

DEVISING THE LAW OF FINANCIAL ASSISTANCE FOR EMPLOYEES' SHARE SCHEME: THE UNITED KINGDOM EXPERIENCE AND THE LESSONS FOR TANZANIA.

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ABSTRACT

The main thrust of this article is to advise on how Tanzania can tailor a clear legal basis to enable companies to provide financial assistance to employees who are interested in acquiring and holding shares. The paper argues that, in tailoring such law, Tanzania can draw lessons from the United Kingdom. The paper advises on how Tanzania can transplant the English law at the same time avoiding its hurdles.

INTRODUCTION.

Section 151 of the United Kingdom Companies Act 1985 contains the general principle that where a person has acquired, acquiring or is proposing to acquire shares in a company, it is not lawful for the company or any of its subsidiaries to give financial assistance directly or indirectly for the purpose of that acquisition. This principle does not, subject to some qualifications, prohibit the financial assistance which is provided for the purposes of employees' share scheme.

The purpose of this paper is to discuss the legislative comprehensives of the provisions in the United Kingdom Companies Act 1985 concerning the financial assistance by companies for the purpose of employee share schemes. In the light of this discussion, the paper advises on how the similar law can be enacted in Tanzania as a means promoting employee share schemes.

BACKGROUND TO THE PRESENT LAW IN THE UNITED KINGDOM

The Evolution of the Rule Against the Provision of Financial Assistance by a Company for Acquisition of Own Shares.

The general principle against company acquisition of own shares in England was formulated by the

House of Lords in *Trevor Vs. Whitworth*¹ in order to preserve the integrity of the capital maintenance fund and thereby to protect creditors. The formulation of this principle came as a settlement to the controversy which had existed, at least potentially, ever since the enactment of the Joint Stock Companies Act 1856². The prohibition of a company to provide financial assistance for acquisition of own shares is one of the particularized forms of this principle. This particularized form was originally enacted in the Companies Act 1928³, following the recommendations by the Greene Committee⁴. Upon consolidation, this provision became section 45 and section 54 of the Companies Act 1929⁵ and Companies Act 1948⁶ respectively.

The provisions on financial assistance posed, and yet still poses, difficulties for practitioners and controversy among lawyers. Indeed, the provision are capable of penalising and preventing many desirable commercial transactions⁷. The general principle of company purchase of own shares was included in a long list of issues on which the Jenkins Committee⁸ received submissions. However, save for some aspects, the committee declined to recommend any amendment to the principle. This refusal was based on the ground that, the committee had received no convincing evidence to justify the recommendations.

Implicitly, the Jenkins Committee upheld the then existing legal provisions that, they had already provided adequate means to achieve the objectives which were referred in the submissions⁹. Presumably, the committee was referring to things like the common practice of administering the employees' share scheme through a trust which is funded by a company. This practice was possible due to the exception in the rules governing financial assistance. The committee did not, however venture to comment on the difficulties which surrounded not only the then absolute prohibition by the company to purchase own shares but also the exceptions thereto.

In spite of the problems which it caused, the law of financial assistance remained unaltered for more than three decades. The first major amendment to this principle was done by the Companies Act 1980.¹⁰ This amendment allowed, for the first time in English law, the repurchase by a company of its own shares. The 1980 amendment did not, however, change much the provisions on financial assistance.¹¹ In a year later, the whole section was repealed and re-cast in the form of sections 42-44 of the Companies Act 1981¹². Sections 42-44 of the Companies Act 1981 'radically revised' the law relating to the giving of financial assistance by the company for acquisition of own shares or its holding company which formerly contained in section 54 of the Companies Act, 1948. In addition to the specific exceptions, provisions were added to enable private companies to derogate from the prohibition (except for shares in any public company or in holding which is a public company) subject to creditor and minority shareholder protection and after complying with a 'gateway procedure' in section 43 and 44 for 'whitewashing' such derogation. Upon consolidation, sections 42-44 of the Companies Act 1981 became sections 151-158 of the Companies Act 1985. They have since then been slightly amended by the Financial Services Act 1986 and the Companies Act 1989.

Development of the Law of Financial Assistance for Employees' Share Schemes.

The very first exceptions to the rule against the provision of financial assistance by a company

for acquisition of own shares related to, *inter alia*, employees' share scheme. These exceptions allowed; *firstly*, the assistance which took the form of the provision by a company in accordance with an employees' share scheme of money for the acquisition of fully paid shares in the company or its holding, being the acquisition by trustees of or for shares to be held by or for the benefit of employees of the company.¹³ This exception was re-enacted by the Companies Act 1981 but the requirement that the funds had to be provided to the trustees of such scheme was dropped; *secondly*, a company to lend money to persons (other than directors) employed in good faith by the company with a view to enabling those persons to acquire fully paid shares in the company or its holding to be held by them by way of beneficial ownership.¹⁴ This exception was retained by the Companies Act 1981, and the Companies Act 1985. It is still one of the major exceptions under which a company can provide financial assistance for employees' share scheme.

Quite apart from having these exceptions, none of them provided a straightforward general permission of the financial assistance for employees' share scheme. The centerpiece exception was the one which is mentioned first. However, the scope of this exception was unclear. The exception referred to the provision of money which was narrower than the definition of financial assistance. The reference to money was thought to extend only to cash advances and the advance of money by the company on loan which is made on arm's length basis or favourable terms.

Further, the exception required the provision of financial assistance to be in accordance with employees' share scheme. A straightforward loan agreement between a company and trustees of an employees' trust would probably not fall within the scope of this exception. Furthermore, the arrangement was supposed to involve the acquisition of fully-paid shares. It was not clear whether or not the shares were required to be acquired at their market value, or rather, fully-paid up to their nominal or par value. Any financial assistance which did not fulfil the requirements of the exception was not lawful, unless in the case of a private company if such assistance was "whitewashed" by the "gateway procedure" in sections 155 to 158 of

the Companies Act 1985.

From 1 April 1990, a new exception with different wording has replaced the former.¹⁵ According to this exception, "the provision by a company, in good faith in the interests of the company, of financial assistance for the purpose of an employee's share scheme" has been lawful. Unlike the previous exception, the assistance is no longer limited to the provision of money for the acquisition of shares but includes all forms of financial assistance. For example, a company is able to assist an employees' share schemes by repaying some or all of the capital or interests charges on borrowings taken out by the schemes by repaying some or all of the capital or interests charges on borrowings taken out by the scheme for the acquisition of company shares. It is also possible for a company to give a guarantee or some other form of security or indemnity if that is required by a bank which is willing to lend money to an employees' share scheme. This exception, however, applies to a public company if it has net assets which are not thereby materially reduced, or to the extent that they are, the assistance is provided out of distributable profits¹⁶.

A further exception in relation to the provision of financial assistance to employees' share scheme was introduced into the Companies 1985 Act by section 196 of the Financial Services Act 1986¹⁷. Under this exception, a company and any of its subsidiaries are permitted to provide financial assistance for the purposes of or in connection with anything done by the company (or a company in the same group) for the purposes of enabling or facilitating transactions in shares in the first-mentioned company between, and involving the beneficial ownership of, those shares be:

- (a) the bona fide employees or former employees of that company or of another company in the same group, or
- (b) the wives, husbands, widowers, children or stepchildren under the age of 18 of any such employees or former employees.

For the purposes of this exception, a company is in the same group as another company if it is a holding company, or subsidiary of that company, or a subsidiary of a holding company of that company. This exception was intended to cover certain particular types of arrangements, such as those facilitating the employee-shareholders in unquoted company to buy and sell shares. In buying or selling shares owned by the employee-shareholders, a company could arrange for bargains to be matched. Alternatively, by establishing an employees' trust, shares can be bought and held by trustees pending resale to other employee. In this case it might be necessary for the company in question to advance funds to trustees to enable them to buy shares. Likewise, other group companies might advance funds by way of gifts or loans to enable the trustee to buy or subscribe shares for the benefit of their own employees.

The general legalisation of the provision of financial assistance by a company for employees' share schemes is one of the key factors which is facilitating the growing numerous types of such schemes. The legalisation provides a convenient and more efficient means under which companies can provide financial assistance for employees' share scheme. This legalisation is to be commended, although, as we shall see later, still requires to be polished. Under the new exceptions, employees' share scheme have developed to cover approximately 4,000 companies and at least 3 million employees have participated. The vast majority of these schemes are the approved share schemes of which there were 867 profit sharing schemes, 984 savings-related share options schemes and 3,981 executive share options schemes in operation in March 1994.¹⁸ Although the general legalisation of the provision of financial assistance by a company for employees' share schemes represents a quantum leap towards simplifying this area of company law, still the drafting is not precise, leaving several potential vagaries. The tailor-made exemption and the associated provisions contains ambiguous 'words and phrases' which can be an obstacle to the establishment of a genuine employees' share scheme. These 'words and clauses' in the tailor made exemption and the associated provisions are discussed below.

Interpretation Problems of the Current English Law

Meaning of Financial Assistance and the external financier for employees' share scheme.

The current legislation contains a definition for the expression 'financial assistance'.¹⁹ The definition covers not only a loan from the company to the scheme or the giving of security by a company to collateralise such a loan but also a loan from an external source, such as bank, used to purchase the company's shares, a loan used to pay deferred consideration due to the employees share-holders, or the grant of security over the company's assets to banks which had guaranteed a loan to the scheme. In view of this definition, penalties attached to the prohibition in section 151 of the Companies Act 1985 extends not only to a company which is giving a financial assistance but also to the third parties such as banks. Whilst the definition is broad enough to catch all the viable methods by which the company might seek to fund or collateralise the finance required for employees' share scheme, it is capable of blocking such methods when a third party such as a bank is involved.

Being a party who can be penalised, a bank lending to an ESOP trust may take a guarantee from a sponsoring company when it is satisfied that the requirements set out in the legislation are fully complied with. If these requirements are not complied with, then the lending bank is at risk in that, its guarantee is not lawful, and therefore, its security is ineffective. Further, it may face criminal sanctions. In order to avoid the outlaw of the security and the criminal sanctions, the bank might demand the appropriate documentation from the company, for instance, certified resolutions of board meetings and opinions from the company lawyer's and auditors. Thus, unless the bank is careful in judging whether or not a particular scheme meets the requirements set out in the legislation, it can refuse to give a loan where it opines that there deviations in the scheme rules.

Definition of employees' share scheme

Section 153(4)(b) of the Companies Act 1985 enables a company to give financial assistance for the purpose of employees' share scheme if such assistance is provided in good faith in the interests

of the company. When considering whether a financial assistance can be given, the directors of the company must satisfy not only that their proposal is bona fide in the interests of the company but also that the object of the financial assistance is the "employees' share scheme". Thus, financial assistance is lawful if a scheme in question falls under the definition of employees' share schemes given in section 743 of the Companies Act 1985. According to this section, "employees' share scheme" is a scheme for encouraging or facilitating the holding of shares or debentures in a company by or for the benefit of:

- (a) Bona fide employees or former employees of the company, the company's subsidiary or holding company or the subsidiary of the company's holding company
- (b) the wives, husbands, widowers or children or step children under the age of 18 of such employees or former employees.

From the employees point of view, the definition is wide enough to enable the holding of shares not only during the period of employment but even after the termination of the contract of employment²⁰. Moreover, the definition enables the close relatives of employees to earn financial assistance when they are participating in the employees' share scheme. However, there are three complexities which can arise out of the definition of employees' share scheme, two of which were featured in the May 1992 issue of *Palmer's In Company*.²¹ These complexities are discussed below.

(i) Meaning of "scheme"

Although the Companies Act 1985 defines the term "employees' share scheme",²² there is no further definition of the 'scheme'. The word 'scheme' is a vague and elastic word meaning, *inter alia*, plan or design. If it used in the context of its literal meaning, i.e. it is likened to combination of things connected and adjusted by design, then it is very difficult for arrangements involving a single employee to qualify as an 'employees'

share scheme'. The practice seems to be that, a scheme is an arrangement whereby the company draws up rules governing the holding of shares by employees. In the presence of the rules, an arrangement qualifies to be a scheme even if a company grants an option to a single director. On the other hand, although not expressly stated as a requirement in the Companies Act, an arrangement which is not set down in writing may not be considered as a scheme.

(ii) **Set of Participants**

The second intricacy to the definition of employees' share scheme concerns the categories of persons which are authorised to participate in the scheme. This complexity have two fragments, one of which featured in the May 1992 issue of *Palmer's In Company*²³.

(a) **'Bona fide' employee**

The primary category of persons which are entitled to participate in the employees' share scheme are 'bona fide employees'. However, it is not clear what is intended by the words 'bona fide employee'²⁴. It seems that, the words are intended to exclude those persons(s) who might be on the payroll but who do not perform any duties as an employee. Assuming someone is a honorary director, can we say that he is not entitled to a share option grant or to participate in a profit sharing schemes merely because he is not in the payroll? The consensus seems to be that, such director is not entitled because he is not a 'bona fide employee'. Since the Act does not define the words 'bona fide employee', employees' share scheme lawyers have difficulties in advising companies wishing to provide financial assistance to schemes incorporates, non-executive directors and/or honorary directors.

For long time, part-time employees were regarded not to be 'bona fide employees' for the purpose of tax-relieved employee share schemes. The legislation covering these schemes either required or permitted

an employer to exclude part-time workers from participation in a scheme²⁵. Last year, the then Chief Secretary to the Treasury, the Rt Hon Jonathan Aitken MP, tabled a new clause to the Finance Bill²⁶. The purpose of this clause is to remove the restrictions on the inclusion of part-time employees in tax-relieved employee financial participation schemes²⁷, and thus to ensure that these tax relief's give equal treatment to part-time employees, most of whom are women. The new clause applies to all five kinds of tax-relieved employee share participation schemes, namely; approved profit sharing schemes, approved savings - related share option schemes, approved executive share option schemes, qualifying employee share ownership trusts (ESOPS) and registered profit - related pay (PRP) schemes. Under the new legislation, part-time employees may in future participate in those schemes from which they are, or may be, excluded currently. In future, part-time employees are to be taken into account in considering whether a PRP scheme relates to sufficient employees for tax-relieved payments to be made under it. This amendment is to be praised for granting the right to part-time employee to participate in tax-relieved employee share schemes. It unfortunate that, the new legislation intends to remove restrictions in the tax-relieved employees' share scheme only and is silent on the non tax-relieved employee share schemes.

(b) **Default Beneficiaries**

This complexity was pointed out in the May 1992 issue of *Palmer's In Company*.²⁸ It is generally unclear whether the list of those who can participate in an employees' share scheme was intended to be all-out. It is not clear if the presence of just one potential default beneficiary can disqualify the whole arrangement from being an 'employees' share scheme' even if the rest are lawful beneficiaries. While it is too restrictive to suggest that only bona fide employees, former employees and their dependants must be intended to benefit, it is also

arguable that it is too liberal to suggest that only one employee need to be a lawful beneficiary to constitute employees' share scheme. There is an argument that, the fact that others might incidentally benefit from the establishment of the scheme should not lead the scheme to fall foul to the prohibition in section 151²⁹. This argument is somewhat correct. Assuming that the provision is amended to make clear that, the incidental inclusion of one default beneficially cannot disqualify an arrangement from being an employees' share scheme. Can we say that no further problems might arise with this legal position? The answer is certainly no. Problems still can arise as to what extent the default beneficiaries can be incorporated in a scheme.

*The meaning of the phrase "encouraging or facilitating the holding of shares"*³⁰

The problematic attributes of the phrase "encouraging or facilitating the holding of shares" was featured in May 1992 issue of *Palmer's In Company*.³¹ This phrase denotes that, unless a scheme is established for encouraging or facilitating the holding of shares by employee, it is otherwise unlawful. It is difficult to conceptualise how the scheme which is designed to last for a short time encourages or facilitates the holding of shares. Arrangements under which an employee is only entitled to encash their shares can hardly be described as 'encouraging or facilitating the holding of shares' by or for the benefit of employees.

The appreciation of the uncertainty surrounding this phrase depends on one's view. For those who prefer the company to have a considerable leeway in establishing the employees' share scheme will regard this phrase as one of the high ranking problems in the law of financial assistance. Conversely, the supporters of the view that, employees' share scheme should develop greater and durable degree of employee share ownership will not consider this phrase as a problem. Economic and psychological convictions supports that, employees' share scheme cannot be used as a means of making quick profits or supplementing salaries or solving

the commercial problems facing the company such as a hostile take-over. On the other side if a company is unable to establish extensive and durable forms of employees' share ownership, there is no convincing reason why such company should not be allowed to establish short term schemes like phantom share schemes and restricted share schemes. In the increasing various forms of employee share ownership, this particular aspect should be streamlined to accommodate both views.

*The meaning of the phrase "in good faith in the interests of the company"*³²

As I have mentioned, the provision of financial assistance for employees' share scheme is lawful when it is given "in good faith in the interests of the company". The phrase 'in good faith in the interests of the company' is necessitated by the policy requirement that, the primary creation of the ESOP must be for the purposes of employees' share scheme. Financial assistance which is provided to an ESOP established to act as 'poison pill' deterrent against hostile take over and potential damaging take over would not be lawful. In the United States, the creation of ESOP in order to prevent a hostile or potentially damaging take over has been held to be lawful³³. The requirement of the financial assistance to be in good faith in the interests of the company is also contained in the general exception, a company can provide financial assistance by the way of reducing or discharging a liability if the principal purpose of such assistance is not to acquire shares. The provision of financial assistance is allowed, if among other things, it is given "in good faith in the interests of the company". The phrase 'in good faith in the interests of the company' is not further defined in the Companies Act 1985.

The absence of the clear meaning of these phrases have attracted a number of criticisms from practitioners and the academic community. The principal criticism is that, these provisions are uncertain in scope. It has been argued that, as the result of this uncertainty, practitioners do not know how to apply them. The uncertainty of these phrases has been escalated by the decision of the House of Lords in *Brady Vs. Brady*³⁵. In that case, the court decided that, financial assistance given to prevent continued

management deadlock in, and a probable liquidation of, the company giving financial assistance was, viewed objectively, in the company's interests. In his judgement, Lord Oliver stated that:³⁶

"The words 'in good faith in the interests of the company' form, I think, a single composite expression and postulate a requirement that those responsible for procuring the company to provide the assistance must act in the genuine belief that it is being done in the company's interest. In the circumstances of this case, where failure to implement the final stage of the scheme for the division of the two sides of Brady's business is likely to lead back to the very management deadlock that it was designed to avoid and probable of being perceived by Brady's directors as calculated to advance Brady's corporate and commercial interests and the interests of its employees but is, indeed, viewed objectively, in the company's interest".

It is not clear from his Lordships statement as to whether or not a subjective or objective test is paramount in determining whether or not the financial assistance was provided 'in good faith in the interests of the company'. There is an argument that Lord Oliver referred the subjective test.³⁷ However, the same statement ends by making reference to the objective test. Having explained the subjective nature of the phrase, Lord Oliver concluded that, *objectively*, the reorganisation of the company had been made in good faith in the interests of the company.

The reasoning of the House of Lords in *Brady* has caused a sufficient uncertainty regarding the scope of the exceptions in section 153(1) and (2) of the Companies Act 1985 to make the employees' share scheme lawyers to believe that, the same uncertainty applies to section 153(4)(b) which have similar wording. Of more significance to employee share schemes lawyer's is which test is appropriate to the phrase '*in good faith in the interests of the company*'. Is a subjective or objective test applied to this phrase? How on the problems inherent in each of these tests be dealt with? Assuming the subjective test

is relevant, still it is not clear as to what degree this test allows directors to collateralise other commercial motives when deciding to give financial assistance for employees' share scheme. This test fits badly to the legal requirement that, in considering whether financial assistance can be given, the directors must be satisfied not only that their proposal is 'bona fide in the best interests of the company', but also that 'the object of the financial assistance is the employees' share scheme'. Application of the subjective test cannot cause the company directors to escape penalties where the creation of the ESOP is associated with other commercial motives such as a desire to secure a substantial block of the company's shares in the 'safe hands' by protecting the company from an unwelcome take over bid.

Likewise, the objective test has technical difficulties. The phrase 'in good faith in the interest of the company' postulates a requirement that directors procuring a company to give financial assistance must act in genuine belief in the interest of the company. The words 'in good faith' and 'in the interests of the company' requires a judgement on the underlying commercial motive of the transaction. If, for instance, directors procure a company to provide financial assistance to an ESOP with a desire to secure a substantial block of company's shares in the 'safe hands', such directors can hardly be said not to have acted in genuine belief in the interests of the company because the move have elements of commercial motives. It is very difficult for one to prove that such directors had not acted in genuine belief in the interests of the company.

The Meaning of the words 'for the purposes of employees' share scheme'.

The problems which can arise from the words 'for the purposes' of employees' share scheme was also featured in the May 1992 issue of *Palmer's In Company*³⁸. Usually, the ESOP trustee acquisition of shares will need to be financed by the company in one form or another. The form it takes will be governed by the purposes for which an ESOP has been set up. For instance, if the shares acquired by the ESOP trustee are to be distributed free to employees, then the company will need to make substantial gifts. Therefore,

financial assistance by a company, whatever form it takes, will be lawful only if it enables the employees to acquire and hold shares in the company and transfer to them. Any financial assistance which is directly absorbed into an ESOP without any manifest result of enabling the employees to acquire and hold shares may not be lawful. The best example is where a company advances sum to an ESOP by the way of debenture stock and is given the opportunity under the trust deed to redeem on favourable terms. If a company delays the redemption because it likely its ESOP to 'warehouse' the stock for a short period, such delay hardly satisfies the requirement that financial assistance must be provided 'for the purposes of employees' share scheme'.³⁹

The meaning of the words 'in the company or its holding company'.

As I have indicated above, the oldest exception is the one which enables a company to make loans to its own employees for the purposes of enabling them to acquire shares.⁴⁰ The problem with this exception is the requirement that, the shares to be acquired must be shares in the employer company or its holding company, not a subsidiary of the company nor any other member of the group which includes the employer company. If the proposed loan arrangements are to fall under this exception, the company concerned must arrange for the employees in question to be transferred to qualifying company. In such circumstances, the provision of the loan will only be possible so long as the companies concerned are willing to transfer the employees.

Special Restriction for Public Companies

The employees' share scheme derogation from the prohibition in section 151 applies to public companies only if a company has net assets which are not thereby materially reduced or, to the extent that its net assets are reduced, if the financial assistance is provided out of distributable profits.⁴¹ 'Net assets' are defined as the amount by which the aggregate of the company's assets exceeds the aggregate of its liabilities (taking account of both assets and liabilities to be stated in the company's accounting records immediately before the financial assistance is given).⁴²

'Liabilities' are widely defined to mean the amount which is retained as reasonably necessary for the purpose of providing for any liability or loss which is likely to be incurred or certain to be incurred but uncertain as to amount or as to the date on which it will arise.⁴³ The special prohibition for public companies is necessitated by Article 23 of the Second EEC Directive on Company Law⁴⁴ which applies to public companies only. This article generally prohibit a public company to 'advance funds, nor make loans, nor provide security, with a view to the acquisition of its shares by a third party'.

Apart from the uncertainties surrounding the calculation of the reduction in the net assets, the subjection of the public companies to this requirement seems to be unnecessarily arbitrary division between private and public companies. There will often be some cases where the assistance might not be actually or potentially contrary to the prohibition in section 151. By contrast, the same transaction is free from any restriction if undertaken by a private company. In addition to this arbitrary division, there are some practical difficulties in the calculation of any reduction in net assets. On one hand, the provision which restricts public companies to provide financial assistance for employee share schemes⁴⁵ suggests that, 'net assets' means market value of the companies assets. On the other hand, the definition of 'net assets' suggests that, the calculation of net assets have to base on the book values of the assets and liabilities immediately before the giving of financial assistance. In view of this uncertainty, it is very difficult for a public company to provide financial assistance which complies fully with the legal requirements. In most cases, the book values of assets and liabilities will reflect low values. Full compliance with book value method can reduce the opportunities available to public companies to fund the employees' share scheme.

It is less disputed that, employees' share scheme can be seen as an effective incentive to motivate employees which have the effect of increasing corporate performance. Therefore, the calculation of any reduction in net assets might base on the expectation and projection on which a scheme is founded. Should the projection in the business plan support the conclusion that the

expected achievement in the degree of corporate performance will offset the reduction of net assets, the financial assistance can be provided. In such circumstances, there is no convincing reason why a public company is prohibited to give financial assistance. In order to reduce the difficulties which may arise in practice, clarification should be provided to the effect that, 'net assets' in section 152(2) means market value of the companies assets. Mechanism should be provided to enable those companies which obtains market valuation and acts upon it not to be prosecuted for breach of the prohibition in section 151.

PROPOSALS FOR REFORM OF THE GENERAL LAW OF FINANCIAL ASSISTANCE IN THE UNITED KINGDOM

In October 1993, the Department of Trade and Industry published a consultation paper in which fundamental reforms to the provisions of the Companies 1985 concerning financial assistance were suggested⁴⁶. The department asked for views on the existing statutory provisions and it set out proposals in its paper. Responses were requested by 14 January 1994 and in the light of such responses the Department would consider whether changes to the legislation are required. The DTI document highlights three possible methods by which the existing law could be reformed. First, the existing statutory provisions could be repealed by a reproduced Article 23. Second, the existing statutory provisions could be drafted a new. I praise the United Kingdom government for considering to streamline the area of law that continues to cause difficulties for practitioners. Some of the problems which are identified by the DTI document applies to tailor-made exemption of the "financial assistance for employees' share scheme" from the prohibition in section 151. It is unfortunate that, the DTI document emphasised that the issue of the consultative document does not mean that the new legislation is in sight. This means that the practitioners will continue to confront difficulties for unknown period before new financial assistance statutory provisions are introduced.

The Law of Financial Assistance for Employees' Share Scheme in Tanzania

In Tanzania, the general prohibition of a company to provide financial assistance for acquisition of its own shares is contained in section 46 of the Companies Ordinance⁴⁷. This general prohibition does not apply to financial assistance is, among other things, is given in accordance with any scheme for time being in force for the purchase by trustees of fully-paid shares in the company to be held by or for the benefit of employees of the company, including any director holding a salaried employment or office in the company⁴⁸. The prohibition also exempts the financial assistance which is in the form of loans to persons, other than directors, who are bona fide employees of the company with a view to enable them to purchase fully-paid shares in the company to held by themselves by way of beneficial ownership⁴⁹. These employees' share scheme related exceptions are similar to those which were contained in section 16(1)(b) and (c) of the English Companies Act 1928⁵⁰.

As I have noted above, exception of this kind *per se* do not entirely authorise the company to provide the financial assistance for employee share scheme. They are not sufficiently worded to serve as a proper legal basis for the provision of the financial assistance in the modern form of employees' share scheme such as ESOPs, profit sharing schemes, executive share options and the savings-related share options. These exceptions requires shares to be purchased, to be full-paid. It is not clear whether the 'fully-paid' requirement relates to the shares market value, nominal value or par value. The requirement of the arrangement to be between a company and the trustees makes the exception to be useless since at the moment there are no such employees' trusts in Tanzania. The reference to money in both provisos implies that the financial assistance can only be given in the form of cash advances to a trustees or to an employee pursuant to a loan agreement which is concluded on arms-length basis or on favourable terms. Unlike the United Kingdom Companies Act 1985, the Tanzanian Company Law does not contain such definition. Generally in Tanzania there is no sufficient legal basis which authorises

the company to give financial assistance with a view to encourage or facilitate employees' share scheme. Most of the modern forms of financial assistance to employee share schemes are capable of falling foul to the prohibition in section 46 (1) of the Companies Ordinance.

In view of the fact that the Parastatal Sector Reform Commission is encouraging employees' share schemes as a privatisation mechanism there is need to revise the current law of financial assistance for employees share scheme. Such revision should come with a straightforward and precise permission of the provision of financial assistance to encourage employee-shareholders. The permission can be modelled on section 132 of the United Kingdom Companies Act 1989 and section 196 of the Financial Services Act 1986.

The permission should cover not only cash advances but also the other forms of financial assistance. For instance, companies should be allowed to assist the employee-shareholders to repay some or all of the capital or interests charges on borrowings taken out for the acquisition of company shares. Companies also should be allowed to give a guarantee or other form of security or indemnity when it is required by a bank which is advancing a credit for the purposes of employees' share scheme. Further, a clear legal framework should be legislated to guide certain types of arrangements such as those facilitating the employees-shareholders to buy and sell shares. For example, a law should be tailored to require a company to arrange the matching of bargains or to establish an employees' trust where the shares can be bought and held by trustees pending resale to other employee.

The general legalisation of the provision of financial assistance by a company for employee share schemes should be legislated in a precise language in order to minimise the interpretation problems. In drafting the permitting provisions, the following issues must be taken into account:

1. The definition of financial assistance should avoid the spreading of the penalties to third parties such as banks which finances the employee share schemes.

2. The definition of 'employees' share scheme' must indicate clearly the arrangements which are 'schemes' referred in the definition and which are not. It should also clarify who is a *bona fide* employee and who is not. Clarification should also be made if a certain minimum number of participants is required to constitute an 'employees share scheme'.
3. The permitting provisions must indicate as to what extent and for how long a scheme have to encourage and facilitate the holding of shares by or for the benefit of employees.
4. The permitting provisions must state if a *bona fide* financial assistance for employee share schemes which incidentally falls foul to the prohibition in section 46 (1) of the Companies Ordinance in necessarily unlawful. Also, it should indicate if a financial assistance which is directly absorbed into an ESOP without any manifest result of enabling the employees to acquire and hold shares is lawful or not.
5. The permitting provisions should allow the loan for the purpose of employee share schemes to be given not only to employees of the company which is giving the loan but also to the employees of a holding company, subsidiary or other company which is a member of the group.
6. As far the public companies are concerned, the conditions attached to the provision of financial assistance must be clear to avoid the unnecessary restrictions like those existing in the United Kingdom.

CONCLUSION

In closing this discussion, I want to make it clear that employee share schemes in Tanzania cannot be efficiently promoted if employees cannot assist

financially that employees to acquire shares. The general legalisation of the provision of financial assistance by the company for the purpose of employee share schemes is one of the key factors which can motivate the employers to assist financially the employees. We can learn from the United Kingdom where the general legalisation has caused more than 4000 companies to establish employee share schemes. In the absence of a similar general legalisation in Tanzania, it is difficult to develop the wide scale share schemes.

END NOTES

1. (1887) 12 App. Cas. 409
2. 19 & 20 Vict. C. 47
3. 18 & 19 Geo. 5, Section 16.
4. 1926 Cmnd. 2627. Paragraphs 30 & 31. The mischief which the provisions were originally designed to prohibit was clearly described by the committee in the following words:

“A practice has made its appearance in recent years which we consider to be highly improper. A syndicate agrees to purchase from the existing shareholders sufficient shares to control a company, the purchase money is provided by a temporary loan from a bank for a day or two, the syndicate’s nominees are appointed directors in place of the old board and immediately proceed to lend to the syndicate out of the company’s funds (often without security) the money required to pay off the bank. Thus in effect the company provides money for the purchase of its own shares”
5. 19 & 20 Geo. 5.
6. 11 - 12 Geo. 6.
7. See the examples of these transactions in Dugan, R. & Keef, S. *Company Purchase of Own Shares: The Case for New Zealand*. Victoria University Press. 1989 p. 14
8. 1962 Cmnd. 1749
9. *ibid.* p.61 According to, Dugan and Keef, *op.cit* (supra note 7), the committee recognised that, ‘the limited exceptions to the rule in *Trevor* would facilitate retirement of shareholders in small private companies and the administration of employee share schemes’.
10. c.22
11. The minor changes to the provision on financial assistance was contained in Sch. 3 para 10, *ibid.*
12. C. 62
13. Section 16(1)(b) Companies Act 1928, Now Section 153(4)(b) as substituted by Section 132 of the Companies Act 1989.
14. Section 16(1)(c). Now Section 153(4)(c) of the Companies Act 1985
15. Section 132 of the Companies Act 1989
16. See section 154 (1) of the Companies Act 1985
17. This exception was slightly modified by section 144(4) and Sch. 18 para. of the Companies Act 1985 as from 1st November 1990 subject to transitional provisions.
18. These figures are provided in Chamberlain, C. *Tolley’s Practical Guide to Employees’ Share Scheme*. Tolley’s, 1994, p. 1. These figures are not necessarily correct.
19. Section 152(1)(a), Companies Act 1985
20. In practice, employees are not allowed to participate in the employee share schemes after leaving employment.
21. See Cohen, D. “Financial Assistance for employee share schemes”, *Palmer’s In Company*. Issue 5 May 20 1992.

22. Section 743, Companies Act 1985
23. Cohen, D. *op. cit.*
24. Sections 743(a) & 153(4)(b)(i) Companies Act 1985.
25. The legislation required part-time employees to be excluded from an approved executive share option scheme and it permitted an employer to exclude part-time employees from an approved profit-sharing scheme, or an approved savings related share-option scheme. It also permitted part-time employees to be left out of account in considering whether sufficient employees are to participate in a registered PRP scheme. See the Press Release, *infra* note 26
26. See Inland Revenue Press Release, 9 February 1995. The tabling of this clause seems to be a response to the House of Lords decision in the case of *Regina Vs. Secretary of State for Employment ex parte Equal Opportunities Commission (EOC) and another* [1994] IRLR 176. In this case the court decided that certain hours of work thresholds, which employees had to meet in order to qualify for statutory unfair dismissal and redundancy payments rights, were not consistent with European equal treatment law.
27. The restrictions to be amended are those in parts III - V of Schedule 9 to the Taxes Act 1988 (for which the word 'full-time' is deleted and replaced by 'an employee'; Schedule 8 to the Taxes Act 1988 and Schedule 5 to the Finance Act 1989 (for which the exclusion by a scheme of employees working less than 20 hours a week is omitted).
28. Cohen, D. *op. cit.*
29. Cohen. *ibid*
30. Section 743, Companies Act 1985.
31. Cohen, D. *op. cit.*
32. Section 153(4)(b), Companies Act 1985
33. For instance, the establishment of an ESOP by Polaroid Inc. in 1988 in order to prevent a hostile take-over bid was upheld by the US courts.
34. sections 155-158 of the Companies Act 1985
35. [1988] 2 WLR 1308. For analysis of the implications of this decision, see, Pettet, B. G. "Developments in the Law of Financial Assistance for the Purchase of Shares", *Journal of International Banking Law*, Issue No. 3, 1988, pp. 96-104.
36. *ibid.*
37. Cohen, D. *op. cit.*
38. Cohen, D. *op. cit.*
39. This point is well dealt by Cohen, D. *Ibid.*
40. Section 154(4)(c), Companies Act 1985.
41. Sections 154(1), Companies Act 1985
42. Section 154(2)(a), *ibid*
43. Section 154(2)(a), *ibid.*
44. Dir. 77/091/EEC O.J 1977 L26/1.
45. See section 154 of the Companies Act 1985.
46. For an account of this document, see, Barham, R. "Financial Assistance: Proposals for Reform" *International Company and Commercial Law Review*. Issue No. 2, Feb. 1994 pp. 39-42; Lumsden, C. "Financial Assistance: DTI Review" *Palmer's In Company*. Issue No. 1, Jan. 1994.
47. Chapter 212 of the Tanzanian Laws. This legislation is modeled on the English

Companies Act 1929.

Commercial Law Review", Vol. 5, Issue 2, Feb. 1994, pp. 39-42.

48. Section 46 (1)(b), *Ibid.*

Cohen, D. "Financial Assistance for Employee Share Schemes", *Palmer's Company*. Issue No. 5, May 20 1992.

49. Section 46 (1)(c), *Ibid.*

"Financial Assistance: A Necessary Prohibition?" *Palmer's In Company*. Issue 12 Dec. 16 1992

50. These exceptions were retained by the Companies Act 1929 and Companies Act 1948 and are also retained by the consolidation Companies Act 1985. They are still one of the key legal basis for the provision of financial assistance for employees' share scheme in the United Kingdom.

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