trustees (acting on behalf of the beneficiaries – in this case the employees as shareholders) and the directors of the Company is of paramount importance.

The interests of those who 'own' the Company and those who have ownership (as trustees) and control of the shares held by the Trust may not always align.

Allowing a Trustee Company to be owned and controlled by persons other than the Company itself can sometimes create a tension due to differences of opinion. In certain circumstances such inherent tensions might be acceptable, even desirable – professional advice should be sought.

4) An Employees' Council

An essential ingredient of employee ownership is effective employee engagement. The model documentation provides for the establishment of an Employees' Council. This is presented purely as an example - it will not be suitable for all businesses. Many businesses will already have established mechanisms for ensuring effective employee engagement and will not need to create something new.

In businesses in which unions are recognised existing trade union machinery could be used to carry out the functions of the Employees' Council.

In small businesses, in which there are no practical problems in gathering all employees together, there maybe no need for employee representatives to be elected to an Employees' Council.

If an Employees' Council is to be established then consideration is needed of its size, of how representatives are chosen, of how often it should meet and of whether there is to be any qualifying criteria (e.g. length of service). In businesses in which unions are recognised, union representatives should be consulted about such issues.

The model documentation presents an example of rules that could be used to govern a postal ballot of employees. However there are many other options that could be considered to determine who sits on the Employees' Council including an on-site ballot with provisions for employees not at site on the day or a simple lottery.

Significant options in the model documentation:

1) Having a Constitution, Principles and Values for the Company

The model documentation includes, at Part A, a guide to the constitution of the Company that wishes to adopt employee ownership. This sets out the Principles governing the relationships and conduct of dealings between employees and other stakeholders in the Company, including the values expected to be adopted by all stakeholders in the Company.

Establishing Values/Principles is not an essential part of adopting employee ownership but it can help to promote a common understanding amongst all interested parties.

2) Having an Employee Director

The model documentation includes the option of providing in the Articles of Associations for the appointment of an Employee Director to the board of the Company.

Some businesses find this helpful in ensuring there is an employee voice on the Board. Employee Directors face the same legal obligations as those of any other director of the Employing Company, including a duty of confidentiality which will necessarily restrict the ability of the Employee Director from disseminating information on matters discussed in the boardroom.

Some businesses decide to have more than one Employee Director and require at least a third or a half of the Directors to be employees. The model documentation can be easily amended to enable such approaches.

Some businesses with employee ownership decide not to have any Employee Directors and instead to use other mechanisms to ensure the employee voice is heard.

3) Numbers and mix of Trustee Directors

If a Corporate Trustee is used, the directors of the Trustee Company will, in effect, be the Trustees and have the same fiduciary duties owed to the beneficiaries of the Trust as if they were themselves the Trustees.

The model documentation suggests that the Articles of Association of the Trustee Company provide for there to be between 3 and 5 Trustee Directors all of whom are

resident in the UK for UK tax purposes. Of these, at least one shall be an Independent Trustee Director and the rest either current or former employees.

4) Profit-sharing to employees

In part 2 (The Principles) of the Guide to the Constitution of the Company there is an option in paragraph 4 to state that the Company will aim to apply a share of profits by way of a distribution to employees. This is an option used by many businesses to motivate employees but may not suit all.

Advice should always be sought as to the tax consequences for both the employer and the employee of structuring the distribution of a profit share to employees and/or employee shareholders.

Other issues to consider:

1) Share transfers and valuation

Article 7 of the Articles of Association for the Employing Company set out how and when and under what terms directly-owned shares can be transferred.

The price is to be agreed between the Directors and the member who wishes to sell shares or if this cannot be agreed by a valuation established by an independent advisor – the cost of obtaining which will fall to the company except in cases of voluntary transfer when the member seeking to sell will need to meet the cost. These arrangements may not suit every company.

It should also be noted that transfers of shares need to be dealt with whenever they arise, there are no provisions included for dealing days.

Some companies may prefer to pay for regular valuations that are then used for transfers that occur within a certain period after the valuation. Professional advisors can adapt the model documentation accordingly.

Care must be taken to identify and take account of the tax consequences for the employer and employees of shares, or interest in shares, being acquired or disposed of, whether or not for a consideration.

2) Bad Leaver provisions

The model documentation does not include any provisions that provide for different outcomes for employees who leave the company under different circumstances. Such provisions are often called ‘bad leaver’ provisions. This is a difficult area and expert advice should be sought.

Annex

Annex A: Benefits of direct and indirect employee ownership

Having **indirect employee ownership** through a Trust (called an Employees' Share Trust in the model documentation but also known as an Employee Benefit Trust) can:

- Provide a more stable and long-term structure for employee ownership including a vehicle, the Trust, that can facilitate giving employees a “voice”
- Make financing the transition to employee ownership easier as it enables financing over a longer period of time by contributions from the business itself – for example, by a loan that is paid back over time by the business
- Make it easier to facilitate the buying-back of shares when an employee leaves, although recent changes to Company Law have also simplified this process under direct share ownership⁸
- Make the tax position more straightforward

Having **direct employee ownership** through a share plan can:

- Allow the company and employees to enjoy the significant tax incentives on offer through tax advantaged employee share schemes: Share Incentive Plan; Save as You Earn; Company Share Option Plan; Enterprise Management Incentives. Using a Share Incentive Plan companies can gift a certain amount of free shares to employees each year with no tax to pay, provided the shares are held temporarily in trust for a certain period
- Give the employees the chance to share directly in the capital growth of the company
- Mean employees can sell their shares at a time when they want to realise the proceeds for an important life event or to transfer the shares into an ISA or a pension to continue the tax advantages
- Bestow voting rights to the employees as any other shareholder
- Allow ex-employees to continue to hold shares in retirement

⁸ <https://www.gov.uk/government/consultations/employee-ownership-and-share-buy-backs-consultation-on-implementation-of-nuttall-review-recommendations>

Annex B: Further sources of information

The Employee Ownership Association - EOA (<http://employeeownership.co.uk/>) is the voice of employee owned business in the UK – most UK businesses that become employee owned are helped to do so by the EOA.

Co-operatives UK (<http://www.uk.coop/>) works to grow the co-operative economy by promoting, developing and uniting co-operative businesses. A guide to co-operative models of employee buyout is available free to download.

Engage for Success (<http://www.engageforsuccess.org/>) provides evidence, case studies and points of view about how employee engagement drives performance and productivity.

Co-operative Development Scotland – CDS (<http://www.cdscotland.co.uk>) supports the development of co-operative and employee-owned enterprises across Scotland.

Wales Co-operative Centre (<http://www.walescooperative.org>) provides support to employee owned businesses and co-operatives in Wales.

The ESOP Centre (<http://www.esopcentre.com>) advocates all forms of broad-based employee share ownership and can provide experts in employee share plans through its wide membership base.

The Department for Business, Innovation and Skills provides further information on employee ownership at: <https://www.gov.uk/government/policies/making-companies-more-accountable-to-shareholders-and-the-public/supporting-pages/making-employee-ownership-more-accessible>

The Cabinet Office supports the creation and expansion of public service mutuals through the Mutuals Information Service at: <http://mutuals.cabinetoffice.gov.uk> and the Mutuals Hotline number (0845 5390 543)

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