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Ref MMCK/mm

Sir

Adjusting Share Schemes

We are writing in response to the open letter from Messrs Stevens and Muriel published by you on 9 January.

Your correspondents are correct in their belief that a share option holder's position is enhanced rather than maintained following a special dividend and share consolidation, and also that an adjustment of the exercise price of the option rather than a share consolidation would seem to be a fairer method of protecting option holders' legitimate interest where a special dividend is paid. Where they are probably under a misapprehension is in their presumption that the Inland Revenue will normally permit adjustment of option exercise price in the event of a special dividend payment. A return of value to shareholders by way of a special dividend represents, after all, the distribution of profits rather than a return of capital and it is on a variation of share capital that the tax legislation makes provision for share scheme adjustments.

Of course, an alternative method for a company to return value to shareholders would be by way of a share buy-back. This certainly would be a variation of capital but one that, by contrast, would require no special treatment for share schemes. In the case of a share buy-back, option holders would be better off since they would hold options over a greater proportion of the company's outstanding share capital. Indeed, this is exactly the situation as it applies to option holders following a special dividend payment and share consolidation. This convoluted process is probably best viewed as an artificial means of putting holders in the same position as if there had been a share buy-back rather than a special dividend payment. Perhaps the share buy-back route would have been better employed in the first place.

It is not the case that the ABI guidelines authorise any particular adjustment process where special dividends are paid. We do consider, though, that it would be better if option holders could be fairly compensated to reflect the reality of the special dividend payment rather than over-compensated as if another type of corporate action had instead been employed. Unfortunately, the tax rules do not seem to permit it. Where, I suspect there is a real sense of irritation among existing shareholders is not so much in this modest degree of over-compensation of employees in share schemes as in the essentially artificial, but no doubt costly share consolidation process that redenominates their ownership interest into a smaller number of shares with obscure par values.

Yours sincerely  
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