

The Companies Act 2006 (2006 Act) - Purchase of Own Shares

Why might a Company Purchase its own shares?:

- As an alternative to issuing redeemable shares, it provides private investors with a ready market for otherwise potentially unmarketable shares. Investors are more likely to invest if they know that they can buy back their shares rather than having to find a 3rd party buyer for what may be a minority shareholding in a family company.
- If a family shareholder with a large number of shares should retire or die (without children to succeed him) and the other members of the family cannot afford to buy the shares and the only other options would be to sell to a third party (possibly resulting in a loss of control of the family business) or liquidate the company.
- If a family shareholder were to die and it is necessary to sell their shares to meet liability for inheritance tax.
- Where a shareholder is required by a company's constitution to sell his shares (e.g. on retirement or ceasing to be a director, or in accordance with bad leaver provisions), a company buying back its shares can help to preserve the balance of power between the remaining shareholders.
- It enables indifferent shareholders to be bought out where the other shareholders may not have sufficient available capital funds to buy out such shareholders, which helps with the effective management of a company.

Companies Act 2006

The Companies Act 2006 brings in changes to the procedure on 01 October 2009. These changes are largely technical and do not in the main merit mention here.

Broadly speaking the procedure is as follows:

1. A company must have authority to purchase its own shares. From 01 October 2009 the Companies Act 2006 implies such authority unless there are contrary provisions in a company's Articles of Association.
2. A company may only purchase its own shares if it has either sufficient distributable profits or capital reserves to fund such a purchase. (A purchase out of capital requires a more detailed procedure).
3. The shares in question must be fully paid up.
4. The agreement to purchase the shares must be detailed in writing and approved in advance by the shareholders of the company. The Companies Act 2006 has brought in changes related to the proposal and passing of resolutions.
5. The payment for the shares must be paid over at completion of the transaction and the written agreement must be kept available for inspection by the company for 10 years following completion.

Failure to Comply

The procedure for a company buying its own shares is highly regulated. Failure to comply can in many instances render the arrangement to be void from the outset, meaning that the shares will never have been transferred.

This can cause serious problems where defects in the process have not been discovered until long after the transaction. A company might carry on for years after a transaction, with everyone acting as though shares have been bought back before it later comes to light that the transaction was void. The company then suddenly has to deal with long forgotten shareholders and issues like whether decisions made since the transaction that require shareholder approval were properly approved, what happens as regards the purchase price that was paid over at completion.

Greater problems occur where the selling shareholder has died and the company then needs to deal with the estate of the former shareholder.

Putting right defective purchase of own shares transactions can be a very time consuming and expensive process so it is very important to ensure that everything is done correctly the first time round.