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it's our business

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Move over Darling

All eyes were on Chancellor Alistair Darling as the new year got under way – to see whether or not he would rework his controversial Capital Gains Tax proposals, which he has threatened to introduce from April 6. Many Centre practitioners are up in arms over the Chancellor's plan to replace the current CGT regime with a simple flat-rate 18 percent charge on share sale profits, regardless of how long employees have held their shares, or share rights. Taper relief would be withdrawn, as would indexation allowance.

Mr Darling had hoped to confirm before Christmas the CGT changes he originally announced in October's Pre-Budget Report (PBR). However, he back-pedalled furiously, such was the weight of criticism thrown at him and later announced in the Commons that the representations he had received had been so complex and he would need more time to consider them.

Centre chairman Malcolm Hurlston has told Mr Darling that the abolition of taper relief would impact on efforts to build up long-term employee share ownership in the UK, for which Gordon Brown, his predecessor as Chancellor, had repeatedly banged the drum.

Under the Darling proposals, if an employee wanted to immediately sell shares acquired on the exercise of CSOP and SAYE options, the rate at which CGT is payable would, from 6 April, be reduced from 40 percent to 18 percent (or, in the case of a basic rate taxpayer, from 20 percent to 18 percent).

However, Pinsent Masons (and others) pointed out that if employees chose to retain any shares acquired through the exercise of CSOP or SAYE options, they would not benefit from any reduction in the effective rate of CGT once taper relief has gone. Thus the effective rate of CGT on sale by employees of CSOP and SAYE shares held for more than two years would be increased for a higher rate taxpayer by 80 percent (from ten to 18 percent) and, for a basic rate taxpayer, by up to 360 percent (from five percent to 18 percent).

This would be bad news too for option holders in the Enterprise Management Incentive scheme, where CGT taper relief, under which the clock runs from the date of option grant, (not its exercise) would cease to apply. If an employee sold shares acquired through the exercise of an EMI option, he would be charged to CGT at 18 percent, and not ten percent (if the disposal is at least two years after option grant) - an effective increase of 80 percent in the rate of tax payable on the sale of EMI option shares. The changes would raise the tax bills of those SAYE-Sharesave participants who hung on to their exercised shares and would punish successful small business founders and key employees who are given performance-related equity awards in their companies, rather than large pay packets. Darling's message to them appears to be: 'exercise your options asap and sell all your shares immediately.'

The Chancellor, under pressure from the Northern Rock and the loss of personal details of 25m child benefit beneficiaries - is loath to tear up his proposals and start again. The question is whether he will exempt approved employee share schemes from the new flat-rate, permitting the continuation of taper relief.

The British Private Equity and Venture Capital Association has asked him to look at eligibility to Eso schemes, as well as tax regimes governing small business. Leon Walker led the Edinburgh University spin-out Mtem, which developed a method of detecting underground oilfields. He said he would have found it easier to attract executives to his board had he been able to include them in share option schemes such as EMI. Walker stands to lose a lot of money as a result of the proposed CGT changes.

*Mark Hoban, Tory Treasury shadow minister, is taking a keen interest in employee share ownership. A team from

From the Chairman

The sword of Damocles Darling remains hanging over our heads but as we head for Davos the skies are brighter in Europe. Under the benign reign of Charlie McCreevy some of the ills of the Prospectus Directive are to be undone.....perhaps he might turn his liberal mind to accounting next. It has always been unfortunate that responsibility for employee ownership as a topic lay, in the arcane world of the European Commission, with Employment and Social Affairs rather than with Internal Market. Let us hope it may be possible, with the enhanced natural role of McCreevy, we can achieve the formal handover of our topic to the part of the Commission where it truly belongs.

Malcolm Hurlston

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the Centre including steering committee member Kevin Thompson of Clifford Chance and chairman Malcolm Hurlston briefed him on the impact of the proposed CGT changes. In turn he asked the Centre for its views on future directions for Eso.

PD FGHTBACK

The Council for European Securities Regulators (CESR) announced last month that it will attempt to alleviate the negative impact of the EU Prospectus Directive (EUPD) on employee share plans, pending legislative changes. Amendments to the EUPD - to lessen the impact on employee share plans – are being worked on, but these will not surface until a review of the PD is completed later this year. In the meantime, CESR has supported the recommendation of Charlie McCreevy, the EU Commissioner for the Internal Market and Services, that regulators adopt a 'light touch' when examining prospectuses for employee share plans. The CESR statement does not make any changes to the EUPD regime for employee share offers, but shows that the Commission and CESR are working together to ease the burden of compliance and disclosure on companies.

NEW AIB EXECUTIVE GUIDELINES

The Association of British Insurers (ABI) has amended its remuneration guidelines following a review last year. In the process, it has interesting comments about the period over which Total Shareholder Return (TSR) performance tests should be measured. The ABI has for the first time suggested that companies disclose how they propose to satisfy awards, said lawyers CMS Cameron McKenna and Clifford Chance. Specific changes this year include:

Pensions: Companies are increasingly offering cash supplements in lieu of pension arrangements. This was originally due to the earnings cap but is now due to A-day changes, which introduced further limitations on Revenue-approved pension benefits from April 6 2006. The ABI now says that these should be separately disclosed.

Performance: The ABI has said before that it is concerned that the start and end points for TSR performance measurement are being averaged over periods that are too long. Many long-term incentive plan (LTIP) awards and, to a lesser extent, share options, have TSR performance targets. Additional guidance now states that the calculation of the starting and finishing values for TSR should be made by reference to average share prices over "a short period of time" at the beginning and end of the performance period and that lengthy averaging periods should be avoided. The ABI does not define what it considers to be short or lengthy, but many companies use a three-month averaging period and it is thought that this is acceptable to the ABI. The guidelines now state that where performance conditions are subsequently found to have been significantly mis-stated so that bonuses and other incentives should not have been paid, effective avenues of redress should be considered by RemComs. The previous version of the guidelines referred to 'legal redress'.

Change of control: The guidelines re-emphasise that performance testing should determine the level of awards receivable on a change of control, but from now on underlying financial performance should be "the" key determinant of the level of vesting achieved, rather than simply being "a" key determinant as previously stated. Time-vesting should be applied further to reduce the number of shares received if the change of control happens before the end of the intended performance period for an award. If, on a change of control, application of a performance test suggests that 60 percent of the shares are receivable, but the change of control occurs half-way through the performance period, then only 30 percent of shares would be received. This may not find support with many smaller companies, however, which still prefer to have remuneration committee discretion determining the number of shares receivable on a change of control. The two top executives at Activision, the US video games group, will receive $40m between them in change-of-control payments if France's Vivendi succeeds in its plan to take a majority stake in the business.

Source of shares & disclosure: The guidelines say that companies should explain how they intend to satisfy awards (e.g. through issuing shares or acquiring shares on the market and holding them in treasury or in employee trusts until needed by employees) as well as the acquisition and funding arrangements for this. This is a development companies may not welcome. It could, if market practice follows the guidelines, lead to some quite heavy disclosure requirements without any apparent benefit to shareholders, as well as limiting companies' flexibility if they wish to change what they have said. The guidelines expect companies to disclose the expected value of awards at the outset, bearing in mind the probability of achieving the relevant performance criteria. The ABI have now extended this requirement so that, when changes are proposed, any resulting changes in the expected value of the awards should be disclosed, together with the reasons why the RemCom consider these to be justified.

Additionally, the ABI sent a letter to the RemCom chairmen of FTSE 350 companies. "This letter perhaps reveals more than the revised guidelines about the current areas of concern for the ABI," said Clifford Chance. The letter noted that there had been a number of issues arising from the year's reporting and mentioned "one-off or exceptional grants". Companies should expect that such grants will in future receive greater scrutiny from the ABI, which drew attention to other share plan issues, namely: *Where two or more performance conditions are used to formulate an award, consideration should be given to making them inter-dependent i.e. integrated in a matrix rather than evaluated independently. The ABI considers that this strengthens the alignment of vesting with improvements in the overall financial performance of the company. *In designing the vesting schedules for long-term incentive awards, the RemCom should consider several factors including the possible use of wider performance targets such as upper decile in the case of TSR performance. *The ABI considers that it is helpful for shareholders if there is disclosure in the remuneration report of the overall share usage (actual and potential) for remuneration purposes, with an indication of whether usage is dilutive or if it has been sourced from market purchase shares.

Davos : Jan 31 & Feb 1 Michael McKersie of the ABI will be a key speaker at Davos this year so members have the opportunity of probing the details of the guidelines. The agenda can be studied on the Centre website at www.hurlstons.com/esop and click onto the 'events' tab. Member practitioner delegates pay £775 for the all-in (except travel) half-board hotel and conference deal, but exceptionally, member plan issuer delegates pay only £275 for the same package. **This is your last chance to register**: please email Fred Hackworth at fhackworth@hurlstons.com now. Could the European Eso industry find itself entangled in the sub-prime crisis later this year? The possibility of share plan administrators being dragged into court to testify in 'stock drop' court cases will also be raised in Davos, starting Thursday Jan 31. Jeff Mamorsky, chairman of the global benefits group at Greenberg Traurig LLP, will give delegates an update on the post Enron US court cases and back dated options fall-out and the companies facing class actions over sudden falls in their stock prices in the wake of the sub-prime mortgages debt scandal. These include: American Airlines, AOL Time Warner, Coca Cola, Lucent Technologies, Pfizer Inc, Polaroid, Royal Dutch Shell and Sears. Some have already thrown in the towel – settling out of court for between $15m and $100m, some of which has to be repaid by senior executives, and agreeing to major corporate governance shake-ups. The world's largest banks have so far written off $45bn in the poisoned debt crisis, but this is only the beginning as the OECD (Organisation for Economic Co-operation & Development) estimates that total losses may exceed $300bn, Jeff told newspad. 401K plans in the US are vulnerable to litigation because they are linked to retirement plans, allowing stock plan 'minders' to diversify employee stock holdings into other quoted companies in order to avoid older employees building up major stock holdings in just one company – the one they work for. Though this type of employee equity plan does not exist in the UK (unlike France), the UK Eso industry may not be entirely out of the woods, as distinctions between employee shareholdings and occupational pension/retirement plans-which involve investment decisions- start to break down (eg HMRC now permits the transfer of employee shares into SIPPs and other pension plans). US lawsuits will involve allegations of breaches of duty brought by participants to recover losses on company stock held in their accounts. The targets will be either company directors and/or stock plan administrators/trustees and the grounds may include: imprudent investment, misrepresentation and/or failure to disclose certain facts, or failure to take steps to minimise losses. US corporate pension plans have $175bn invested in mortgage-related securities.

Asked about the likely fall-out from the sub-prime crisis on the Eso world, Jeff told newspad: "This is only the beginning of the sub-prime crisis from a litigation standpoint. You are very lucky that Europe does not have such an active plaintiff bar." Around 50 delegates will gather in the five-star Steigenberger Belvedere Hotel, from early evening Wednesday Jan 30. The other speakers are Dilpreet Chatha of E & Y, Karen Cooper of Osborne Clarke, Barbara Seta of UBS, Ed Buckland of Bedell Group, Alan Judes of Strategic Remuneration, Kevin Lim of RBC CEES, Eugene Weultjes of Greenberg Traurig, Peter Mossop of Capita Trustees, Michael Sterchi of KPMG; David Pett of Pinsent Masons, Paul Stoddart of HBOS EES and Mahesh Varia of Travers Smith

Cannes June 5-6, 2008: The European Centre's 20th conference takes place at the Majestic Hotel in Cannes on Thursday June 5 and Friday June 6 and delegates can book places for the Wednesday pre-conference seafront dinner. Those who wish to speak at this event should email their presentation proposals to fhackworth@hurlstons.com asap. All approved speakers will be offered a room with a sea vieew. <u>The recent sharp fall of sterling vis-à-vis the euro and Swiss franc makes it most unlikely that we will be able ever again to offer the same package deal prices as we do now</u>.

TREASURY CUTS RED TAPE

The amount of information that companies have to provide on their share scheme returns for 2007/08 and later years has been reduced, announced HMRC. Copies of the revised returns are now available. Required information has been reduced by removing certain sections of Forms 34 and 35 relating to exchange of options, variations of share capital, amendments to scheme rules and changes in participating companies in approved schemes and by reducing the number of entries to be made on Form 35 to report option exercises. In future, companies will not be required to report exercises between three and ten years from the date of grant, unless there has been a disqualifying or taxable event.

*Despite the sub-prime mortgage and credit crunch crisis, the Eso market in the UK has not ground to a halt, though there may be a bit more hesitancy around, said William Franklin of Pinsents. Meanwhile, Bill Cohen, partner, global employer services, at Deloitte & Touche said he and his colleagues were very busy indeed.

ESO BUILDING TRIUMPH

Eso increased significantly at **Halcrow**, from eight percent to 17 percent between 2000-2005, after it converted to private limited status 20 years ago. A bigger push was needed to hit the board's Eso participation target of 35 percent and this spurred the launch of a Share Incentive Plan (SIP) last March. The campaign tried to appeal to different salary and age ranges. It included news items in the company magazine, a fortnightly email bulletin, a brochure, coasters and balloons and a prominent position on the company intranet. Rather than putting up posters explaining the scheme, a teaser design was created showing a squirrel with acorns and the title 'from little acorns…' The next poster proclaimed 'mighty oak trees grow' with the image of a tree and information about the scheme. Executives gave 55 presentations to its 26 UK offices in three weeks. Of the 3,994 people eligible to join the scheme, 773 did so, raising Eso participation to 27 percent. A Halcrow spokesman said: "Through the increasing number of employee shareholders, we are adding to a culture whereby employees regard the bottom line as their personal responsibility."

SOUR KRAUT

Germany's President hit out at fat-cat pay deals for chief executives after Wendelin Wiedeking, the boss of Porsche, was awarded a €70m (£51m) salary package. Outside the corporate sector barely €1,000 a month divides bus drivers' salaries from those of doctors or engineers, said The Times. Mr Wiedeking, previously regarded as a talented but modest businessman, has broken all records securing a 2006 profits-linked package that puts him alongside some of the world's best-rewarded business leaders. President Kohler told the Handelsblatt business daily: "People understandably feel there's something wrong when wages go up steeply (at the top) while other wages are allowed to stagnate. Bosses have to grasp that their behaviour has an impact on social solidarity and I can see that society and the business culture are growing further apart." Mr Kohler said that ceos should demonstrate "moral leadership and open themselves up for a dialogue with citizens" rather than focus solely on the bottom line. Porsche more than doubled its pre-tax profit from €2bn to almost €6bn in 2006 and awarded an €5,200 bonus to each of its 11,000 full-time workers. However, that pales against the cash bonanza the six-man management board handed itself for its 2006 performance - €113m between them - up from €45.2m in the previous year. The basic salaries of the directors do not have to be disclosed because Porsche is not listed on the DAX. "I have the same contractual terms as I did when I first joined Porsche 15 years ago," Mr Wiedeking said, anticipating a media onslaught. By contrast, Dieter Zetsche of Daimler, formerly DaimlerChrysler, earned €7.5m in 2006 while Bernd Pischetsrieder of Volkswagen picked up a mere €3.1m, according to Manager Magazin. The packages include share options but not pension arrangements. The other leaders of the DAX pack have been Hennig Kagermann of software company SAP (€9m) and Wolfgang Reitzle of the Linde engineering and white goods group (€7.3m).

COMPANIES

More than 68,000 **Crédit Agricole Group** employees in France and 17 other countries subscribed to shares worth €540m, which had to be scaled back to €500m, in accordance with the terms of the latest Eso issue. This level of employee investment was significantly up compared to the last employee share issue, with a subscription rate of 46 percent of employees in France and 20 percent in other countries. Since its IPO in 2001, Crédit Agricole has offered Eso awards every two years. The issue resulted in the creation of almost 23m new shares, bringing the number of shares held by Crédit Agricole group employees via company savings schemes up to 106m. Employees owned 6.34 percent of the group's share capital as of 5 December.

On December 21 **Helical Bar**'s Esop purchased 200,000 ords in the company at 300p per share. The Esop now holds 3,770,868 ords in the company, equivalent to almost four percent of the equity. **Independent News & Media** (IN&M) has granted shares options to its ceo Sir Anthony O'Reilly and five of its top managers. Sir Anthony paid €150 to receive options over 1.5m IN&M shares exercisable for seven years after December 19 2010. The options were priced at €2.23 each, 13 cents less than its December 21 closing price of €2.36. Gavin O'Reilly, Donal Buggy, Vincent Crowley, Ivan Fallon and Brendan Hopkins each paid €100 for options over one million IN&M shares each exercisable in the same period at the same price.

The Aga Khan felt obliged to offer Eso to **Meridiana**'s staff after the Italian airline struggled financially in 1997 and since then it has gone from strength to strength, adding new routes in Italy, France and the UK. Now staff own 15 percent of the equity.

Rangers Football Club issued options over 1.2 m ords to Martin Bain and Donald McIntyre, both executive directors, at an issue price of 62.5p per share. The options vest over a period of six months and are exercisable at any time over the next ten years. An association of employee shareholders at **Siemens** fears that at least 10,000 jobs could be cut in administration and sales. It has demanded that management restructure central areas in a 'socially acceptable manner.' The association has called for an amendment to the company's statutes, limiting settlements for top managers and abolishing share options. Peter Loscher, head of the management board, recently criticised the costs of its sales and administration which are five percentage points above the company's best competitor. **Tullett Prebon** announced that on December 14 Walbrook Trustees (Guernsey) Ltd, the trustee of the Tullett Prebon ESOT, acquired 3.2m ords. The shares were subject to an equity swap to hedge the company's commitments under the Tullett Liberty Equity Incentive Plan. Former **UnitedHealth** chief William McGuire will forfeit about $620m in share options gains and retirement pay after the Securities and Exchange Commission's investigation into backdated share options. He retains about $800m worth of options.

The Employee Share Ownership Centre Ltd is a members' organisation which lobbies, informs and researches on behalf of employee share ownership.