

# SLAUGHTER AND MAY

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28 January 2005

Simon Cubley  
HM Treasury  
Capital Markets and Governance Team 4/22  
One Horseguards Road  
London  
SW1A 2HQ

Your reference

Our reference  
JZF

Direct line  
020 7090 5025

Dear Mr Cubley

## UK Implementation of the Prospectus Directive 2003/71/EC

I am writing on behalf of Share Plan Lawyers in relation to the Consultation Document issued in October 2004 (Implementation of the Prospectus Directive).

Share Plan Lawyers (formerly known as the Share Scheme Lawyers Group) is an informal group of lawyers in private practice. The group has approximately 160 members representing 47 law firms with a further 6 specialist practitioners and counsel. Members include many senior lawyers from all the major City and regional law firms.

You raised a number of questions in the Consultation Paper. Those questions and our answers to them are set out below. We have commented on the Paper with a view to the effect that the Directive will have on the operation of employee share arrangements in the UK.

*Question 1: Do you agree that the Directive definition of a public offer benefits from this clarification?*

Yes we do. We would, however, suggest there are a number of further areas where clarification would be desirable in the context of employee share offerings.

A number of points on this were made in the paper sent to HM Treasury by the Share Plan Lawyers dated 24 May 2004, a copy of which is attached for ease of reference.

*Question 2: Do you anticipate particular issues regarding the application of the definition of a public offer in other circumstances?*

It is somewhat odd that a communication which provides "sufficient" information to enable a person to decide to purchase or subscribe for securities is a public offer whereas an entirely inadequate communication does not and is not regulated. That seems a rather perverse result.

TN Clark  
R Slater  
TA Kinnersley  
DJ Beales  
JEF Rushworth  
MGC Nicholson  
SM Edge  
NPG Boardman  
IW Goldie  
M Hughes  
GW James  
EA Codrington  
RMG Goulding  
ARF Hall  
AJR Newhouse

GES Seligman  
PFJ Bennett  
St JA Flaherty  
RM Fox  
DT Frank  
CFI Saul  
CJ Saunders  
RJ Thornhill  
GJ Airs  
RNS Grandison  
CR Smith  
GP White  
NJ Archer  
AG Balfour  
CM Horton

EA Barrett  
PP Chappatte  
RJN Cripps  
P Jolliffe  
CD Randell  
WSM Robinson  
RV Carson  
SL Edwards  
JM Featherby  
F Murphy  
PM Olney  
PH Stacey  
CWY Underhill  
OA Wareham  
RJ Clark

SJ Cooke  
PLR Deckers  
DL Finkler  
CW Harvey-Kelly  
A-A Maggjar  
SJ Phillips  
JD Rice  
MA Whelton  
MD Bennett  
RD de Carle  
SP Hall  
WJ Sibree  
RC Stern  
JR Triggs  
EGL Wyld

A Beare  
JD Boyce  
MEM Hattrell  
KI Hodgson  
N von Bismarck  
PWH Brien  
JM Fenn  
AN Hyman  
AC Johnson  
EF Keeble  
KR Davis  
SR Galbraith  
NDF Gray  
MS Hutchinson  
SRB Powell

AG Ryde  
JAD Marks  
SD Warna-kula-suriya  
DA Wittmann  
TS Boxell  
SJ Luder  
AJ McClean  
JC Twentyman  
GN Eaborn  
CG Earles  
HK Griffiths  
STM Lee  
P-P Bruneau  
AC Cleaver  
EJD Holden

KM Hughes  
G Iversen  
DR Johnson  
RE Levitt  
S Middlemiss  
RA Swallow  
DCR Waterfield  
DJ Bicknell  
CS Cameron  
CA Connolly  
PJ Cronin  
BJ-PF Louveaux  
MS Rowe  
MST Leung  
R Doughty

E Michael  
RR Ogle  
SL Paterson  
PC Snell  
HL Davies  
JC Putnis  
RA Sumroy  
GP Brown  
JC Cotton  
RJ Turnill  
WNC Watson

All the partners in the firm are solicitors except A-A Maggjar and P-P Bruneau who are Avocats à la Cour d'Appel de Paris.

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We are aware of one major private company that will have some difficulty going forward. At present it is able to rely on the exemption in the Public Offers of Securities Regulations 1995, Reg 7(2) to make share purchase offers annually to all employees linked to its bonus schemes. It operates in over 20 jurisdictions; the value of offers each year is well in excess of €2.5 million and there are at least two EU member states, including the UK, where there are over 100 employees.

On our reading therefore none of the exemptions in the Prospectus Regulations (or the underlying directive) will apply and it will be forced into issuing a prospectus.

There are other substantial private companies that will fall into a similar category.

Rule 1.2.2(5) of the Prospectus Rules in Annex 5 to the Consultation Paper refers to an "affiliated undertaking". It was not clear to us that there was a definition of affiliated undertaking for this purpose. It would be helpful if this term was to be defined and if, for example, it was at least as wide as currently permitted by Regulation 7(2)(o) of the Public Offers of Securities Regulations - which extends to offers by "a relevant trustee".

Again I

would refer you to the paper of 24 May 2004.

*Question 3: Do you consider the €2.5 million threshold to be an appropriate level at which the production and approval of prospectus is required under UK law?*

From the point of view of employee share schemes we consider this to be an appropriate level. However, as referred to in the paper of 24 May 2004, there can be real difficulties in determining whether employee offerings fall within the Prospectus Directive.

In many cases employee shares are offered for free and, therefore, if it is simply the purchase price that is used for this calculation they will always fall below that threshold.

*Question 4: What form of additional UK prospectus regime should apply below the €2.5 million threshold?*

We do not believe that any additional regime should apply in the UK. If any does apply the exceptions to it should be sufficiently wide so that it does not apply to arrangements for providing shares to employees.

*Question 5: Do you agree with our approach to implementing the exemption where the offer of securities is addressed to few than 100 persons?*

It seems to us that the basis on which you have suggested this exemption be drafted may cause problems for companies offering securities to employees each year because you are

aggregating an offer with any other offer that was open at any time within the period of 12 months ending with the date on which the second offer is made. Therefore whenever an offer is made at the same time each year (as will often happen with employee offerings) and is open for a period, it will always be two years worth of offers that are aggregated.

For example if a company offers shares to 60 employees on 1 March with the employees having until 15 March to accept the offer and does the same thing the following year, the two offerings would be aggregated. The exemption would not be available whereas it seems to us that they should be treated as separate annual offerings, each to less than 100 persons. You could deal with this by reducing the 12 month aggregation period to, say, 11 months or by further drafting to make this clearer.

*Question 6: Do you agree with our proposed implementation approach for attaching responsibility for a prospectus?*

The Financial Services and Markets Act 2000 (Official Listing of Securities) Regs f2001 paragraph 10 will be repealed by the proposed new Regulations, Schedule 3. However there is no replacement provision for identifying the persons responsible for prospectuses. It is important that an equivalent to the existing Regulation 10(2) is contained in the new Regulations. This is to ensure that persons who make an offer "in association with" an issuer, which could, for example, include employee trusts in an IPO, are not fixed with the responsibility for the prospectus alongside the issuer.

*Question 7: Do you agree that the UK should have a qualified investor regime?*

Yes. In order to operate the regime as effectively as possible, we would suggest that some element of self-certification is permitted (for example arrangements that rely on certification from an individual's accountant may in practice be too unwieldy to operate).

*Question 8: Do you agree that a prospectus should be made available on an issuer's website in addition to in printed form?*

We do not believe that this should be compulsory. There are still a number of small and medium sized enterprises who do not have a website.

In the employee context it is also likely that an employee offering (if it does fall within the Prospectus Directive) will only be available to employees and not to the public. Therefore making the offering document available on a public website is at best irrelevant and at worst potentially misleading in that other individuals may seek to apply for offerings to which they are not entitled.

*Question 9: Do you agree the notice should be published setting out how a prospectus has been made available and where it can be obtained by the public?*

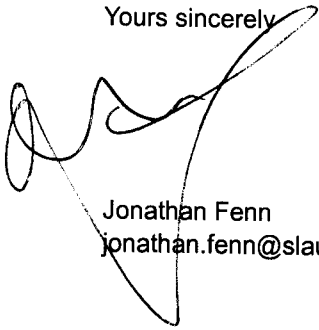
SLAUGHTER AND MAY

From our point of view we do not see a need for such a notice or for such notice to be published. Unless there is a particular reason for it we would suggest that it would be better not to impose this additional regulatory requirement.

As referred to in the answer to question 8, in the employee share offering context such a notice may well be entirely irrelevant since the public are likely to be unable to participate in an offering to employees.

I hope that the above comments are clear. If not please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jonathan Fenn', written over a large, faint, stylized graphic element that resembles a signature or a large letter 'J'.

Jonathan Fenn  
jonathan.fenn@slaughterandmay.com

**THE PROSPECTUS DIRECTIVE – ISSUES FOR EMPLOYEE SHARE PLANS**

**24 MAY 2004**

Share Plan Lawyers (formerly Share Scheme Lawyers Group) was formed more than 12 years ago by lawyers from City law firms whose main practice is employees' share plans. The group now has more than 150 members representing 47 law firms and a number of specialist practitioners. Our members include senior lawyers from all of the major City law firms and most of the major regional firms. The main purpose of the group is to meet, consult with and make representations to institutions involved in the regulation of employee share plans.

The Prospectus Directive raises a number of very important questions for employee share plans which could affect the ability or willingness of companies, from inside and outside the EU, to operate employee share plans in the EU.

It will be expensive for companies to produce a prospectus and to ensure continuing compliance with the requirements of the Prospectus Directive. It is likely, therefore, that companies which are required to produce one in order only to operate their employee share plans in the EU, will carefully consider whether that expense is warranted. It is likely that many will simply decide not to extend to their employees in the EU the benefits of employee share ownership.

The current uncertainty over how the Prospective Directive mainly affects companies which are not incorporated in a member state (**Non EU Companies**). The uncertainty may cause such companies to stop employee offerings for fear of triggering a "home member state" election that they do not wish to make. The purpose of this note is to set out five issues which are causing the uncertainty and to inform you of the views that a number of practitioners are taking on those issues.

**1. QUESTION 1**

**1.1 The question**

As you are aware, if a Non EU Company makes a public offer of certain securities in a Member State after 31 December 2003 but before 1 July 2005, that offer may fix the non EU Company's home member state. In deciding whether an offer of securities to employees of a Non EU Company's group in the EU is a public offer for this purpose, do you look to:

- what is a offer to the public under the local law of the relevant country applying at the time; or
- what would be treated as a public offer under the Prospectus Directive?

## 1.2 Why is the question important for employee share plans?

This question is important for employee share plans because Non EU Companies which operate employee share plans in the EU need to know whether or not an offering pursuant to such a plan will fix their home member state for the purposes of any future offers to the public in the EU.

## 1.3 Commentary

As a matter of law, we consider that the more logical approach is to use the definitions in the Prospectus Directive. The choice of home member state will have continuing implications under the Prospectus Directive after it has been implemented, so it would seem surprising to fix the home member state by reference to laws developed without the Prospectus Directive in mind.

To determine the issue by the application of local law, for this purpose, would produce diverse results, as the operation of an employee share plan in one member state may be considered an “offer to the public” under local law, while it may not in another. For example, in the UK, an offer of shares or options to employees is currently not treated as an offer to the public by reason of Regulation 7(2)(o) of the Public Offers of Unlisted Securities Regulation SI 1995/1537, while, in Belgium, it may be, if it is made to more than 50 people.

The application of local law for these purposes will mean that the home member state of a Non EU Company may be determined by which member state it happens to first make an offer under its employee share plan. Such a result may distort behaviour. The decision to offer shares to employees in a particular member state would normally be driven by a company’s recruitment or retention requirements in that member state.

On the other hand, using the Prospectus Directive to determine whether an employee offering is a public offer, for these purposes, could raise difficulties because it will be necessary to interpret provisions in the Prospectus Directive which have not come fully into force and before they have been implemented in member states. Presumably offers mentioned in Article 3 would not be public offers for the purposes of the Directive. Guidance would be needed from the relevant regulators.

In many cases, it would not be clear, even assuming that the Prospectus Directive did apply, whether an employee offer was or was not an offer of securities to the public for the purposes of Article 2(1)(m)(iii). Would an offer with a consideration of less than €2.5 million be such an offer?<sup>1</sup> Could an offer to less than 100 people per member state<sup>2</sup> fix a company’s home member state? Would an offer by an EU listed company be an offer to the public, even though there would be no requirement to

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<sup>1</sup> Article 1(2)(h)

<sup>2</sup> The same question would arise on any other offer within Article 3 as it is not clear whether this article is intended to list offers which are not offers to the public (so distinguishing it from Article 4) or whether it is intended to list offers which are offers to the public but which are exempt (distinguishing Article 3 from Article 1(2) but calling into question the distinction between Articles 3 and 4).

publish a prospectus in respect of it because it was to less than 100 people per member state or because the total consideration was less than €2.5 million?<sup>3</sup>

#### 1.4 **Previously expressed views**

Use of the Prospectus Directive definitions, for this purpose, is consistent with the view expressed by FSA and Treasury representatives in meetings with the ProShare European Issues Sub-group<sup>4</sup> and at a joint IPMA/lawyers meeting<sup>5</sup>.

However, we are aware that the European Commission has suggested that local law should be used for this purpose<sup>6</sup>.

## 2. **QUESTION 2**

### 2.1 **The question**

Would the grant of options to subscribe or purchase tradable equity securities (whether to employees or otherwise) be outside the Prospectus Directive if the options themselves are not transferable or not normally dealt is on a capital market?

### 2.2 **Why is this important for employee share plans?**

Almost all share options and share awards under employee share plans are non transferable. In some cases, the terms of the award or option are such that the award or option will lapse if the employee tries to transfer it. In other cases, it is made clear that only the employee to whom the award or option is granted can benefit from the exercise or vesting of the award or option. Such options are not tradable on any market.

### 2.3 **Commentary**

The Prospectus Directive does not apply to options and awards which are not transferable, even if the underlying securities are transferable.

The Prospectus Directive only applies to “offers of securities to the public”. Securities are defined<sup>7</sup> as “*transferable* securities as defined in the Investment Services Directive”<sup>8</sup>. This covers shares and bonds which are negotiable on a capital

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<sup>3</sup> Such an offer would fall within the exemption in Article 4(1)(e) from the requirement to publish a prospectus. Under that article, however, such an offer would, presumably, still be an offer to the public unless Article 3(2)(b) or Article 1(2)(h) overrides Article 4.

<sup>4</sup> Adetutu Odutola (FSA) and Richard Weaver (Treasury) at a meeting with ProShare on 18 February 2004

<sup>5</sup> Mike Duignan (FSA) and Richard Weaver (Treasury) at a joint IPMA/lawyers meeting on 22nd April 2004

<sup>6</sup> In a letter from Hubert Dumoulin of the DG Internal Market to Clifford Dammers of the International Primary Market Association dated 13 October 2004.

<sup>7</sup> Article 2(1)(l)

<sup>8</sup> Article 1(4) of Directive 93/22/EEC.

market and “any other securities *normally dealt in*, giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement”. The preamble indicates that “transferable securities, means those classes of securities which *are normally dealt in* on the capital market ...” and that only negotiable (i.e. traded) futures and options are intended to be caught. As employee options are not transferable, it cannot be said that they are normally “dealt in” on a capital market or otherwise. (Occasionally, employee share plans allow awards to be transferred to a limited class of transferees (such as family members or family trusts). In these cases, the same analysis would apply, as the awards, although transferable, are not “*normally dealt in*” on a capital market.)

There may be an argument that, while the grant of non-transferable options falls outside the Prospectus Directive, the grant of an option is, in fact, an offer of the underlying (transferable) securities which is made at the time the option is granted.

We note that if non-transferable options are outside the Prospectus Directive, they are likely still to be regulated by local rules in the country in which they are offered. This may result (as now) in offerings of options being treated in different ways in different countries i.e. as a public offering under one local law and as an exempt offering in another. Issuers would have to comply with different prospectus requirements in different countries.

## 2.4 Previously expressed views

So far as we are aware, neither regulators in any member states nor the Commission has expressed any views on this.

## 3. QUESTION 3

### 3.1 The question

If *grants* of non-transferable employee options are not covered by the Prospectus Directive (see Question 2), would the *exercise* of these options (if that exercise were to result in the acquisition of transferable shares) be considered an “offer to the public” within the Prospectus Directive (assuming that none of the other exemptions would apply)?

### 3.2 Why is this important for employee share plans?

If the exercise of an option were to be treated as an offer of securities to the public, companies will have great difficulty complying with their prospectus obligations. Employee options frequently have exercise periods of up to 10 years and a company cannot know when, in that period, an employee will choose to exercise an option. It could not comply with its obligations under the Prospectus Directive each time an option were exercised.

### 3.3 Commentary

In our view, the exercise of an option cannot be considered an offer to the public. Rather, it is the exercise by an optionholder of a right granted to him at the time that the option was granted.

### 3.4 Previously expressed views

It was accepted by the FSA at a meeting of the ProShare EU Sub-group that the exercise of options should not be an offer for the purposes of the Prospectus Directive.<sup>9</sup>

## 4. QUESTION 4

### 4.1 The question

Is an offer of securities to employees for free caught by the Prospectus Directive?

### 4.2 Why is this important for share plans?

Many employee share plans offer participants shares or other securities (such as options) for free. It is, therefore, important to identify if the Prospectus Directive applies to these grants.

### 4.3 Commentary

In our view, such offers seem to fall outside the Prospectus Directive. An offer of securities to the public means “a communication ... presenting specific information on the terms of the offer and the securities to be offered so as to enable an investor to decide to *purchase* or *subscribe* to these securities”.<sup>10</sup> The words “purchase” and “subscribe”, clearly assume that there is some form of consideration involved in the offer or its acceptance.

This interpretation would not be inconsistent with the other purposes of the Prospectus Directive. Employees who are offered shares or options for free are not taking any risk at the time of offer. They therefore do not need the protection which the Prospectus Directive extends to other investors who will generally be paying for the securities they receive.

There is an exemption for bonus issues and other issues of shares “free of charge to existing shareholders.”<sup>11</sup> The existence of the exemption could be seen as suggesting that an offer for no consideration would appear to be capable of falling within the ambit of the Prospectus Directive. However, shareholders who receive a bonus issue do, in fact, give consideration for the new shares they receive as their existing holdings are diluted to the extent that new shares are issued.

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<sup>9</sup> Adetutu Odutola (FSA) and Richard Weaver (Treasury) at a meeting with ProShare on 18 February 2004

<sup>10</sup> Article 2(1)(d)

<sup>11</sup> Article 4(1)(d)

If an offer of free shares or securities is not an offer to the public for the purposes of the Prospectus Directive, any such offer would, presumably, fall outside it because the consideration given for the offer would always be less than €2.5 million.<sup>12</sup>

#### **4.4 Previously expressed views**

So far as we are aware, neither regulators in any member states nor the Commission has expressed any views on this.

#### **5. CONTACT**

Please direct any responses to, or queries on, this paper, to Jocelyn Mitchell on 020 7832 7191 or at [jocelyn.mitchell@freshfields.com](mailto:jocelyn.mitchell@freshfields.com).

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<sup>12</sup> Article 1(2)(h)