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## **SPECIAL RIGHTS SHARES**

This note sets out the background to, and objectives set for, Special Shares created in privatised companies and the policy constraints applying to existing and any new Special Shares. Special Shares have been used in narrowly defined circumstances in a number of privatisations where there has been a need to protect a business from takeover, for example on national security grounds or, as a temporary measure, to allow the management time to adjust to the private sector.

2. The case for any future Special Share arrangements should be considered on a case by case basis against the background of the policy outlined in this paper, as any proposals for the transfer of businesses to the private sector come forward. Departments wishing to pursue the case for a Special Share should consult, and secure agreement from, their contact division at HM Treasury, in consultation with PEP.

### **A. BACKGROUND**

3. One of the main reasons for transferring businesses to the private sector is to expose them to commercial disciplines and market pressures. It is therefore important that any remaining Government interest should be narrowly defined and exercisable only within a framework where both the strategic and day to day control of the business concerned rests with the private sector owners and managers. The development of Special Shares needs to be seen in this context.

4. Normally, the powers relating to control of a private sector company rest with the shareholders and are usually formalised in the Articles of Association of the Company. These regulate the rights of the members of the Company and determine the manner in which the business of the company shall be conducted. Articles may only be amended by a special resolution of the company, which requires a 75 per cent majority of shareholders present or 75 per cent of votes cast in a ballot. One means of protecting strategic national interests would have been for the Government to retain a holding of voting shares in a privatised company just in excess of 25 per cent. This would have been contrary, however, to the objective of achieving complete transfer to the private sector. Indeed, in cases where the nature of the sale meant that

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the Government temporarily retained a residual shareholding, the policy has been to undertake not to exercise any voting rights.

5. The alternative which has been developed is the creation of a single share with special rights which are set out in the Company's Articles of Association. Special Shares are held by the Secretary of State with policy responsibility for the privatised industry. The rights attached to a Special Share cannot be varied without the Government's consent.

6. It is possible for restrictions to be embodied in the Articles of Association of a privatised company without these being entrenched by a Special Share - for example British Airways has Article restrictions only to protect its designation as a British carrier on international routes.

7. Special Shares are not needed in all cases; indeed a wide range of privatisations have been effected without Special Shares; these include Associated British Ports, some British Rail subsidiaries, Railtrack, the National freight consortium, major Rover Group subsidiaries. Civil Service businesses, such as ECGD, PSA Projects and PSA Building Management were also sold without Special Shares.

8. The first Special Share was created in 1982 when 100 per cent of the equity in Amersham International was sold. There are currently 21 outstanding Special Shares, these are primarily in the electricity generating and transmission industries and certain defence companies. A list of the companies in which Special shares are outstanding is at Annex A.

9. A number of Special Shares have been redeemed including those in Amersham International, Britoil, Enterprise Oil, Jaguar, British Steel and BT. Many have expired automatically in the recent past: 31 December 1994 in the case of the 10 Water Companies, 31 March 1995 for the 12 Regional Electricity Companies and 31 March 1997 for the British Technology Group (BTG) and for BTG (International).

### **B.OBJECTIVES/POLICY**

10. The use of Special Shares should be the exception, not the rule. Their use should be

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confined to those companies where the Government judges that it needs to retain specific limited powers over the future ownership, control, or conduct of a privatised company. Given the objective of establishing as clean a break as possible when transferring a company to the private sector the creation of Special Shares should be avoided wherever possible.

11. The key aims of the restrictions imposed by Special Shares has been to preserve the independence of companies:

- because of their strategic importance: or,

- in order to give newly privatised industries time to adjust to the private sector and to establish a track record.

12. Where there is a security dimension, the Special Share is likely to be long-term ("timeless"), unless security priorities change. Where there is no security dimension the Share is likely to be a temporary arrangement ("time-limited").

13. It is important that Special Shares be time-limited wherever possible and should in any case have their continued existence subject to review.

14. Where Special Shares are agreed to be necessary it is important that they should avoid provisions enabling the Government to interfere in the general conduct of the privatised business.

### **C. FEATURES OF SPECIAL SHARES**

15. The exact powers to be taken need to be determined by the circumstances of the company in question but should be limited to the minimum necessary to secure the relevant objectives.

16. Typical Special Share powers include:

- (i) a clause providing that the holder of the Special Share may redeem the Share at any time for its face value (usually £1);

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(ii) a clause limiting shareholdings by any one person, or group of persons acting in concert, to 15 per cent, with powers for the board of Directors to disenfranchise any shareholder in breach of this limit to the extent of the excess;

(iii) a clause entrenching itself, and the two clauses above, against amendment unless there is both a resolution passed by the ordinary shareholders at general meeting in the usual way and the holder of the special share has given written consent.

17. The aggregate 15 per cent shareholder limitation figure was set at this level because a person, or group acting in concert, could exercise influence, eg by stopping special resolutions, if they controlled more than 15 per cent of the share capital. The ownership limits which attach to most Special Shares have survived. However, the initial original 15 per cent restriction on foreign shareholdings applicable to defence industries has been increased to 29.5 per cent.

18. The 15 per cent limit on shareholding is a widely used feature of Special Shares created for a utility sale but it was decided in 1988 that provisions relating to the right to appoint Chief Executives should be confined to privatised industries with a defence or security dimension.

19. In addition, ten of the Special Shares include powers over the disposal of material assets (again mainly in connection with defence or security issues).

20. It has been the practice for Special Shares in companies with a defence or security dimension to include provisions to appoint or nominate directors. But it was agreed in 1993 that the Government would give up its rights under the BT Special Share to appoint or nominate upto two BT Directors. The BT special share itself was redeemed in 1997.

### **D. EC AND LEGAL CONSTRAINTS RELATING TO SPECIAL SHARES**

21. Even if it is agreed that it is desirable to have provisions in the articles of a privatised company designed to restrict the future ownership or control of the company there may be legal

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constraints upon the ability to so do, particularly under EC law. The following summarises the most relevant areas.

22. Restrictions on foreign ownership of shares affecting nationals of other EC member states is prohibited under EC law (see for example article 52 of the Treaty of Rome - right of establishment, article 221 - equal treatment as regards participation in the capital of companies, and article 73B - free movement of capital). There are only two justifications for such restrictions, both very limited:

(a) article 223.1(b) permits measures considered necessary for the protection of the essential interests of a member state's security, which are connected with the protection of, or trading in, arms, ammunition and war material. Even where justified, the restriction has to be proportionate and not distort competition in non military products.

(b) under article 90 (2) where the privatised company is an undertaking entrusted with the operation of services of general economic interest or a revenue-producing monopoly where the application of the Treaty would obstruct the performance of a task entrusted to it.

23. Foreign ownership restrictions are also prohibited under the OECD code of Liberalisation of Capital movements. The only relevant exemption would be on security grounds.

24. Restrictions on the ownership of shares more generally (eg a limit on the percentage that may be held by any one party, as well as foreign restrictions) are prohibited under the EC Admissions Directive which provides that all shares must be freely negotiable. Privatised companies to which a Special Share is attached and which are to be listed require an exemption from the Stock Exchange's Quotations Committee. The Committee has agreed to restrictions in the past where special circumstances surround a privatisation and warrant a restriction on the ownership or transferability of the shares.

25. Although such restrictions have been accepted in the past it should not be assumed that

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acceptance is automatic and careful consideration should be given as to whether they can be justified in new cases. In addition, EC law aspects should also be addressed.

26. Requirements that the Chairman, Chief Executive and other senior management should be British nationals are prohibited under Article 48 of the Treaty of Rome. They can only be justified under article 223.1(b), see 24(a) above, or on security or public policy grounds. These latter exemptions are narrowly interpreted and would have to be proportionate.

### **E. MECHANISM FOR CREATING SPECIAL SHARES**

27. Aside from taking a power for the relevant Secretary of State to hold the Special Share, no provision is needed in legislation. Special Shares are brought into being by resolutions adopted at company General Meetings.

28. The resolution creating a Special Share is typically passed when the company is still owned by the Government which then votes in favour of the resolution. The creation is, however, generally conditional on privatisation taking place so that the Special Share does not come into being until after the ordinary share capital is sold.

29. A Special Share itself confers no powers other than those assigned to it under the Articles of Association of the company. So in parallel with the creation of the Special share, resolutions have to be passed at a general meeting, again whilst the Government still owns the share capital, to adopt the requisite powers.

30. Although Special Shares are normally created prior to privatisation, they can be created at any time, provided that the support of 75 per cent of the vote on the special resolution can be secured. Special Shares were created after privatisation for British Aerospace and Cable and Wireless, but whilst the Government still held a large percentage of the shares.

### **G. EXEMPTIONS TO UNIVERSAL SHAREHOLDING LIMIT**

31. in general the main exemptions from the 15 per cent limit provided for in the Articles of

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Association have been for:

- i) a trustee for an employee share scheme;
- ii) the nominee company of the UK Stock Exchange, as the temporary nominee owner of shares which have been sold but for which payment has not yet been made, reflecting the fact that more than 15 per cent of the shares may be changing ownership at one time.

32. When new Special Share rights are being considered it is appropriate to determine at the outset, the form of Articles that need to be put in place to establish the appropriate exemptions to cater for overseas listing requirements. There may also be a need, in particular in connection with Special Share arrangements in a company that wishes its shares to be listed overseas, to make provision in the Articles to allow appropriate stock exchange organisations in other countries to be exempted from the limit.

33. Furthermore, exemption provisions should, as far as possible, be general rather than for particular overseas stock exchanges; again to avoid the need for amendments. Where exemption provisions are general it needs to be considered whether the Special Shareholder's consent should be required for each particular exemption.

34. The Articles should be framed in such a way as to require the Special Shareholder's consent for each exemption so that the Government can be reassured that an exempted body could not be used to conceal the build-up of individual or associated holdings of more than 15 per cent, and that adequate arrangements are in place to ensure that the exempted body exercises voting rights in accordance with the wishes of the beneficial shareholders.