

CONFIDENTIAL*From the Secretary of State*

The Rt Hon John Biffen MP
Lord President of the Council
Privy Council Office
Whitehall
London
SW1A 2AT

26th

April 1983

We are advised that legislation is urgently needed to sort out an unfortunate legal tangle which has arisen in the case of pension funds, employee share ownership schemes etc. The Attorney General's advice has been sought and he agrees.

The problem is as follows:-

Investments owned by pension funds, employee share schemes etc are normally held by trustees. It is common practice for a company setting up such a fund or scheme to incorporate a subsidiary to act as trustee. If a "trustee/subsidiary" of this kind owns shares in the parent company, and if there is a residual interest in favour of the parent company as there normally will be, those shares are void. In the case of an employee share scheme it is of the essence of the matter that the trustees should hold shares in the parent company : and it is not uncommon in other cases as well. Legal advice is that unless expressly excluded the law presumes a residual interest in favour of the parent company : and in the case of approved schemes, the Inland Revenue demand that there should be such a residual interest. In the result a very large number of shares held by pension funds etc are void.

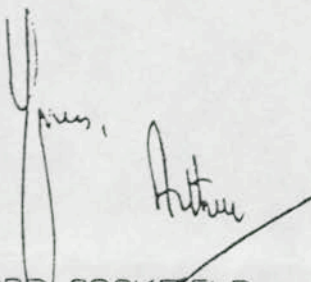
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From the Secretary of State

The problems goes back to 1947. It is surprising that attention should not have been drawn to the matter before. Fortunately at present very few people are aware of the situation : but it is not too much to say that a state bordering on panic already exists among those who do know. The reaction if the news spreads would be serious. There is, I am advised, no way of dealing with the matter other than by legislation. We hoped that this could be incorporated in the Finance Bill but this has not proved possible. Separate legislation would be required. This would be simple and would extend only to six substantive clauses. We would expect such a Bill to be entirely non-controversial and therefore suitable for the Second Reading Committee procedure in the House of Commons, and assured of rapid passage in the Lords. Obviously it will be necessary to confirm this by informal consultation before we proceed further. But if this can be cleared I hope very much that you and the Lord Privy Seal would agree to find time for such a Bill.

I am copying this to William Whitelaw as Chairman of H Committee as policy clearance will also be required, and to the Lord Privy Seal and the Chief Whips (Lords and Commons).


LORD COCKFIELD



THE COMPANIES ACTS, PENSION SCHEMES AND EMPLOYMENT SHARE SCHEMES

Companies Act 1948, S.27

1. The problem with S.27 arises where a parent company has used a subsidiary company as a trustee of the company's pension scheme, employees' share scheme or any similar scheme for the benefit of employees, and those schemes hold shares in the parent company. S.27 is designed to stop a subsidiary holding shares in its parent, because this would enable the parent to control itself. By way of exception, however, S.27 permits a subsidiary to hold shares in the parent company if the subsidiary is concerned only as trustee and if the parent company is not beneficially interested in the shares.

2. It has long been common practice for companies to establish a subsidiary company to act as trustee of group pension, employees' share or other employee benefit schemes. Many such schemes have held and hold shares in the parent company as part of a pension scheme's investment policy, as a result of a merger of pension funds following a corporate merger or acquisition, by virtue of the very role of employee share schemes, or for other reasons. These two circumstances are only lawful in combination under S.27 if the parent company does not itself have a beneficial interest in the shares held by the schemes. Until recently, it was not appreciated that any such interest existed. However, it is now recognised that, unless there is express provision to the contrary in the terms of such a scheme, the parent company would under the equitable doctrine of "resulting trust" be entitled to receive back any surplus remaining in the scheme after the satisfaction of its objects eg. on the winding up of a pension scheme. Thus the parent company has a beneficial interest contrary to S.27 where any of its own shares are held by the scheme. Moreover in relation to schemes needing approval by the Inland Revenue, the Revenue insists that a term of the scheme should be that any eventual surplus should accrue to the parent company (and not, for example, be paid as a kind of untaxed bonus to others under the trust).

3. Since under S.27 any transfer or allotment of shares to a subsidiary in breach of the Section is void, the continuity of title to particular shares will have been breached in many particular cases since 1948. Moreover many present schemes must "hold" shares, in some cases given the practice of self-investment up to a sizeable proportion of the scheme's assets, to which they have no lawful title.

4. We do not believe that there has been any significant mischief in terms of company law as a result of these breaches of S.27. Those concerned and their advisers believed that they were acting within a permitted exception and no objectionable consequences of the breaches S.27 have come to light. It seems justified accordingly to legalise the void transfers or issues retrospectively.

Companies Act 1980, S.37

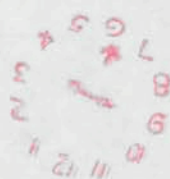
5. S.37(1)(d) of the Companies Act 1980 provides, in accordance with the EC Second Directive, that where shares in a public company are acquired with financial assistance from the company, and the company has a beneficial interest in those shares, the shares must be disposed of within one year or be cancelled, and must not be voted before



disposal or cancellation. Whether or not a company's employee share or pension scheme has a subsidiary as a trustee, the parent company will typically fund the scheme and, as described earlier, has a residual interest, if not expressly provided then on the resulting trust principle. Retrospective and prospective exemptions are therefore needed to S.37 similar to any provided in respect of S.27 of the 1948 Act.

Proposed Legislative Provisions

6. It is proposed to validate retrospectively and exempt prospectively transactions involving pension schemes and employee share schemes where any beneficial interest has been or is only a residual interest. Supplementary provision would be made to restrict the scope for abusing any such interest which vested in possession on satisfaction of the objects of the scheme.





Ind. Pol. Prime Minister ²
ms 17/5

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

16 May 1983

ms

Dear Arthur

✓
Thank you for your letter of 26 April about new legislation to amend the Companies Acts in relation to pension funds etc. I have subsequently seen your Private Secretary's letter of 3 May to the Home Secretary's Private Secretary.

It seems to me clear that we will have to legislate on this matter as soon as possible and I hope that you will receive policy clearance from H Committee. As for the timing of the legislation, this will clearly have to wait for a decision until after the election, when the Cabinet will wish to examine the programme for the new Session. In the meantime I see no reason why preparations should not go ahead. On the understanding, therefore, that policy approval is forthcoming from H Committee, I authorise the employment of Parliamentary Counsel to draft legislation on a contingency basis.

I am copying this letter to the Prime Minister, the members of H Committee, the Attorney General, the Lord Advocate, Sir Robert Armstrong and First Parliamentary Counsel.

ms
John Biffen

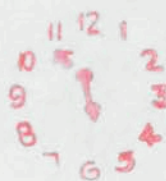
JOHN BIFFEN

The Rt Hon The Lord Cockfield
Secretary of State for Trade
1 Victoria Street
London SW1H 0ET

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Incl bel Oct 49
Company's bill

1983





From the Secretary of State

Colin Walters Esq
Private Secretary
Home Secretary's Office
HOME OFFICE
50 Queen Anne's Gate
London
SW1H 9AT

Prime Minister

To see. Early legislation
is required to put right a
loophole in the Companies
Acts, whereby a large number
of pensions and other funds

3 May 1983

are found to have no good
title to their assets.

MUS 4/5

Dear Colin,

My Secretary of State wrote to the Lord President on 26 April outlining the importance of early primary legislation this session to cover a very serious technical problem which has arisen relating to the application of certain provisions of the Companies Acts to pension schemes, employee share schemes and similar schemes for the benefit of employees. His letter was initially given a relatively limited circulation. Following the Home Secretary's 28 April letter to the Secretary of State, I am now copying this letter more widely to those suggested, and to Michael Scholar at No. 10.

I am also enclosing a memorandum explaining the background to the problem and our legislative proposals in more detail.

As the Secretary of State's letter of 26 April states, knowledge of the problem, which only came to light relatively recently, is at present being closely held. Once it became clear that the necessary legislation could not be incorporated in the Finance Bill, we received confirmation from the Attorney General last month that the problem could only be put right by independent legislation. It was as a result of this that the Secretary of State sent his letter to the Lord President.

It is important that knowledge of the problem should not spread more widely until the Government is in a position to remedy the situation. Until such action can be taken, there is an ever-present risk of a pension fund trustee or investor acting on the assumption that the ostensible owner of shares affected does not have good title to them. This could cause serious disruption and loss of confidence in the financial markets, and probably to the detriment of funds. It is because of this "time-bomb" character of the problem that the Secretary of State is seeking authority for very urgent legislation. For this reason, it would be particularly welcome if, as the Home Secretary suggests, the matter could be cleared without a meeting.



From the Secretary of State

As noted, I am sending copies of this letter to Michael Scholar (No.10), the Private Secretaries to members of H Committee, the Attorney General, the Lord Advocate, Sir Robert Armstrong and to the First Parliamentary Counsel.

Yours sincerely,

A handwritten signature in dark ink, appearing to read 'John Rhodes'.

JOHN RHODES
PRIVATE SECRETARY

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Ind. Pol.

K/BPM

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY

MS 2/6

Telephone 01-407 5522

From the Joint Parliamentary Under Secretary of State

The Rt Hon William Whitelaw CH MC DL
Secretary of State
Home Office
Queen Anne's Gate
London SW1

26 MAY 1983

Dear Mr Whitelaw,

COMPANIES ACTS AND PENSIONS SCHEMES ETC

I have seen Arthur Cockfield's Private Secretary's letter of 3 May to your Private Secretary and the related correspondence. I would wish on Norman Fowler's behalf to add this Department's support for early legislation to put matters right. We are extremely concerned that all transactions on behalf of pension schemes should be validated. The situation where the pension scheme is a subsidiary of the parent company is a fairly common one and it is accepted that Inland Revenue requirements lead to the parent company having a beneficial interest, at least in theory, on a contingency basis.

Copies of this letter go to Michael Scholar (No 10), members of H Committee, the Attorney General, the Lord Advocate, to First Parliamentary Counsel and to Sir Robert Armstrong.

Yours sincerely,
David Trefgarne

LORD TREFGARNE

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From THE PRIVATE SECRETARY

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NORTHERN IRELAND OFFICE
GREAT GEORGE STREET,
LONDON SW1P 3AJ

John Rhodes Esq
PS/SOS Department of Trade
1 Victoria Street
London
SW1H 0ET

19th May 1983

Dear John,

COMPANY LAW AMENDMENT

Thank you for copying to me your letter of 3 May to Colin Walters about the need to remedy a defect in the law on trust funds.

Northern Ireland company law, which is identical to the GB legislation, also contains the serious technical problem which you describe. If legislation is required, we should need to amend both codes and it would be essential that amending provisions to the GB and the Northern Ireland legislation came into effect at exactly the same time. If this is not achieved the gap in these inter related statutes covering the UK as a whole might be able to be exploited in a damaging way.

At present officials from the Department of Economic Development in Northern Ireland are in contact with Department of Trade officials to establish the best means of achieving the necessary amendment to the NI legislation. If you agree, I suggest that contact continues at official level with a view to presenting Ministers with possible solutions immediately after the general election.

I am copying this letter to the recipients of your letter of the 3 May.

Yours ever,

John Lyon

J M LYON

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Ind Pet
Oct '79
Companies Bill

