



Operating Share Plans in Spain, Italy, France and the Netherlands

Major Issues and Recent Developments

Panelists

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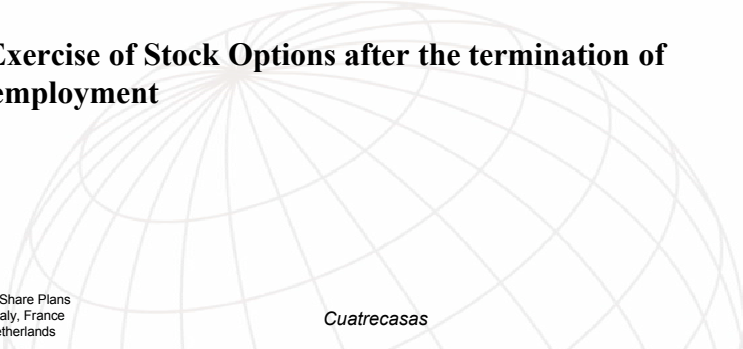




Stock Options in Spain: Summary

TWO MAIN PROBLEMS HAVING FINANCIAL IMPACT FOR EMPLOYERS OFFERING SOPs IN SPAIN

- 1. Stock Options and Severance Payments**
- 2. Exercise of Stock Options after the termination of employment**



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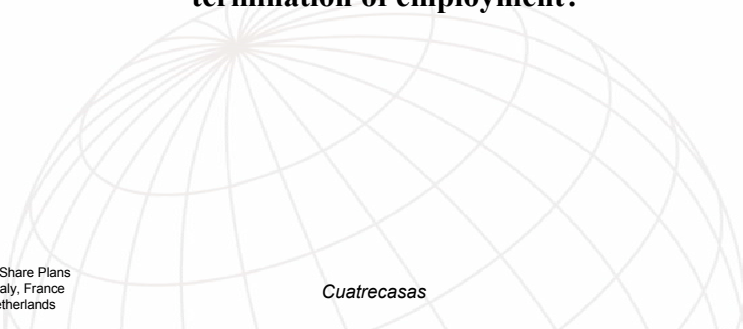
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Spain: Stock Options and Severance Payments

Is the benefit arising upon the exercise of SOPs part of the salary to be taken into consideration when calculating severance/redundancy payments due in the event of termination of employment?



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Spain: Stock Options and Severance Payments

CASE LAW OF THE SUPREME COURT OF JUSTICE

- **Transferable SOPs:**
 - SOPs may be considered as salary for indemnity purposes on the Grant Date, and for the Fair Market Value of the Options as of the Grant Date.
- **Non-transferable SOPs:**
 - SOPs may be considered as salary for indemnity purposes on the Exercise Date, equaling the difference between the Fair Market Value of the Shares and the Exercise Price (plus Option Price, if any).
 - The above-referenced benefit may be pro-rated for each portion of the SOPs.

Spain: Stock Options and Severance Payments

FURTHER CONSIDERATIONS

- **Interpretation of the clause “No Labour Effects” of the SOP Plans: potential waiver of rights not allowed under Spanish law.**
- **Interpretation of the “Governing Law” clause of the SOP Plans: limited possibilities of enforceability before Spanish employment courts.**
- **The same problem arises no matter whether SOPs are offered by the Holding Company or by the Spanish Subsidiary.**

Spain: Stock Options and Severance Payments

Annual Salary: US\$ 70,000

Length of Service: 5 years

Daily Salary: US\$ 194.44

Severance Payment: US\$ 43,750

SOPs Grant	SOPs Granted	Exercise Price	SOPs Vested	SOPs Exercised	FMV	Benefit (US\$)	Pro-rata (US\$)
2004	1000	US\$ 40	0	0	US\$ 50	0	0
2003	1000	US\$ 35	250	250	US\$ 50	3,750	3,750
2002	1000	US\$ 45	500	500	US\$ 50	2,500	1,250
2001	1000	US\$ 25	750	750	US\$ 50	18,750	6,250
2000	1000	US\$ 20	1000	1000	US\$ 50	30,000	7,500

Total: 18,750

Annual Salary: US\$ 88,750

Length of Service: 5 years

Daily Salary: US\$ 246.52

Severance Payment: US\$ 55,467

Difference: US\$ 11,717 (26 %)

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Spain: Stock Options and Severance Payments

CONCLUSION

**Following the decisions of the Supreme Court of Justice,
SOPs may be considered as salary on the Exercise Date,
equaling the difference between the Fair Market Value of
the Shares and the Exercise Price.**

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Spain: SOPs and Termination of Employment

Is an employee being terminated or made redundant able to exercise SOPs after the termination of employment (no matter what the terms of the SOP Plan provide)?

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Spain: SOPs and Termination of Employment

CASE LAW OF THE EMPLOYMENT COURTS

- **Supreme Court of Justice and Lower Courts:**
 - The terminated employee is able to exercise his/her SOPs after the termination of employment as if he/she were retired, dead or disabled.
 - A termination without cause must be treated like a situation of retirement, death or disability since it is deemed to be a “non-voluntary” termination and must have the same legal effects.
 - This controversy is still young and subject to further consideration.

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Spain: SOPs and Termination of Employment

FURTHER CONSIDERATIONS

- Interpretation of the “Continuity of Employment” clause of the SOP Plans: a fair termination cannot have the same legal effects as an unfair termination.
- Interpretation of the “Governing Law” clause of the SOP Plans: limited possibilities of enforceability before Spanish employment courts.
- Need to develop a consistent Human Resource strategy in the event of restructuring/termination of employment.

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Spain: SOPs and Termination of Employment

Termination Date: April 17, 2004

FMV Term.: US\$ 50

Example of Exercise Date: April 16, 2005

FMV Exerc.: US\$ 65

SOPs Grant	SOPs Granted	Exercise Price	SOPs Vested	SOPs Outstand.	FMV (Term.)	FMV (Exerc.)	Benefit (US\$)
2004	1000	US\$ 40	0	1000	US\$ 50	US\$ 65	25,000
2003	1000	US\$ 35	250	750	US\$ 50	US\$ 65	22,500
2002	1000	US\$ 45	500	500	US\$ 50	US\$ 65	10,000
2001	1000	US\$ 25	750	250	US\$ 50	US\$ 65	10,000
2000	1000	US\$ 20	1000	0	US\$ 50	US\$ 65	-

Total: 67,500

Potential Claim to be brought by the employee: US\$ 67,500

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Spain: SOPs and Termination of Employment

CONCLUSION

The Courts are holding that no matter what the terms of the SOP Plan are, and no matter whether or not there is a conflict of law provision, the terminated employee is able to exercise his/her outstanding SOPs after the termination of employment.

Further Court decisions are expected in due course.

Spain: SOPs and Termination of Employment

HOW TO MITIGATE

- **Different consequences for fair termination versus unfair termination.**
- **Avoidance of different SOP Plans at a time.**
- **Reduction in the number of SOPs.**
- **Reduction in the Exercise Period.**
- **Incorporation of a payroll-deduction system.**
- **Offer of Stock Awards instead of SOPs.**
- **Incorporation of a choice of law provision (both in the Plan and in the Grant Documents).**



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Italy

CHANGES IN SECURITIES LAWS

Legislative Decree No. 6 (the “Reform”)

- **Amended Italian Civil Code effective January 1, 2004**
- **New ways to facilitate employee participation**
- **Extraordinary shareholders’ meeting, where allowed by corporate by-laws, to grant a share in the profits by issuing ordinary or special classes of shares**
- **Extended to employees of companies controlled by issuer**
- **Increase in company share capital still required**

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CHANGES IN SECURITIES LAWS

Greater Variety of Classes of Shares May Now Be Issued to Employees – Several Special Types Expressly Recognized

- **Shares that participate in losses differently from ordinary shares**
- **Shares preferred in distribution of profits and repayment of share capital in case of winding-up**
- **Shares with different voting rights**
- **Shares with economic rights related to results in certain sectors of the company's business (tracking or targeted stocks)**
- **Shares redeemable by the company or the shareholders upon certain events or a term**

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CHANGES IN SECURITIES LAWS

Financial Instruments (Different from Shares) Now May Be Issued

- **Effective January 1, 2004**
- **Extraordinary shareholders meeting may issue to employees of the company or of controlled companies**
- **Administrative or economic rights, but not voting rights in general shareholders' meeting**
- **Companies may issue to shareholders or third parties for work done or the supply of services**
- **Cannot be accounted for in the share capital**

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CHANGES IN SECURITIES LAWS

Article 2441 of the Civil Code

- **Shares offered under employee equity plans in connection with corporate transactions**
- **If approved by vote at extraordinary shareholders meeting, pre-emption rights of shareholders may be waived with respect to one-fourth of newly issued shares**
- **Reform extended to employees of the issuing company or companies controlling the issuer or controlled by same**



Italy

CHANGES IN SECURITIES LAWS

Pending Developments

- **Due to recent implementation of the Reform and lack of case law or business practices on point, limits on the autonomy of by-laws are not yet clear**
- **A bill designed to ensure consistency between the Reform and various Acts currently is under examination by Italian Authorities and probably will become law and be in effect in next few months**



Italy

CHANGES IN TAX AND WITHHOLDING LAWS

Legislative Decree No. 344 (December 12, 2003)

- **Effective January 1, 2004**
- **The new rules affect:**
 - Capital gain tax regime
 - Taxation of dividends



Italy

CHANGES IN TAX AND WITHHOLDING LAWS

Capital Gain Tax Regime

- **The tax regime has changed for the sale of qualified participation**
 - 27% substitute tax abolished
 - Capital gains now partially (40%) included in tax basis of the seller
- **No changes have been made for the sale of non-qualified participation**



Italy

CHANGES IN TAX AND WITHHOLDING LAWS

Taxation of Dividends

- Dividends related to qualified participation must be included in annual income tax return and 40% of amount subject to personal income taxes
- For dividends related to non-qualified participation, entire dividend subject to withholding rate of 12.5% and not included in annual income tax return
- Tax credit granted under prior rules abolished for dividends distributed after January 1, 2004 on qualified and non-qualified participation

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France

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STOCK OPTIONS: A REGULATED ENVIRONMENT

- **Qualification requirements in France for stock option plans are relatively strict**
- **Stock option plans that do not meet qualification requirements will give rise to taxation as wages at full income tax rates (marginal rates up to 57% including 10% supplementary social security contribution)**
- **In most cases, failure to qualify will frustrate the aim of the plan – alternative incentives such as performance bonuses or free share attributions could be more suitable**



STOCK OPTIONS: REGULATED ENVIRONMENT

- **French corporations may grant stock options in the form of either: (i) share subscriptions or (ii) share purchases**
- **Subscription options are shares issued by the employer at the time of exercise of the options**
- **Purchase options are shares of the issuer's own stock acquired and held on behalf of the employees until exercise**
- **Note: an issuing company in France may not hold more than 10% of its outstanding stock**



STOCK OPTIONS: REGULATED ENVIRONMENT

- **Main requirements to qualify for favorable tax treatment:**
 - Class of beneficiaries limited to employees and corporate officers (excludes board members without offices);
 - For listed companies, stock subscription price may not be below 80% of stock quotation price (based on quotation average over last 20 trading days);
 - For unlisted companies, 20% discount on fair market value permitted only for purchase stock options - no discount permitted for subscription options;



STOCK OPTIONS: REGULATED ENVIRONMENT

(Main requirements continued)

- Stock price must be determined at the time of the option grant and not subsequently at time of exercise;
- Total number of options may not exceed one-third of company share capital; and
- No beneficiary may hold more than 10% of the issuing company share capital.



France

STOCK OPTIONS: TAX TREATMENT

TAXATION – Part One of Three Parts

- 1. Grant Gain: If the Stock Option price is below the fair market value at the time of the stock option grant by more than 5%, then the beneficiary will be taxed on the portion of the discount exceeding 5% as wage income at the time of exercise of the stock option.**



France

STOCK OPTIONS: TAX TREATMENT

TAXATION – Part Two

- 2. Exercise Gain: Beneficiary will be taxed on the gain derived from the difference between the fair market value of the share when the stock option is exercised and the stock option price.**
 - Provided the shares are held during a certain period, the Exercise Gain will be taxed as capital gains at the reduced rate of 26% (including 10% SSSC) for the portion of the Exercise Gain not exceeding 152,500 Euros. Conversely, higher tax rates apply.



France

STOCK OPTIONS: TAX TREATMENT

TAXATION – Part Three

3. Capital Gain: Beneficiary will be taxed on the gain derived from the difference between the share sale price and the fair market value of the shares at time of the option exercise.

- Capital Gains will be taxed at the reduced rate of 26% (including 10% SSSC)



France

STOCK OPTIONS: CONDITIONS

- **Granted options are irrevocable and may not be amended or cancelled without beneficiary's consent (notwithstanding stipulations otherwise in the plan)**
- **Upon option exercise, beneficiary is entitled to full rights attached to the shares**
- **Employer may prohibit the employee from reselling his shares for a period not exceeding three years after the date of exercise**



France

STOCK OPTIONS: EMPLOYMENT ISSUES

- **Unless otherwise stipulated in the stock option plan, employees may exercise after employment termination**
- **Certain French courts have permitted the plan to restrict the exercise of the options to current employees**
- **Legal counsel should be sought in drafting a stock option plan, with particular regard to retired and disabled employees**
- **French company is subject to obligation to consult Workers' Councils prior to authorizing the plan**



France

STOCK OPTIONS: CORPORATE ACCOUNTS

Greater Transparency

- **French companies: Special annual report prepared by the Board of Directors must be submitted to the shareholders at annual meeting**
- **The report must detail the number, exercise date limit, and price of stock options granted to each of the corporate officers (including options in affiliate companies), and those for the ten non-officers granted the the greatest number of options**
- **Similar information must be given to the AMF (French SEC) in respect of corporate info documents requiring its approval**



France

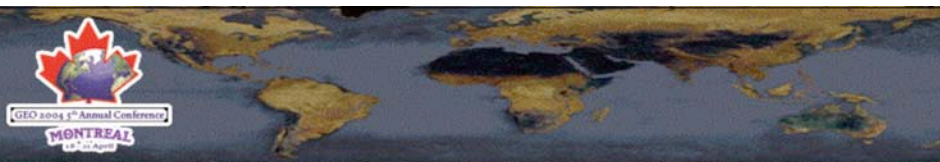
GROWING ALTERNATIVE: FREE SHARE ATTRIBUTION

- **AMF has admitted for French companies the possibility of free share attribution incentive plans in favor of corporate managers under certain conditions, notably:**
 - beneficiaries limited to managers holding substantial personal investments in employer (without employer financing) for at least three years
 - share attribution based on pre-determined performance goals
- **Main advantage: ascertaining the gain for beneficiary**
- **Main drawback: taxation of beneficiary as wage income**

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The Netherlands

OVERVIEW

Share Plans in the Netherlands

- **Wider use of share options, awards and appreciation rights in recent years for employees and directors**
- **Legislative intent underlying securities, tax and other laws governing equity compensation generally is to permit options and other arrangements to serve as incentive remuneration and as a means of motivating employees**

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FOCUS FOR THIS DISCUSSION

Offering Equity Incentives to Dutch Employees

- **Securities Law Compliance**
- **Employee Rights**
- **Tax Treatment of Share Options and Recent Simplification**
- **Impact of New Corporate Governance Code on Share Plans**

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SECURITIES LAW COMPLIANCE

Securities Supervision Act 1995

- **General Rule:** Securities offering requires filing with Dutch Financial Markets Authority and compliance with financial disclosure obligations
- **Exception:** Offering within “restricted circle” or “closed circle” (e.g., employees/directors of company or company group)
 - Group receiving offer limited in number and clearly identified
 - Recipients have certain relationship with issuer
 - Offer made only to members of group



The Netherlands

SECURITIES LAW COMPLIANCE

Recent Development: Expanded Insider Trading Exemption

- **General Rule:** Shareholders possessing inside information prohibited from trading (in or from the Netherlands) securities listed/likely to be listed on *any* stock exchange
- **Exception:** Exemptions for employee incentive awards
 - Until mid-2003, only for share options
 - Recently extended to all types of securities granted under employee incentive plan (shares, options, appreciation rights, warrants, convertible bonds)



The Netherlands

SECURITIES LAW COMPLIANCE

Expanded Insider Trading Exemption (continued)

- **Application:** Netherlands-based issuers and issuers listed on foreign stock exchange that grant shares to Dutch employees
- **Requirements**
 - Shares must be awarded under employee incentive plan
 - Plan must specify dates/periods of grant, total number of shares, and eligible employee class
 - Dutch FMA must be notified at least 2 months before grant

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EMPLOYEE RIGHTS

Employer Obligations and Planning Opportunities

- **Consultation with Works Council**
- **Equity Incentives as Component of Employment Contract**
 - Incentive awards not automatically incorporated into contract but under certain circumstances may be considered term of employment
 - Recommendation: clarify that award is discretionary
- **Recovery of Incentives in Action for Unfair Dismissal**
 - Recommendation: stipulate in incentive plan that awards are cancelled upon employment termination

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TAX TREATMENT OF SHARE OPTIONS

Current Tax Laws: Two Alternatives

- **Alternative 1: Taxation when options become unconditional**
 - Meaning of “conditional” vs. “unconditional”
 - *Vesting schedule OR performance requirement (such as continued employment) alone does not make option conditional; combination generally required*
 - Different tax treatment depending on holding period
 - *Option held for at least 3 years taxed based on fixed 4% assumed investment yield, with no additional tax at exercise*
 - *Option granted after June 1998 and held fewer than 3 years also taxed upon exercise as employment income*

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TAX TREATMENT OF SHARE OPTIONS

Current Tax Laws: Two Alternatives (continued)

- **Alternative 2: Taxation when options are exercised**
 - Employee elects to pay income tax only upon exercise
 - Tax based on expectation value of option
 - Social security contributions (and tax on intrinsic value of option) still due when option becomes unconditional
 - Employer and employee must file joint request for tax deferral with tax inspectorate before first date option may be exercised

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TAX TREATMENT OF SHARE OPTIONS

Recent Development: Tax Simplification

- **Finance Ministry announcement of option taxation only upon exercise**
 - *May* be effective January 1, 2005
 - Transition details and application to existing and new options to be announced
 - Intended to reduce administrative burden (e.g., joint statement requirement to defer taxation)
- **Result: Options will cease to be taxable when they become unconditional**

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CORPORATE GOVERNANCE

Recent Development: Code of Conduct

- **Effective January 1, 2004 for Dutch listed companies**
- **Overriding Principle: “comply or explain”**
- **Implications for Equity Compensation Arrangements**
 - Greater transparency regarding executive compensation
 - Option terms limited to 7 years
 - Share options to be awarded to management board members only with pre-determined performance criteria
 - Shares obtained under share plan must be held until employment termination or retirement

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Questions?

Thank You

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