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it's our business

newspad of the Employee Share Ownership Centre

Centre warns Chancellor as ESO axed at Scottish Power & Corus

Centre chairman Malcolm Hurlston is to write to Chancellor Gordon Brown warning him that tens of thousands of UK employees are losing their employee share ownership schemes when companies are acquired by foreign-owned business empires or by private equity consortia.

The Centre wants the Chancellor to speak out publicly against this accelerating process, which will shortly claim the ESO schemes at both Scottish Power and Corus Steel.

Mr Hurlston will urge the government to ask organisations contemplating either M & A or private equity buy-outs to offer rank-and-file employees in the target companies participation in new ESO schemes at least up to pre-takeover levels. In addition, the Centre chairman wants the Chancellor and HMRC to ease the complex tax rules, which currently make it difficult for private equity backers to offer all-employee share schemes when they acquire companies.

Otherwise, broad-based employee ownership in the UK could be on its knees within a decade, given the dramatic spurt in foreign takeovers of UK quoted companies, the Centre chairman will warn.

Mr Hurlston is hoping for a sympathetic ear from Mr Brown, who saw employee ownership as an aid to productivity and legislated to introduce two of the UK's most successful post-war schemes – the Share Incentive Plan for rank-and-file employees and Enterprise Management Incentives for key employees in growing small companies.

"*There is growing evidence that all-employee share ownership schemes are quietly being ditched in a number of UK companies which are acquired either by foreign owners or by private equity consortia,*" said Mr Hurlston.

"While it is unrealistic to expect the Chancellor to ban such behaviour, it would make a big difference if the government were to speak out in defence of all-employee share ownership schemes and if the Chancellor were to condemn the practice of strangling ESO when the new owners get their hands on these companies. Only US-owned companies are exempt from this criticism since the anglosphere shares a common appreciation of shareholding"

The trigger for Centre action was the news that ESO schemes are to be wound down at Scottish Power this autumn, six months after the completion of its imminent takeover by Iberdrola, the Spanish-based global energy company. Scottish Power has told its employees: "As far as possible, the management of Scottish Power and Iberdrola are keen to ensure that Sharesave and Esop participants do not suffer additional costs nor are unduly disadvantaged by the change of control." Sharesave participants who exercise their options will receive an aggregate payment of 412p plus 0.165 of a new Iberdrola share in line with other shareholders. Employee participants will be able to continue their Sharesave monthly savings contracts with Halifax Employee Equity Solutions in the short-term, but will be able to exercise their options only during the six-month period following the completion of the takeover, using accumulated savings and interest in their accounts.

Scottish Power and Iberdrola have agreed that participants will receive compensation for any additional income tax liability that they incur as a result of early exercise. If savings contracts cannot be completed before the last date for options exercise, compensation will be paid for the resulting loss of profit, grossed up for income tax. After the takeover, the Esop will operate as a closed scheme.

Continued overleaf

From the Chairman

Two rays of hope in a gloomy Esop scenario. Gloom because private equity and eastern hemisphere predators are ditching esops as this month's newspad shows.

I am writing to the Chancellor for you and putting forward suggestions on the private equity front.

The market crash however is an opportunity for companies with a perspective to launch new schemes from a lower base. And it is good to see Stuart Bailey of Abbey moving to the Financial Services Authority.

The future of Esops will be less self-standing and there is a strong need to develop the link with financial capabilty - which will be Stuart's task in Shaun Mundy's team.

Malcolm Hurlston

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Stock exchange rules state that all outstanding shares have to be called in and redeemed once a takeover is approved, but what is at issue here is whether or not the previous all-employee share schemes, now defunct, are replaced by similar employee share schemes operated by the new overseas-based employer. In many instances this is not the case, especially in large conglomerates owned by families from the Middle East and/or the Indian sub-continent, where knowledge of, and sympathy for, broad-based ESO is usually very low.

Meanwhile, live employee share ownership in the Corus steel company looks set to end on March 29, following the imminent takeover by the Indian Tata Group. An egm was being held in London on March 7, at which shareholders were expected to rubber-stamp the 608p per share offer. A Tata spokesman said share dealing in Corus would cease on March 29 and shareholders would be *given a cash offer, not a share alternative* within the Tata Group. Corus was formed in October 1999 by the merger of the former British Steel and the Dutch-based Hoogovens companies. The steelworkers will receive cash payouts averaging more than £6,000 each as soon as the £6.7bn takeover bid by Tata Steel is approved.

More than 9,000 Corus UK workers participate in the company's Sharesave scheme. About 11,700 (including many of the former) participated in another ESO scheme set up in 2001, which involved a free allocation of 54 shares per employee. Many employees also invested in the company's 2003 rescue rights issue, when new shares were sold to investors at a discounted rate of 117p each.

We said of Scottish Power in last month's *newspad* "*It remains to be seen whether employee share schemes have a future there*." Now we know the answer.

Several ESO schemes were either axed or wound down last year, including those at **P & O**, which was taken over by Dubai Ports World, owned by the Maktoum family, and at **Viridian**, when shareholders of the Northern Irish electricity group accepted a £1.62bn takeover by Bahrain-based Arcapita, allowing Viridian's employee share schemes to be killed off after de-listing.

Paul Stoddart, head of new business at HBOS Employee Equity Solutions, pointed out that £75bn of UK business was bought by foreign parents in 2006, according to the Office of National Statistics.

Other examples of the UK plc sell off to foreigners in recent years include: Thames Water Holdings, sold to Kemble Water, an equity finance consortium led by Oz bank Macquarie; airports operator BAA sold to Ferrovial of Spain; O2 was bought by Spain's Telefonica and Abbey National acquired by Banco Santander in 2004. Associated British Ports fell to a consortium headed by US investment bank Goldman Sachs; drinks giant Allied Domecq fell to France's Pernod Ricard and St Gobain snapped up BPB, the plasterboard maker. Aggregate Industries went to Switzerland's Holcim in 2005, following the capture of Blue Circle by Lafarge and BOC was acquired by Linde of Germany. Retailers Iceland, Warehouse, Whistles, Hamley's, House of Fraser, Karen Millen and Goldsmiths were all bought by Iceland's Baugur in raids starting in 2003. London Electricity, sold to French utility giant Electricité de France, is now part of EDF Energy.

Will members please tell us how many of these new owners still run all-employee schemes for their UK employees? Email fhackworth@hurlstons.com. There is a ray of light at Banco Santander (see below) but this may be an exception.

ESO delivers reward

Grupo Santander, the parent company of **Abbey,** has announced plans to award 100 free Santander shares to all 129,000 employees in the group. The shares are being awarded to mark the bank's 150th anniversary and are subject to shareholder approval at the next agm planned in June. On current valuation the shares will be worth £950 to each employee. Chairman Emilio Botín said that the free shares plan "is a clear sign of our confidence in Santander's future. Few companies in the world can claim to have been so successful over time."

Staff at banking giant **HBOS** are to share a £210m windfall from their company share scheme. The firm says 50,000 employees across the UK will benefit when a series of saving schemes mature in the next few weeks. Every member of the HBOS staff is eligible for the free share option plan and a share-kicker scheme. In 2004 the company handed 50,000 employees varying numbers of free share options based on 20 percent of their salary grades. The scheme is believed to be one of the very few in the UK financial services industry to include staff at so many levels. The options mature on March 16 and should generate an average gain of more than £2,000 for each employee. Almost a third of HBOS staff participate in the share-kicker scheme that enables them to take all or part of their annual bonus in shares. The 2004 share-kicker offer matured on February 28 and shares worth £90m were being released.

More than 8,000 employees at supermarket giant **J Sainsbury** - from checkout girls to store managers - look set to benefit from takeover speculation swirling around the retailer. The staff are in line for a £23m payout as the company's Sharesave scheme matures with shares still close to an eight-year high. Its shares rose sharply following news that a consortium of private equity bidders - CVC, Blackstone and KKR - is considering a bid. The 8,000 staff, who have saved up to £250 a month during the past three or five years, are in line for average gains of more than £2,500. They can convert their savings into Sainsbury's shares at either 241p or 302p a share respectively. But senior managers who participated in the Sharesave will be barred from instantly selling the shares under City rules.

Small firms should emulate supermarket giant **Tesco's** ESO scheme to reward staff and improve business performance, said a Liverpool lawyer. About 50,000 Tesco staff shared in a £148m pay-out, some netting up to £7,000, when their SAYE scheme matured last month. Employees who joined the scheme five years ago were able to buy shares at 198p. When the scheme matured Tesco's shares were valued at 429p each. Corporate lawyer Bruce Robinson said: "Through the share plan employees are being rewarded for their contribution to Tesco's business, which has seen enormous growth over the past five years. Such schemes motivate staff by giving them a sense of ownership and a keen interest in how the business performs."

Whoops! … from HMRC

The Inland Revenue's latest share schemes news website apologises for having incorrectly reported the demise of the notorious Form 42. It said: "A press release dated 29 November 2006 and re-published in Tax Bulletin 86 headed 'Quicker and simpler tax system for small businesses' incorrectly reported the withdrawal of Form 42'. - Form 42 has not been withdrawn and the text has now been corrected."

Moving On

Stuart Bailey is leaving **Abbey** to join the Financial Services Authority. Stuart will be working as part of the financial capability team working with employers to deliver financial education programmes to employees in the workplace. Stuart writes: "*Whilst the new role is a lot wider than my previous job I intend to keep very close to the share plan industry. I think there is much more that companies can look to provide at the time of share plan maturities etc. I suspect my new email address will be stuart.bailey@fsa.gov.uk"*

Unfair shares

Robert Peston, BBC Business Editor, has taken up cudgels against those private equity houses which run roughshod over rank-and-file employees in businesses which they acquire. Mr Peston said on his BBC website blog: "Following a private equity takeover, the mediocre managers may be kicked out and replaced by better ones, who would be massively motivated to improve corporate performance by being given equity or sold it on very attractive terms. These managers can make sometimes tens of millions of pounds, if they boost the value of these businesses during the three to five years they are typically owned by private equity funds. But, in many cases, the employees, who've stuck with the business through thick and thin, get zilch. In fact it's worse than that, as there's an increase in job insecurity for all, while the business is being reconstructed under new ownership; and some will lose their jobs You don't need to look further than that to understand why the campaign against private equity led by the GMB trade union is resonating in the way that it is. The fruits of success at a business in private-equity hands are very unequally shared. Executives in the companies owned by private equity often make fortunes. Partners in the private-equity management firms accumulate tens of millions of pounds each. Investors in private equity funds will frequently make returns on their investments well above the norm. However, if they're lucky, staff at companies owned by private equity get to keep their jobs. *My experience of private equity firms over many years is that they are so arms-length from the employees of their companies that they view employees as statistics to be manipulated, not as people engaged with them in a common endeavour. This may explain why they so rarely award equity in bought-out businesses to all staff. They seem to regard the spreading of equity to all employees as an unnecessary expense, but this is short-termist in so many different ways. Sharing the rewards more widely would defuse much of the recent criticism of unfair shares and it could improve business performance and it would only undermine the viability of the more marginal private equity deals***.** I've run the numbers on several recent private-equity transactions. There would still have been very rich pickings for the owners and managers if employees had been given equity that ended up being worth a few thousand pounds per person."

One of the many emailed replies came from 'Thomas,' who wrote: "*Part of the problem is that the tax rules are skewed heavily against equity participation by employees. I advise companies on employee share participation and always encounter the basic problem that the best schemes for employees - like Sharesave and the SIP - can't be offered to employees of private equity backed companies because of the maze of restrictions that the legislation places upon these sorts of schemes. If ESO is a genuine government priority, then ministers should seriously consider a liberalisation of the regime that applies to all ESO plans. Private equity backed companies would like to extend employee share ownership, but the complex rules governing the taxation of employees' shares introduced in FA 2003 make it too complex and too costly."* The Centre is following up.

Final Salary Pensions Doomed

Two-thirds of private sector firms have banned new employees from joining their gold-plated pension schemes. This creates a 'pensions apartheid' as older workers enjoy lucrative final salary schemes and new employees are forced into poorer deals, a survey has shown. The research, published by the National Association of Pension Funds, reveals that between 1995 and 2005, more than 2,000 final salary pension schemes were closed to new employees. Government rules will force companies to provide pension schemes for all employees by 2012. Many firms will offset the cost of this by closing their more expensive final salary schemes to new members. Tom McPhail, of the financial advisers Hargreaves Lansdown, said: "Final salary schemes have become an albatross around employers' necks. Even if schemes manage to repair their huge deficits, employers will just grab this opportunity to wind them up." The UK could be rapidly approaching a time when no employee joining a private sector firm will get a final salary pension. Some of the nation's biggest final salary schemes, such as the BBC's, have closed during the past year. The story is very different for the UK's six million public sector workers as the majority are still able to join lucrative final salary schemes. The survey admits that the loss of final salary pensions, also known as defined benefit pensions, is a severe blow for private sector employees, most of whom are allowed to join only a defined *contribution* pension, which is less attractive because employers pay in much less money every month – typically an employer pays 16 percent into a final salary scheme, compared to just six percent into a defined contribution scheme. The survey, which covered 321 firms employing three million people, raised doubts about whether the Government's radical pensions overhaul will succeed.

CONFERENCE

More than 30 people have registered so far for the European Centre's annual employee equity conference, which takes place at the Majestic Hotel, in Cannes, on **Thursday July 5 and Friday July 6,** this year.

Confirmed speaker companies to date include: Bedell Group (trustees); Capita Share Plan Services, Citigroup, Cyril Sweett Ltd, Freehills (Australia), HBOS Employee Equity Solutions, Hewitt Bacon & Woodrow, Shearman & Sterling, Watson Wyatt and White & Case. The Centre is offering the usual conference package deal, including **two nights accommodation** (single room on July 4 & July 5) in the Majestic Hotel, with breakfasts, lunches, delegate pack, plus cocktail party invitation. Cannes 2007 has an exciting programme, with stock plan case histories and live ESO/FP issues, such as exporting share plans, latest trends in executive reward, options expensing, US option plans, restricted stock, employment issues, LTIPs and the Prospectus Directive. More agenda detail can be found on the Centre website at www.hurlstons.com/esop and click onto **'events.'** **From April this year, the Air France subsidiary City-Jet is launching a daily **direct** return flights service from London City Airport to Nice, using AVRO RJ85 95-seater jets.*

European Awards:

The Centre invites applications from members for its European Awards 2007. The winners will be announced during the Centre's 19th annual conference in Cannes on July 5 & 6. The closing date for entries is May 21. Download an application form from the Centre's website. The rules and qualifying conditions are explained on the form. The two annual award categories are: Best Employee Share Ownership Plan (in companies with more than 1,500 employees) Best Employee Share Ownership Plan (in companies with fewer than 1,500 employees). The entries will be judged by an expert panel, convened by Centre chairman Malcolm Hurlston.

COMPANIES

Centre member **BA** does not have any active all-employee share plans this year and has launched nothing since the last Sharesave matured in 2003. The focus has been on cash profit share plans only, owing to business requirements. BA reward manager Alison Macleod told *newspad* "I hope the position will change at some time in the future if a business case can be developed"

BP was informed on February 20 by the BP ESOT trustee that, following awards by the company's remuneration committee under the BP 2004 Long Term Performance Plan and the executive directors' incentive plan, for the period 2004-2006, several directors of BP, had gained shares, including Lord Browne of Madingley, who received 380,668 ords and Dr D. Allen who received 112,941 ords. The Trustee of the BP ESOT purchased 774,091 BP ords at £5.37 per share on February 15 to satisfy these and other awards. The BP ESOT sold, 156,074 ords on February 19 at £5.37 per share, on behalf of Lord Browne, to meet his share award tax liability.

INTERNATIONAL

Aotea Electric Group, founded in Dunedin, New Zealand, has launched an employee share scheme. Following two years of planning, the company share offer was finalised last December and employees can look forward to a dividend payment at the end of Aotea's financial year. There is a confidential single-figure percentage on the number of shares which can be allocated each year and the number of employees involved. Aotea has 350 employees, including 30 apprentices, working at 12 South Island sites and one North Island site. Initially, selected employees at three sites were made the offer, but it is planned to extend the share scheme to Aotea's other sites. The share scheme is modelled on another Dunedin-founded company understood to have 60 percent of its staff now participating in a profit-sharing scheme.

FirstChemical Holding, a Hungarian purchase vehicle set up by private equity fund Permira, announced that it would exercise its right to squeeze out small shareholders in chemicals company BorsodChem. First Chemical Holding acquired 89pc of voting rights in BorsodChem in a buyout offer, which closed last Xmas. With the withdrawal of employee shares, its stake rose to 94 percent, exceeding the 90 percent level necessary to exercise its squeeze-out rights.

Irish Prospectus problem

Thousands of employees working for US multinationals in Ireland could lose out on tax-efficient share-option schemes because of the EU Prospectus Directive, which states that employers whose shares are not listed on an EU stock exchange must prepare a prospectus if offering shares to employees. If a company is listed on an EU stock exchange, it does not have to prepare a prospectus. Before the PD law was passed in July 2005, employers whose shares were listed outside the EU did not have to prepare a prospectus. ''These companies must decide between incurring significant costs to prepare a prospectus for their employee share offers or suspending offers of shares to employees altogether," said Rosaleen Boyle, share scheme manager at a Dublin law firm. The cost of preparing a prospectus could ''easily be a six figure sum'' and ''leaves non-EU employers in a much worse-off position than their EU counterparts.'' The huge cost recently prompted one Irish employer with shares listed in the US to suspend its employee share scheme, said Sheena Doggett, a partner with A&L Goodbody. ''In another instance, an EU-wide scheme operated by a US-listed company was changed so that employees in certain EU countries only take a cash equivalent, rather than shares, thus losing the opportunity to own shares in the parent company.'' Brian Healy, director of trading and regulation with the Irish Stock Exchange, said: "Preparing a prospectus can be costly as the company has to hire auditors, financial advisers and so on."

The Employee Share Ownership Centre is a members' organisation which lobbies, informs and researches on behalf of employee share ownership. It is operated by staff of Hurlstons Corporate Consultancy Ltd.