

**Open Letter to the Association of British Insurers  
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Sir,

This is an open letter because we feel your Association needs to review the guidance given to companies about adjusting their share schemes.

The schemes need to be adjusted when the number of shares issued by a company changes (as in a rights or bonus issue), and when capital is returned to shareholders. It should be a guiding principle that such adjustments keep unchanged the value such schemes have for their participants. Your guidance now allows such values to be enhanced at existing shareholders' expense without good reason being offered.

When capital is returned to shareholders, those scheme participants holding share options will have had their interest in the future share purchase diminished. To maintain the share option incentive, the option price needs to be reduced to reflect the loss in share value caused by the removal of capital. The Inland Revenue permits this for their approved schemes. Your guidance rightly allows this form of adjustment. But it also allows, as an alternative, the consolidation of company share capital to avoid the loss in share value. This form of adjustment is not neutral in its effect.

By returning capital the Company disposes of unwanted assets. These should be those that make the least contribution to the company's profits. So when holders exercise their options after the share consolidation, they get the right to an increased share of the earnings from the remaining more profitable assets. This enhanced benefit is the difference which holders get from a share consolidation rather than a reduction in the option price. Option holders have nothing to lose by the consolidation since the share price is being geared up to be at least the same as before.

The very recent proposals put to Mitchell & Butlers (M&B) Shareholders are a case in point. M&B's Chairman claimed that the proposed consolidation of shares (exchanging 12 new for 17 old) was necessary to "maintain the position of participants under the Share Schemes". He justified the consolidation ratio on the grounds that 29% of the M&B's capital worth is to be returned to shareholders by a special dividend. (The Company appeared to forget about paying any ordinary dividend until reminded about this at the EGM. They have now written to say they will additionally pay 12/17ths of the promised ordinary dividend.)

Because M&B's option holders can still buy the same number of shares at the same price after consolidation, they will be entitled upon the exercise of their options to a larger share of the Company's profits by a factor of  $17/12=1.417$ .

At the EGM last Monday, M&B's Chairman argued, quoting the authority of your guidance, that this proposal was only maintaining and not enhancing the position of share scheme participants.

We think your present guidance is being used to mislead shareholders. It also encourages companies to waste substantial sums of money consolidating their shares to give share scheme participants extra benefit. This motive gets dressed up in the name of providing share price compatibility before and after returning capital to shareholders. M&B paraded this as a prime reason even though the company is only 6 months old and is yet to pay a dividend.

We call on you to clarify your guidance, and to state the principles on which it is based. If you adopt the principles set out in our second paragraph, your guidance will need amending.

Yours sincerely

J N Stevens

Robert Muriel