Vol 19 No 5 **September 2008**

it's our business

newspad of the Employee Share Ownership Centre

Centre set to spread the Esop word in Dubai

The Centre is embarking on a 'hearts and minds' exercise in Dubai in order to encourage the creation of a new legal environment, which would favour the development of local broad-based employee share schemes.

Among the obstacles facing companies which want to install Esops locally are legal restrictions on foreign nationals who want to own shares in UAE companies and a general limit on the extent of foreign ownership of shares (only minority ownership stakes permitted) in all types of UAE companies.

There are onerous conditions which govern share transactions, including sales and purchases, in unlisted UAE companies. Furthermore, UAE commercial law prevents companies from holding their own shares to use as treasury stock in order to satisfy stock/share option maturities.

More than 30 registrations have been taken to date for the Centre's first Esops conference in Dubai, which has attracted a record number of co-sponsorships. This event, entitled 'The prospects for employee equity plans in the United Arab Emirates and in the Middle East,' will take place on Monday November 17 & Tuesday November 18, this year at the Palace Hotel.

Emirates National Bank of Dubai, the Centre's conference partner and lead co-sponsor, hopes that the presence in Dubai of top share scheme practitioners from the West will help increase the pressure on ministers to remove or reduce the impact of these obstacles which currently make it difficult to set up Esops in the United Arab Emirates.

Emirates NBD is not the only large influential business in Dubai to be exasperated by the high levels of staff turnover. The frequent need to replace trained staff who have been poached by rivals creates instability and imposes heavy additional recruitment costs on such businesses. This is a powerful motivator in the push for changes that could facilitate the future widespread adoption of Eso in the UAE, the Gulf and beyond, because equity incentivised staff would have much more to lose if they continued to job hop.

Another issue set to raise its head during the Dubai conference concerns the role of sovereign wealth funds (SWF), vis-a-vis employee share ownership. The question is how the owners of such powerful funds can be encouraged to look positively on Eso. Dubai's SWF, Dubai International Capital (DIC) has large stakes in UK companies, including Travelodge, The London Eye, Alton Towers, HSBC and the London Stock Exchange. TAQA, the Abu Dhabi Sovereign Wealth Fund, invests in and runs energy companies worldwide. Sovereign funds in the UAE already have an asset base of £900bn, a figure higher than the SWFs for Saudi Arabia and Kuwait combined.

Finally, Eso needs to be friendly with one of the world's fastest growing financial sectors, Islamic finance. As our programme will demonstrate, certain forms of Eso can be Sharia law friendly.

The key topic presentations are: Damian Carnell and Martin McGuigan of Towers Perrin on aspects of executive compensation; Nicholas Greenacre and Oliver Brettle of White & Case on choosing the right law for international incentive plans; Emirates NBD with personal experiences in a case history of an employee equity plan launched in the UAE. Peter Leach and Martin Osborne-Shaw of Killik Employee Services will discuss how best to communicate employee share plans. Mark McGinness of the Dubai Financial Services Authority, will talk about regulatory issues in the UAE and Malcolm Hurlston, chairman of the Esop Centre, will laud the wider benefits of Esops. Three Centre members are senior

From the Chairman

The Centre is relaunching the Emisphere this month - its online forum for companies interested in Enterprise Management Incentives. Speakers at the Centre's joint conference with the Institute of Directors on September 17 (a few places are still available) will be able to intervene with authority and the forum will be open to all delegates at the Centre/IoD event as well as to Centre members.

Esopians suffering post-Olympic withdrawal symptoms should now perhaps be looking towards Sochi, host city to the 2014 winter games. According to the FT, it is the aim of the Russian hosts to make Sochi like Davos and Cannes! On the other hand, it is next door to newly but contentiously independent Abkhazia........

Malcolm Hurlston

The ESOP Centre Ltd, 2 Ridgmount Street, London WC1E 7AA
tel: 020 7436 9936 fax: 020 7580 0016 e-mail: esop@hurlstons.com
www.hurlstons.com/esop

co-sponsors of the two-day event – Emirates National Bank of Dubai; the global professional remuneration consultancy Towers Perrin and top legal group White & Case LLP. Other Centre members are co-sponsoring this pathfinder event – Jersey based member Appleby Global, which offers employee benefit trust and share plan administration services and Killik Employee Services, a force in the provision of outsourced share plan administration. European and US equity plan service providers will meet local business people interested in Eso and discuss with them how best this can be adapted and used in the UAE and in the wider region generally.

To view the full programme, visit the Centre website at: www.hurlstons.com/esop and click onto to the 'events' tab and download the registration form. The majority of our reserved rooms in the Palace Hotel have been taken, so register without delay.

PEARSON MATURITY IN THE MONEY

Despite stock market turbulence, Pearson Group's 2003 five year, 2004 four year (France only) and 2005 three year Save For Shares option contracts all managed to mature last month in the money. The share price did drop to £5.70 in mid-July but then rose by almost £1, reports Pearson share plans manager Gabbi Stopp. They stood at £6.82 at the time of writing.

Here is the detail: 2005 three-year UK options: option price £5 share price on maturity £6.50; 433 participants at maturity; average monthly savings £79; average profit per participant was £979. 2003 five-year UK options: option price £4.25; share price on maturity £6.50; 168 participants at maturity; average monthly savings £152; average profit £6,138. Of the 170 UK participants who submitted instructions straight away, 60 percent elected to keep their shares either in certificated form or the corporate nominee, Share Store. 200 participants in 24 jurisdictions worldwide also had WorldWide Save For Shares options maturing alongside the UK plans. The countries involved were: Australia, Greece, India, Ireland, Israel, Korea, New Zealand, S Africa, Brazil, China, Singapore, Hong Kong, Japan, Philippines, Belgium, Canada, France, Germany, Italy, Poland, Spain, Chile, Colombia and Mexico. Of the 105 international participants who submitted instructions immediately, just 20 percent chose to sell all their shares. However, Pearson's 2001 seven-year plan, with an option price of £9.57 was deeply underwater and savings + interest were repaid automatically on maturity to these participants. Ceo Marjorie Scardino told participants: "Whatever the share price when you started saving, I hope you'll stay interested in this plan. Markets go up and down, but I'm confident that over the long haul the rich combination of some of the best businesses in the world and the talent and attention of everyone who works in Pearson will make our company more valuable. Owning part of the company that you are so instrumental in making valuable will continue to be the best way to enjoy the benefit of that wonderful combination."

BACKDATED OPTIONS PAY BACK

Former **Apple Inc.** top legal officer Nancy Heinen will pay a $2.2m civil settlement to resolve charges that, on behalf of the company, she backdated executive stock-option grants, including some to ceo Steve Jobs. The Securities and Exchange Commission settlement called on Heinen to return $1.6m of allegedly fraudulent gains from the stock options she received, plus interest, and pay a $200,000 penalty. It also barred her from serving as a public company officer or director for five years and from practising securities law for three years. Heinen settled without admitting or denying the SEC's claims that she caused Apple to backdate two big options grants in 2001 and altered company records to conceal the actions. The awards at issue were 4.8m options awarded in February 2001 to top executives, including herself, and a December 2001 grant of 7.5m options to Steve Jobs. Apple's expenses were under-reported by nearly $40m as a result of the backdating, the SEC said. The settlement resolves a civil lawsuit filed in California by the SEC in April 2007 and a separate SEC administrative proceeding. The SEC said Apple backdated the agreements to days when Apple's stock price was lower, making the options potentially more valuable. It said Heinen had her staff prepare documents showing the February 2001 grants were made in January, and had the December options grants backdated to October. Heinen signed documents stating that Jobs's stock grant was approved at a special meeting of the board, a meeting the SEC claims never occurred.

CONFERENCES

Centre-IoD, September 17: Almost 80 delegates, mostly from SME companies, have registered for the 12th joint Eso schemes for SMEs conference on Wednesday September 17, organised by the Esop Centre and the Institute of Directors. There is still time for you to register for this important event at 1 Whitehall Place London SW1. For full details, including speakers and topics, click onto the Centre website at: www.hurlstons.com/esop and download the brochure, or contact Holly Bruce at the Centre: hbruce@hurlstons.com (phone 20 7636 5214).

Esop Centre Awards Dinner: Tuesday October 14 The Oriental Club in the West End will host the Centre's first annual awards dinner. Mark Hoban MP, shadow Treasury minister will be the keynote speaker at this black-tie event and awards will be presented to the winners and advisers of the European Centre Awards, in addition to the Esop Institute's 'Student of the Year'. Contact Holly Bruce at the Centre to buy seats or a table (see her co-ordinates above).

Davos February 5 & 6: Several agenda topics are in place for the tenth Global Equity Forum at the Steigenberger Belevedere Hotel in Davos on Thursday February 5 and Friday February 6. More speaker proposals are being sought among Centre members. Speakers will pay only £695 (and no VAT) for the conference and two-day hotel package deal, instead of the normal Centre member practitioner fee of £875. Email

Fred Hackworth at: fhackworth@hurlstons.com to summarise your proposed presentation.

Diary note: Cannes 2009: The 21st annual conference of the European Centre in Cannes will take place on Thursday July 9 and Friday July 10 at the Majestic Hotel. The Centre has put back the dates by a month in order to maximise the prospect of sun and bonheur. The usual conference plus accommodation package deal Majestic Hotel bednights will be Wednesday July 8 and Thursday July 9.

EXECUTIVE REWARD

Both Callum McCarthy, outgoing chairman of the Financial Services Authority, and Hector Sants, its ceo, have called upon the financial sector to reconsider its incentive structures. Their criticism is focused on those remuneration structures that place excessive emphasis on short-term performance, where employees receive immediate rewards and do not suffer personally from any subsequent corporate losses. In the FSA's view, firms should focus on ensuring that employees and shareholders share in the risk of both the upside and the downside. But how practical is that and who is the FSA seeking to protect?, asked Insurance Day. The message from the FSA is that boards and shareholders must rethink the incentive structures currently in place. Hector Sants said that while it is not the regulator's role to dictate quantum of individual reward, the FSA will institute regular probes into whether reward structures are affecting the level of risk taken on by individual institutions - are executives taking excessive risks in order to make short-term bonus gains? However, if the reward structures within the financial services industry are pruned and become unattractive, will talented individuals migrate to less regulated industries with more attractive incentives on offer? Achieving the goal of shared risk between employees and shareholders by deferred compensation, coupled with the use of claw-back provisions as suggested by Sants, will create resistance. The circumstances in which claw-back would bite would have to be very clearly set out and may be difficult to frame adequately. In practice, it may only be realistic where some element of deferred compensation is yet to be paid. The ABI's own guidelines suggest that there should be discretion to reduce or reclaim bonus payments where performance achievements are later found to have been significantly 'mis-stated.' However, companies should ensure that deferral of compensation or delay in vesting of share options would not be considered an unreasonable indirect restraint on trade, for example, where those rights will be lost if an employee is forced to leave. The FSA seems to oppose incentives based on performance of individual parts of an organisation. The ABI's guidelines say vesting of awards under share incentive schemes is conditional on satisfying overall corporate performance conditions. But employees expect to be rewarded for their own performance and that of their team and not be disadvantaged by under-performing colleagues. Bonus arrangements based on performance of a division, rather than the company as a whole, are not uncommon in the broking industry. FSA-regulated firms will need to take a good look at their incentive structures: employment contracts and bonus arrangements should be reviewed, including early termination of employment terms. If firms consider that their existing arrangements are satisfactory, they should say so in the face of the FSA's intention to focus on the issue with "increased intensity". Firms that fail to do so can expect further regulatory scrutiny. *A New York hedge fund has offered £156m to a 38-year-old star trader to keep him in the business. Fortress Investments, which also runs private equity funds, has given £156m in shares to Adam Levinson, a chief investment officer. He now runs the firm's $8.8bn global macro hedge fund. But Citigroup analyst Prashant Bhatia said that the share package hurts existing shareholders by increasing the number of issued shares by seven percent, thereby diluting the value of each share. Boards of alternative investment management companies face a quandary when going public - on the one hand they have to retain talent that could earn considerably more at private rivals, while delivering value for shareholders on the other

PRIVATE EQUITY & ESO

When the private-equity firm Charterhouse acquired Saga, the holiday and financial-services firm for the over-fifties, the buyout was structured to give management and staff a significant interest in the company's future. Ceo Andrew Goodsell bought an eight percent stake in the business, while the finance and marketing directors each took four percent. More than 90 percent of the employees bought 20 shares in the company for £1 each. Saga's merger with the Automobile Association three years later provided an opportunity to release some money to its backers. Not only did Charterhouse and the senior management take a dividend, but staff discovered that their £1 shares were worth £525. Most staff have reinvested some of their profits into the company. Charterhouse holds a 40 percent stake. Permira and CVC, which were co-owners of the AA, each have 20 percent. Management and staff own the rest. "The structure means that people are committed to the business and have a real interest in improving its performance," said Saga. Management and, in some case, employees too own big minority stakes in half the companies in this year's league table of the largest privately owned UK companies. Like Saga, most are backed by private-equity funds who choose to align the interests of investors, managers and sometimes staff, by giving employees the opportunity to share in future profits. Management and employee share ownership has become a more common way of creating value in the private-equity industry. But some private equity houses still dislike Eso as they consider it to be dilutive and a potential threat to their control. Law firms have played a key role in creating this new entrepreneurial share-owning class, writes Chris Bown, of Freshfields Bruckhaus Deringer. "Not only do they help put in place the senior debt and mezzanine finance that buyouts typically require, they advise on how to structure the shareholder loans, preference shares and ordinary shares that enable management to invest in the companies they lead. They ensure the structure reflects the deal agreed between management and the private-equity investors and that it fits HMRC's rules," he said. Highly profitable exits in recent years have allowed staff like those at Saga to realise at least a portion of their gains. But what will be the consequences as the debt markets tighten and the prospects for a quick and lucrative exit recede? Other financial backers must be paid before benefits start accruing to equity stakeholders. As private-equity firms cut the amount of leverage in their deals, expect to see management taking bigger stakes and larger risks in deals. Expect more schemes to reward staff according to the performance of their division, rather than that of the entire business.

ON THE MOVE

John Meehan has left Capita and gone to Citigroup.

Iain Williamson is now director of sales & marketing at HBOS Employee Equity Solutions. Iain joined HBOS EES in July as director of client relationships. Iain has held senior management positions within the HBOS Group during the past 20 years. He was previously director of key account relationships at Birmingham Midshires Solutions. He can be contacted on iainwilliamson@hbosees.com or Mobile +44 (0) 7768 537056

BOOK REVIEW BY MALCOLM HURLSTON

Fresh light is cast on the curious relationship between trades unions and esops in the new autobiography of Lord Thomas of Macclesfied, 'An inclusive community with integrity'. Terry Thomas was MD of Unity, the trade union bank, and he accompanied me to the United States in 1986 to look at esops there. After our return David Reid, then of Clifford Chance, created a UK esop lookalike. Terry was instrumental in creating some of the first Esops - and tells the start of the Roadchef story as well as the more convoluted story of British Rail Engineering Ltd. Although the trade unions were major shareholders in Unity and Unity was becoming the market leader in esops, the unions failed to embrace the idea. However pragmatism sometimes prevailed, no more than in the case of BREL, which was to be privatised, despite the objections of the National Union of Railwaymen then under the strong leadership of the late Jimmy Knapp. However when privatisation was inevitable he looked away so management and employees could buy the company with an esop, without the union's complicity. "I will contact my men and tell them to look the other way," said Jimmy. If only then and later trade unions had been able to take a positive line, many more employees would be sharing the wages of capital. Royalties from the first edition will be donated to Greenpeace. The book is available price £19.50 from the Memoir Club, Langley Park, Durham. DH7 9XE.

COMPANIES

The Esot at **Aer Lingus** has not been consulted about a plan to appoint businessman Dermot Desmond as the next chairman of the company. Shay Coady, chairman of the Esot, responded to a letter from the Central Representative Council, which represents nine unions at the airline, to say the Esot had not been consulted about the proposal to appoint Mr Desmond. The Esot owns 14 per cent of the airline, making it the third-largest shareholder after Ryanair, which owns 29.8 per cent, and the Government, which owns 25 per cent.

Norwegian Air Shuttle, the Nordic region's biggest budget airline, may ask employees to take between a five to ten percent cut in wages to keep the company afloat during a period of high fuel prices, news agency NTB said. In return, Norwegian Air would issue share options for its employees, who could then take advantage of any gain in the company's value.

William Hill announced that on 8 August, 48,885 ords held by the company in treasury were transferred out to meet the exercise of a nil cost award under the company's Performance Share Plan 2005. Following this transfer from treasury, the company has 347,637,904 ords in issue and 6,080,855 ords in treasury.

Woolworth's, the struggling retailer, has appointed the former boss of Focus DIY as its new ceo on a pay package worth more than £9m over four years. Stephen Johnson will receive a base salary of £550,000 and will be entitled to two bonuses of up to 50percent of his salary next year. He has also been awarded 24m shares, worth £4.8m at the maximum payout price over four years. Johnson replaces Trevor Bish-Jones, who was ousted by chairman Richard North earlier this summer. North said that he believes there is a pot of gold at the end of Woolworths' rainbow, "but I am under no illusions about how hard it will be to get to it."

Italy: The Decree 112/2008 that abolished qualifying treatment for normal value share options is now law with a late amendment added that all options exercised on or after June 25 this year will be exempt from social security contributions. Accordingly, all options exercised on or after that date will be subject to income tax on the difference between the normal value of the shares at exercise and the exercise price. Deloitte is investigating whether there is scope for applying the social security exemption to other types of equity awards e.g. free shares, said Bill Cohen. Options exercised before June 25 may still benefit from the income tax and social security exemption provided that all applicable conditions required under the previous legislation are fulfilled.

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