Employee Share Schemes and the European Prospectus Directive — The Arrival of a “Light Touch” Regime?

Since our last article on this subject the Committee of European Securities Regulators (CESR) and the EU Commission have initiated developments which affect the regulatory landscape that employers must navigate when considering issuing equity incentives to their European employees. This Client Alert reviews the latest developments in the UK and Germany.

The Prospectus Directive and Employee Stock Incentives — A Recap

As we explained in our previous article any public offering of securities made in the European Union (EU) must be made pursuant to a prospectus approved in the issuer’s home member state — unless it falls within an exemption. A prospectus is essentially an offer document which contains certain information (proscribed by the EU Prospectus Directive (the PD)) regarding the risks associated with purchasing the securities on offer. This applies to all companies issuing securities in Europe wherever those companies are based. Therefore US companies which allow their European employees to participate in their stock incentive plans should be aware of the PD.

If an employer grants stock options to its European employees, compliance with the PD is only necessary if that offer comprises an “offer of securities to the public”. The PD defines “securities” as “transferable securities” which are “shares and other securities which are negotiable on the capital market”. This means that, as a general rule:

- options that are non-transferable are not caught by the PD regime and provided that an option plan is carefully drafted to make it clear that the options are non-transferable, the issuer need not be concerned by the PD; and
- free shares for which no consideration is paid, will not be caught by the PD in the UK as technically no “offer” for sale is made (although note that in some EU jurisdictions the regulators focus on the concept of “value” rather than “consideration” and therefore free shares which are deemed to be of value to the employees can be caught).

In addition there are also other diminimis “get outs”, which are not due to change under the new proposals. These are summarized at the end of the this Client Alert.

“Options which are non-transferable are not caught by the Prospectus Directive regime.”
What Happens When the PD Applies?

In our last article we focused on the potential risks of employee stock purchase plans being caught by the PD and the need to draft such plans carefully to avoid this. In this Client Alert, we focus on what happens when share incentive plans are caught by the PD because they comprise an “offer” of “transferable securities”, and the new developments in this area.

The Employee Stock Incentive Plan Exemption

Where an employee incentive plan does comprise an “offer” of “transferable securities”, there is currently a narrow partial-exemption to the obligation to produce a full PD compliant prospectus. This exemption is available to employee stock incentive plans where a company already has securities listed on an EEA regulated market.

This means that the exemption is not currently available for:
- Companies with securities traded on any other market in the EEA (e.g., The Alternative Investment Market (AIM)).
- Companies with securities listed or traded on investment exchanges outside the EEA (e.g., NASDAQ or NYSE).
- Private companies and unquoted public companies.

In Germany and the UK, this partial exemption applies whether or not the securities which are offered to employees are the same as the securities which are listed. In some other EEA states, the partial exemption is only available if the securities offered to employees are the listed securities.

What Requirements Must the Company Meet if the Employee Share Scheme Exemption Applies?

Where the employee share scheme exemption applies, the company is exempt from issuing a full prospectus for a public offer made to existing and former employees and directors of that company or any of its affiliated undertakings. Instead, the company should issue a more limited “information document”, which provides information on the number and nature of the securities offered and the reasons for the offer. This is a far less onerous obligation than producing a full prospectus and seeking approval for the prospectus from the relevant authority.

In January 2009 the EU Commission considered expanding the scope of this document to comply with its new short form prospectus regime (see below). However, fortunately this proposal appears to have been scrapped, as it would have been more onerous on employers.

Possible Expansion of the Employee Share Scheme Exemption

Our previous article reported that the European Commission was considering a proposal to amend this exemption so that it applies to employee share schemes more generally.

On 23 September 2009 the European Commission published a proposal that in future, the exemption would become available for all companies and not just those with securities listed on an EEA-regulated market. This would clearly have been good news for employers.

However, on 11 December 2009 the Council of the EU published the latest, more conservative draft of the proposed directive, which will amend the PD to expand the employee share scheme exemption. This proposal envisages expanding the exemption so that there are only two new categories of companies that may benefit from the exemption:

1. Companies with shares listed on a “multilateral trading facility” (as defined by the Markets in Financial Instruments Directive (MiFID)) provided that the multilateral trading facility is subject to:
(a) ongoing disclosure requirements covering price sensitive information and publication of annual reports; and (b) market abuse rules. In the UK, this means the exemption will become available to companies that are listed on the AIM, which is perhaps the most notable implication of the proposed expansion of the exemption; and

(2) companies listed on markets outside the EEA provided that:
(a) those markets have regulatory and supervisory standards equivalent to those which apply to EEA-regulated markets; and
(b) adequate information is provided to the employees (which includes the “information document” mentioned above) in a “language customary in the sphere of international finance”. Documents produced in English meet this requirement.

The European Commission will have the power to determine whether a non-EEA market has the “equivalent standards” of an EEA-regulated market and the local competent authorities (i.e., the FSA in the UK and BaFin in Germany) will be responsible for submitting applications to the European Commission for a market to be deemed to meet the “equivalent standards”. The competent authority will be required to provide appropriate evidence as to why it considers the non-EEA market’s standards to be EEA-equivalent.

It is still not clear whether this latest proposal will be implemented or whether there will be further amendments to the draft directive as the process involved in amending a directive is far from simple.

What requirements must the company meet if no exemptions apply and it has to produce a prospectus?

In our previous article we reported that in December 2007 the EU Commission and CESR were considering the adoption of a “light touch” approach to employee share offers. The idea was to avoid the need for employers to publish a full PD compliant prospectus where their stock incentive plan was caught by the PD and they were not eligible for the employee stock incentive exemption or any of the other exemptions (see below).

On 10 February 2009 CESR published guidance as to what this new “light touch” regime comprises. This has been labeled the new “short form prospectus regime”. The new regime allows eligible companies to prepare a short form prospectus rather than a full prospectus in circumstances where their employee incentive plan is caught by the PD and no exemption is available.

CESR has given guidance on the information that a short-form prospectus must contain by listing the information normally required in a full prospectus, which can be omitted from the short form prospectus. However, a short-form prospectus must be scrutinised and approved by the local regulator (e.g., the FSA in the UK and BaFin in Germany) and CESR has said that the local regulator can require any of the normal PD required information to be included if it deems it necessary.

**Application of the New Short Form Prospectus Regime**

The new regime applies to companies making public offers of shares to existing and former employees and directors of that company or any of its affiliated undertakings provided that the company has securities traded on any market — not only an EEA regulated market. This means that companies with securities listed on AIM or non-EEA markets such as NYSE or NASDAQ are able to benefit. However, the new short-form regime is not available to private companies and unquoted public companies.

It is important to note that this new regime is likely to be temporary and if the EU Commission proceeds with its proposed amendments to the PD so that more companies can benefit from the employee stock incentive plan exemption, this short-form prospectus guidance will be revised.
What Hasn't Changed? The Other Exemptions...

It is worth remembering that if a company offers transferable securities to its employees in return for consideration, and cannot come within the partial-exemption above, there are still three other exemptions which may be available:

- €2.5 million threshold
- If the combined consideration paid for securities is less than €2.5 million, when aggregated across all member states in any 12-month period, then the offer of securities will not come within the scope of the PD.
- Offers to fewer than 100 persons
- If less than 100 employees participate in a stock incentive plan in each member state, the obligation to produce a PD compliant prospectus will not be triggered
- Offers of transferable securities worth less than €100,000 in total
- An offer of securities with a total consideration throughout the EEA of less than €100,000 (when aggregated with offers made in the EEA in the previous 12 months) is exempt from the prospectus requirement.

Given that the new short-form regime still requires a significant amount of information to be included in the short-form prospectus and the approval of the relevant authority, it is still worth exploring whether a particular incentive plan could fall within one of these exemptions as an alternative to preparing a short-form prospectus.

Finally, we should point out that there are local nuances in the way that the PD is interpreted across Europe and when considering offering equity incentives to European employees, local advice should be sought to verify the current approach in each jurisdiction.

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