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## Update: UK Government Publishes Changes to Law on Share Buy Backs

*Changes aim to help companies make greater use of employee share schemes and equity arrangements.*

On 19 March, the revised draft of the UK Companies Act 2006 (Amendment of Part 18) Regulations 2013, including final draft regulations on share buy backs, was published.<sup>1</sup> The amendments are limited to those necessary to reflect the UK government's position as outlined in its February 2013 response to the October 2012 consultation on the first draft. Our analysis of the consultation response can be found below.

The amendments allow, amongst other things, private companies to use small amounts of cash that do not have to be identified as distributable reserves to buy back their shares where this is authorised in the Articles of Association.

The draft regulations are expected to enter into force on 30 April 2013.

### Background

On 15 February, the UK Government published its response<sup>2</sup> to its consultation on the share buy back recommendations made by the Nuttall Review on employee ownership. Included in the response are the government's proposals for changes in the current law, which are aimed at encouraging companies, particularly smaller companies, to make greater use of employee share schemes and equity arrangements.

The Nuttall Review—published on 4 July 2012 by the Department for Business, Innovation & Skills—set out the findings of an independent financial adviser, Graeme Nuttall, on the barriers to the creation and uptake of employee ownership arrangements in the UK. One aspect of the report concluded that the current provisions concerning share buy backs discourage employee ownership structures by making them too burdensome. On 30 October 2012, the UK Government published a consultation paper on the recommendations of the Nuttall Review relating to share buy backs. The consultation was mainly concerned with off-market share buy backs by companies without publicly quoted shares, with a particular focus on employee share schemes.

Private companies that offer employee share schemes and equity arrangements often have a policy that employees who own shares in the company are required to sell such shares upon leaving their employment. However, in order for this procedure to work, there must be a transferee available to acquire the shares, because only certain quoted UK-incorporated companies can hold their own shares as treasury shares. As a result, some companies establish employee benefit trusts to hold the purchased shares until they are acquired by an existing employee or new recruit, rather than cancelling the shares that are sold by the departing employee. However, the cost of implementing and managing an employee benefit trust has been seen as a disincentive to offering wider share ownership to employees, particularly for smaller companies. As an alternative, it is possible for private companies to buy back the shares and cancel them, provided that the companies are in compliance with the

1. View the draft regulations at <http://www.legislation.gov.uk/ukdsi/2013/9780111537145>.

2. View the government response at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/81699/bis-13-590-employee-ownership-and-share-buy-backs-implementation-of-nuttall-review-recommendation-v-government-response-to-consultation.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81699/bis-13-590-employee-ownership-and-share-buy-backs-implementation-of-nuttall-review-recommendation-v-government-response-to-consultation.pdf).

requirements of the Companies Act 2006. The Nuttall Review concluded that this existing regime governing share buy backs by private companies is overly burdensome and discourages companies from offering share incentive schemes.

## Government Proposals

Following the consultation, the government has published a number of proposed changes to the existing law on share buy backs, which are intended to be introduced by way of secondary legislation during 2013. The proposals include the following:

- Off-market share buy backs may be authorised by ordinary resolution. Currently, a special resolution is required. This amendment would apply regardless of whether the buy back is made in an employment context.
- Where the buy back is for the purposes of, or pursuant to, an employee share scheme, the following proposals will apply:
  - Private companies will be entitled to obtain shareholder authorisation in advance for multiple share buy backs, as opposes to being required to obtain approval for each individual share purchase contract.
  - Private companies will be permitted to pay for shares bought back in instalments. There will be no maximum time limits imposed by law for such payments.
  - Private companies will be able to finance buy backs out of capital, subject to the signing of a solvency statement by the company's director and the passing of a special resolution.
- Where there is provision in the company's articles to do so, private companies will be permitted to buy back shares using small amounts of cash (not exceeding the lower of £15,000 or 5% of share capital in any financial year) that do not have to be identified as distributable reserves. Where there is no such provision, a shareholder special resolution will be required.
- Private companies and unlisted public companies will be allowed to hold shares in treasury on a similar basis to that which is already permitted for certain public companies.

The government further plans to conduct a three-year review of the changes and will consider in this review, amongst other items, whether

- short notice resolutions should be allowed;
- payment by instalment may disadvantage selling shareholders and the company's creditors;
- there is merit in allowing shares
  - to be bought back using capital to become treasury shares; or
  - to be newly issued directly into treasury.

## Impact

The UK Government hopes that the amendments will encourage private companies to offer equity participation by making it easier to divest departing employees of their shares without using employee benefit trusts. It is further hoped that the ability to hold treasury shares may make it easier for unquoted companies to support employee share schemes.

## Contacts

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