The way to a European Framework for Financial Participation [*]

by
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In every political system based on a market economy, the concept of property, and especially the legal institution of private property, plays a determining role. But the privatisation, increasing concentration, unequal distribution and internationalisation of property have created economic, political and social problems which so far have defied solution. The creation of a "New Social Europe" and the recent inclusion of not less than eight Eastern European states make the property question even more urgent. Financial participation (in the form of employee ownership as well as profit-sharing) based on an appropriate legal framework addresses these problems at their source. Instead of eliminating private property and thereby destroying the market economy, wage dependant employees can be enabled to acquire productive property as shareholders in successful business corporations. Thus the challenge of "New Social Europe" is to create a proprietary society of functional owners, incorporating those who have so far been excluded by a closed system of ownership.[1]

1. Introduction

1.1. Socio-economic background

In the EU 15 more than 19% of employees in the private sector currently participate financially in the enterprise where they work through profit-sharing or share ownership.[2] These existing schemes constitute a pillar of the European social model. Based on partnership they are seeking to overcome the rivalry between capital and labour. So far only participation in decision making is incorporated in the legal framework of the EU treaties.[3] The basic conception of civil society as a society of private property owners has not (yet) been sufficiently recognised by European law.[4] So far the only explicit support for a framework for financial participation is to be found in Part 7-II of the Action Programme for Implementing the Community Charter of the Fundamental Social Rights of Workers.[5] A rare exception to the general

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[1] See H. Roggemann, "Functional Change in Property Rights in the Welfare State: Lessons from the Federal Republic of Germany", in *I. Collier / H. Roggemann / O. Scholz / H. Toman* (Eds.), Welfare States in Transition – East and West, New York (St. Martins Press) 1999, p. 25-40.

[2] A5-0150/2003, Report of the Committee on Employment and Social Affairs of the European Parliament on the Commission communication on a framework for the promotion of employee financial participation (COM(2002) 364 – 2002/2243(INI)), p. 12.

[3] E.g. in the context of the European Company Statute in the COUNCIL DIRECTIVE 2001/86/EC of 8 October 2001, „supplementing the Statute for a European company with regard to the involvement of employees", OJ, L 294/22.

[4] Art. 295 (former 222) of the Treaty of Amsterdam excludes private property as a legal institution from the law of European contracts; the European Charter of Fundamental Rights (Art.17, property rights) adopted as part of the Treaty of Nice in 2001 is not genuine *jus cogens* and has no *res judicata* effect.

[5] The Charter of 9 December 1989, which was also signed by the United Kingdom in 1998, is neither a binding legal act nor is it a treaty among the signatory states. It is merely a solemn declaration which should nonetheless serve as an aid to the interpretation of the provisions of the EC Treaty, since it reflects views and traditions common to the Member States and represents a declaration of basic principles which the EU and its Member States intend to respect. Together with the Action Programme, which has also been approved by the Heads of State or Government, it is therefore used by the Commission as a basis for justifying many of the Directives it proposes.

silence is the second Council Directive on Company Law.[6] Altogether, the community law seems to be deficient regarding employee participation in general and financial participation in particular.

The second PEPPER report of 1996/97[7] found that there had been no major changes in the national policies in regard to the promotion of financial employee participation schemes. With the exception of Great Britain and France, the variety of incentive systems offered was rather small.[8] The schemes analysed in the PEPPER reports were schemes promoted by the European Union that are company level, broad based plans dependent on company performance, while not excluding participation in company assets. Thus gain-sharing, irregular cash based profit sharing, share options schemes not broad based and executive stock option schemes were excluded.

1.2. European initiatives

Reinforcing the integrational function of ownership by making ownership more broadly accessible requires a legal foundation for the implementation and support of financial participation schemes. This involves two main goals: Firstly, to develop regulations concerning financial participation at the Directive level, providing for a broader incentive system in order to support financial participation more actively and to overcome national differences in taxation policy; and secondly, to attain a general inclusion of the principle of financial participation of employees in the legal framework of the European Social Constitution.[9]

Both the European Commission and the European Parliament recently launched a new initiative, manifested in the opinion of the Economic and Social Committee of 26 February 2003,[10] on the Commission communication "on a framework for the promotion of employee financial participation".[11] Given this remarkable political initiative by the European policy-makers, we surmise that the conditions for improving the legal framework for financial participation of employees (and therefore for the transformation of non-owners into shareholders) are now especially favourable.

The European Parliament called on the Commission to submit studies on the issues raised in the Resolution, including a study on setting up a European monitoring body. Our proposed project ideally complies with the first request for analysing and describing the overall framework of employee participation in general, and already existing financial participation schemes in particular. As an alternative to the creation of a European Recommendation or Directive on financial participation, we suggest the application of existing national Company Law rooting in the second Council Directive on Company Law.[12] Furthermore the amendment[13] of existing European

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[6] See Art. 19 para. 3, 23 para. 2, 41, para. 1 and 2 of the Directive, 77/91/EEC, dating back to 13 December 1976 which allow derogations from the European legal framework for Joint Stock Companies designed to encourage the financial participation of employees (see below 3.4.).

[7] The report was designed to give a review of the effects of the mentioned recommendation of the Council of the European Union 92/443/EWG in the member states; see PEPPER II report 1996, KOM(96)0697 -C4-0019/97.

[8] With preference generally given to profit sharing models in France and share ownership models in Great Britain.

[9] EU Treaties in the actual form of the Nice Treaty. See Title XI, Article 136, fol.; TItle XVII, Article 158, fol.

[10] SOCI 115, Employee Financial Participation, CESE 284/2003.

[11] COM (2002) 364 Final.

[12] The Directive of 13 December 1976, 77/91/EEC allows various derogations designed to encourage the financial participation of employees in joint stock companies.

Company Law, i.e., the European Company Statute[14] is looked upon. Advantages and disadvantages of financial participation schemes at the country level are discussed in support of the promotion of such schemes on a European level.

1.3. Summary of the postulate of the European Policy makers

The Commission communication seeking "a framework for the promotion of employee financial participation"[15] sets forth the following essential principles of a financial participation model:

- participation must be voluntary;
- all employees must be included in the participation scheme (no discrimination against part-time workers or women);
- the scheme must be clear, transparent and simple;
- it should be, as far as possible, a regular scheme, consistent with the situation of the company, the undertaking and the economy;
- unreasonable risks for employees must be avoided;
- the scheme must be a complement to not a substitute for existing pay systems;
- the scheme must be compatible with worker mobility.

According to the Commission communication, employee participation in capital improves the debt-to-equity ratio, making it easier to raise capital from outside sources (Basle II), with both factors increasing the investment potential of the enterprise.

The Commission and Parliament identified the following transnational obstacles[16]:

- different levels of taxation on share values and on dividend income in the Member States (double taxation);
- the right time to tax share options depending on the exercise of a stock option;
- diverse social security contributions on income from financial participation and investment holdings;
- legal questions arising from differences in the laws on securities and prospectuses and in labour and social security laws;
- blocking periods when employees may not dispose of their shares;
- cultural differences in the social partnership;
- the problem of raising the new member countries' awareness of employee participation;

1.4. The situation in the New Member and Candidate Countries

Except for shareholding schemes in the context of the ongoing privatisation process, almost none of the new member countries provide a legal or fiscal framework for employee participation. The following table from the forthcoming "PEPPER III Report – Financial Participation of Employees in the New Member and Candidate Countries of Central and Eastern Europe" illustrates these findings.

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[13] Like the Council Directive 2001/86/EC of 8 October 2001, "supplementing the Statute for a European company with regard to the involvement of employees", OJ, L 294/22, but with regard to financial participation.

[14] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE); OJ, L 294/1.

[15] COM(2002)364 Final 5 July 2002.

[16] See Report of the High Level Group of independent experts, on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, May 2004.

Table: The Current Situation in the new Member and Candidate Countries

Country	General attitude	Legislation and Fiscal or other Incentives	Schemes and their Incidence
Cyprus	• FP not an issue on **TU** / **EA** agendas • FP so far ignored	**ESO:** NCL - preferential ES in JSC; financing ES by firm possible; NTL - dividends/gains from share sale tax free **PS:** None	**ESO:** AI, insignificant; **PS:** AI, insignificant
Czech Republic	• **TU / EA** indifferent to FP, not a current topic on their agendas • **ESOP** discussed in 1990; FP ignored after introduction of Voucher concept;	**ESO:** NCL - preferential ES/SPS in JSC; not considered public offering; ES discount limit: 5% of equity capital / financing by firm possible; NTL - uniform 15% dividend tax **PS:** NCL - CPS/SPS in JSC	**ESO:** Insignificant; 0.31% of the privatised assets **PS:** AI, insignificant
Estonia	• **TU** indifferent to FP, **EA** opposed to any extension of employee participation; • PrivL supported **ESO** until 1992; after 1993 FP ignored	**ESO:** NCL - rights attached to shares issued before 1 Sept.1995 remain valid; no public prospectus for ES needed; NTL - 18.24% income tax on dividends from resident firms; "bonus" exempt; **PS:** None	**ESO:** 2005 2% (after privatisation average 20%) of firms majority employee owned, 20% minority; **PS:** AI, survey evidence, very few cases
Hungary	• FP for managers means to avoid external control, for employees to preserve work-place; **TU** lobbied **ES/ESO** in privatisation, recently passive; **EA** indifferent • **ESOP/ES** strong support in PrivL until 1996; climate FP friendly but lack of concrete economic policy decisions	**ESO:** PrivL - preferential sale; discount max.10% firms assets and 150% of annual min. pay, instalments; Decree "*Egzisztencia*" Credit; NCL - specific "ES"in JSC, discounted / free, max.15% of equity capital, financing by firm possible; since 2003 tax-qualified stock plans, first ½mln.HUF free, than 20% tax **ESOP:** ESOP-Law 1992; preferential credit; corporate tax exempt until end 1996; contribution to Plan max.20% tax deductable; tax base lowered; **PS:** None	**ESO:** 1998 1% of assets privatised; preferential privatisation in 540 firms; CS strong decline; now AI, 30% of firms (70%SO,30%ES), mostly foreign **ESOP:** initially 287 employing 80,000, in 2005 151 left; 1.2% of employment by private corporations **PS:** AI, 20% of firms, mostly foreign, but only 10% of entitled receive profit
Latvia	• **TU / EA** indifferent to FP, not a current topic on their agendas • Little support for **ESO** in PrivL; FP so far ignored	**ESO:** PrivL - max. 20% ES; specific "ES" in state / public firms; NCL - preferential ES in JSC free / discounted possible; NTL - Dividends tax exempt; **PS:** None	**ESO:** PrivL 110.6mln. vouchers to 2.5 mln. people; AI, 1999 16% of 915 firms dominant ESO but falling over time **PS:** AI, 7% of firms; mostly IT, consulting, real estate
Lithuania	• Climate FP friendly; **TU** interested, lack of actions; **EA** support individual firms • **ESOP/ES** strong support in PrivL until 1996; now FP not on political agenda of Parliament and Government	**ESO:** PrivL - 5%ES deferred paym. max.5 years; NCL - in corporations ES for 3 years non transferable/non voting, financing by firm possible; NTL - uniform 15% dividend tax; after holding period profits from sale of shares not taxed **PS:** None	**ESO:** low and decreasing; AI, 2000 36% (1995 92%) privatised firms dominant ESO, falling over time; **PS:** AI; CPS mostly foreign (IT, consulting, avertising, etc); DPS few cases 2005 linked to employee savings plan
Malta	• **TU** support schemes in practice; FP not a current topic in national tripartite dialogue • FP collateral effect of nationalisation (80´s) and privatisation (90´s) not a current issue	**ESO:** NCL – ES in corporations, exempt from prospectus/investment rules; max.10% discount, financing by firm possible; NTL - SO only taxable at exercise **ESOP:** Trust Act refers to FP; taxed 15% interest / 10% investment **PS:** mentioned in Labour Law	**ESO:** AI; banking sector: ES, SAYE scheme, SO, **ESOP:** AI, Trust Funds in Bank of Valetta / Malta Telecom **PS:** AI; 2004 public sector (Shipyard 1,761 employees); private (foreign) firms, mostly reserved for management
Poland	• **TU/EA** indifferent to FP; managers / employees pragmatically motivated; Lobby groups / Institutions e.g. banks for **ESO** • FP Supported in early privatisation period; **ESO**	**ESO:** PrivL - 15% ES for free, non transferable, *National Investment Funds* 1995, shares for symbolic fee; NCL - ES/SPS in JSC, financing by firm possible; NTL - uniform 15% dividend tax; **EBO:** PrivL - *Leverage Lease Buy-Out*, anticipated ownership transfer possible;	**ESO:** low and declining; AI in privatised firms, 2000 ca. 11.4% (1998 12.7%); NIF adult citizens 1 share in 15funds **EBO:** LLBO 2002 1/3of privatisations, most frequently

	in most privatisations, since mid-90´s more and more ignored; **PS** ignored	interest 50% of refinance rate; interest part of lease payments are costs; Insolvency Law - buy-out right; **PS:** NCL - CPS/SPS in JSC	used single method, over 1000 firms, 14% over 250 employees **PS:** AI, limited to management (*bonus*)
Slovak Republic	• **TU / EA** indifferent to FP, not a current topic on their agendas • **ESOP** discussed in 1990; **EBO** concept failed 1995; FP now generally ignored	**ESO:** NCL - preferential ES and SPS in JSC; max.70%discount/ financing by firm possible; **PS:** NCL - CPS/SPS in JSC	**ESO:** Insignificant; AI, banking sector / new privatisations **EBO:** AI, in privatisation context, usually management-led **PS:** Insignificant
Slovenia	• **TU/EA** very supportive to FP; Employee Ownership Ass. lobbies legislation; active support by Works Councils/Managers Ass. • Strong political support to FP; draft laws 1997/2005 in parliament rejected;	**ESO:** PrivL - max.20% ES for Vouchers; Vouchers free, shares for overdue claims; NCL - preferential ES/SPS in corporations; discount / financing by firm possible **EBO:** max.40%, shares 4years non transferable; Worker association proxy organisation under Takeover Law; **PS:** PrivL- SPS in internal buy-out	**ESO/EBO:** 90% of privatised firms; CS 1998 60% majority ESO while only 23% of capital (2004 18% strong decline); **PS:** CS, in statutes of 32% of firms, but unexploited in 22%; for board members 20% of listed firms
Croatia	• **TU** recently promote **ESO** in revision of privatisation; **EA** indifferent to FP; long tradition of Self-management • **ESO** supported until 1995, since then FP ignored	**ESO:** NCL - ES in JSC financing by firm possible; NTL - Dividends tax exempt; profits from sale of shares not taxed **ESOP:** general rules of NCL apply; planned in new PrivL; **PS:** None	**ESO:** 2005 more than 10% of value of privatised firms (1996 20%); 2004 12% firms with majority ESO; **ESOP:** Survey evidence, ESOP elements in 9,4% of firms (52 out of 552), completed ESOP approx. in ¼ of them; **PS:** AI, taxation unfavourable
Bulgaria	• **TU** open to FP, **EA** indifferent; not a current topic on either of their agendas; • **ESO** strong support 1997-2000 since then ignored; FP generally ignored	**ESO:** None; NTL - Uniform 7% dividend tax **PS:** None; NTL - SPS personal income tax exempt	**ESO:** 10% Mass-Priv, 4-5% Cash-Priv; low, decreasing **MEBO:** 1436 28% privatisations; managers took over most **PS:** AI, few cases survey evidence
Romania	• **TU** support indiv. cases; **EA** avoid topic; Tripartite council tackled FP sporadically • **ESO** supported until 1997 esp. **MEBO**; then support declined; current government gives little support and has other priorities	**ESO:** PrivL - aim 30% of privatised assets Vouchers/ES; Vouchers free; 10% discount ES; NCL - ES in JSC, financing by firm possible; NTL - 10% dividend tax; **ESOP:** PrivL on Empl. Associations; leveraged transaction, preferential credit, max. interest rate 10%; **PS:** Ordinance, State/Municipal firms	**ESO:** ES 10% of shares issued at privatisation, decreasing **ESOP:** 1998 1/3priv., most frequently used single method 2000 2632 firms, average 65% ESO, 1652 majority ESO **PS:** estimated 1.2 mln. employees in public sector covered
Turkey	• Climate FP friendly; **TU** supportive, **EA** undecided, split; employees interested • FP issue1968 in Tax Reform Commission; some attention in individual privatisations; 2002 program, lack of concrete measures	**ESO:** PrivL - decrees for individual firms; discount / instalments; NTL - after 1year share-sale profits not taxed; for SO limited tax on dividends/profits from sale **ESOP:** NCL / CivC "welfare/mutual assistance funds" of firms; financing by firm profits/contributions **PS:** NCL / CivC both CPS and SPS; max10%prior reserve	**ESO:** AI PrivL 12main cases 9-37% ESO, 1case majority, up to 15%discount; SO/ESO private firms mostly foreign (26 registered 35 applications) **ESOP:** N.A. **PS:** AI retained profits as dividends widespread; CS 38 out of 50 listed firms

Source: PEPPER III; *Excluded from studies*: Management Buy-out, General Savings Plans, Consumer Cooperatives, Housing Cooperatives; *Abbreviations*: AI = Anecdotal Information only; NCL = National Commercial Legislation; NTL = National Tax Legislation; CivC = Civil Code; CS = Case Studies; CPS = Cash-based Profit-sharing; DPS = Deferred Profit-sharing; EBO = Employee Buy-out; ES = Employee Shares; ESO = Employee Share Ownership; ESOP = Employee Share Ownership Plan; EA = Employer Associations; FP = Financial Participation; JSC = Joint Stock Companies; MEBO = Management-Employee Buy-out; PrivL = Privatisation Legislation; PS = Profit-sharing; SO = Stock Options; SPS = Share-based Profit-sharing; TU = Trade Unions;

2. The way to a European Regulation

2.1. Focus: Legislating Financial Participation Schemes

Although tax incentives are the most common way of encouraging financial participation schemes, a common European legal framework imposing such tax incentives would collide with the national legislative sovereignty over taxation. Under the European Union each member state retains exclusive power over all matters involving taxation; any Directive involving taxation requires the unanimous consent of the Member States. Therefore a European approach to the problem must provide a broad incentive system going beyond the classical instruments of tax legislation. Establishing such schemes through legislation is of primary importance, as it gives companies a distinct legal entity and provides them with a clear framework for company decisions and actions. At the same time, establishing a legal framework delineates what is possible for companies without inviting sanctions from regulatory, legal or taxation authorities.[17]

2.2. Unanimous Decision vs. Majority Vote

Diverse national approaches to both financial participation and participation in decision-making constitute further impediments to change. For obvious reasons, it is very difficult to reach a unanimous supranational compromise either in the Commission or in the Council. The law of European Treaties in general permits majority vote decisions in a limited number of cases, recently extended by the Treaty of Nice.[18] No less than 27 provisions change over completely or partly from unanimity to qualified majority voting, among them measures to facilitate freedom of movement for the citizens of the Union (Article 18 ECT) and industrial policy (Article 157 ECT). As to taxation (Articles 93, 94 and 175 ECT), however, the requirement of unanimity for all measures is maintained across the board. In the field of social policy (Articles 42 and 137 ECT), despite maintenance of the status quo, the Council, acting in unanimity, can make the co-decision procedure applicable to those areas of social policy which are currently still subject to the rule of unanimity.[19] The Intergovernmental Conference has not, however, extended the co-decision procedure (Article 251 ECT) to legislative measures which already come under the qualified majority rule (e.g., in agricultural or trade policy). Therefore the search for a legal foundation at the Directive level has to focus on those "majority vote" regulations if it is to be successful. This is further true because the position of the governments in relation to the social partners, their role in society, and their relation to each other varies significantly in the different member countries.[20]

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[17] See A. Pendleton, et al., Employee Share Ownership and Profit-Sharing in the European Union", European Foundation for the Improvement of Living and Working Conditions, 2001, p. 9.

[18] The Treaty of Nice has extended the scope of co-decision. This procedure will be applicable to seven provisions which change over from unanimity to qualified majority voting (Articles 13, 62, 63, 65, 157, 159 and 191; for Article 161, the Treaty stipulates assent). Accordingly, most of the legislative measures which, after the Treaty of Nice, require a decision from the Council acting by qualified majority will be decided via the co-decision procedure.

[19] This "bridge" cannot, however, be used for social security.

[20] E.g., the consensual continental contrasts with the Anglo-American confrontational model; likewise the strong position of the state in France contrasts with the powerful role of the German "Tarifpartner" (collective bargaining parties, such as trade unions and employer associations). See *A. Pendleton / E. Poutsma,* "Financial participation: The role of governments and social partners", European Foundation for the Improvement of Living and Working Conditions, Dublin 2004.

2.3. Different Contexts, Different Approaches

A strict distinction concerning suitable options and legal procedure to create solutions at the European level has to be made between participation in decision-making and financial participation of employees. Participation in decision-making, whatever its form at the national level, is as a rule obligatory for enterprises in the given country.[21] Since community law would be equally binding, a supranational compromise can encompass only the smallest common features of the diverse national regulations.[22] Financial participation on the other hand is traditionally an optional instrument for improving company performance and corporate governance; enterprises are therefore free to introduce financial participation schemes.[23] Thus, provided that they are granted voluntarily on the national level, a supranational platform can offer a variety of incentives from which to choose.

A European Regulation thus should encompass a broad incentive system which provides different and flexible solutions, compatible with those already established in the Member States. An adaptable scheme can provide for a solution suitable for use throughout the European Union, comprising best practises of national legislation and customs.[24] Combining them in a single program with alternative options leads to a "Building Block Approach", with the different elements being mutually complementary. While profit-sharing schemes, stock options and employee shares are relatively widespread in the European Union, Employee Stock Ownership Plans (ESOPs) are predominantly to be found in countries with an Anglo-American tradition, e.g., the United Kingdom and Ireland.[25] Originated in the United States as a technique of corporate finance, the ESOP, using borrowed funds on a leveraged basis, has the capacity to create substantial employee ownership and can be used to finance ownership succession plans, an important feature, especially for European SMEs.[26] Furthermore, it can be used to refinance outstanding debt, to repurchase shares from departing plan participants, or to finance the acquisition of productive assets.[27] The last two functions are both possible on an unleveraged basis as well. In the unleveraged case, of course, less stock can be acquired in any given transaction.

2.4. The Building Blocks

Regardless of the form profit-sharing takes, the resulting funds may be used to create employee share ownership, as in the case of share-based deferred profit-sharing used in various other combinations in France, the United Kingdom and Ireland. The existing variety of national profit-sharing schemes (often involving an institutional

[21] As, for example, the German Mitbestimmung and the Works Councils in France and the Netherlands.

[22] This problem is well illustrated by the prolonged controversy over the so called European Workers Council, and as a consequence the rather minimal compromise of the regulation in the European Company Statute.

[23] A rare exception exists in France where enterprises with more than 50 employees are required to establish a participation fund. See PEPPER II Report, 1996/97; KOM(96)0697, C4-0019/97, p.19-20.

[24] Compare White and Case, *The European Company Statute*, 2001, pg. 4.

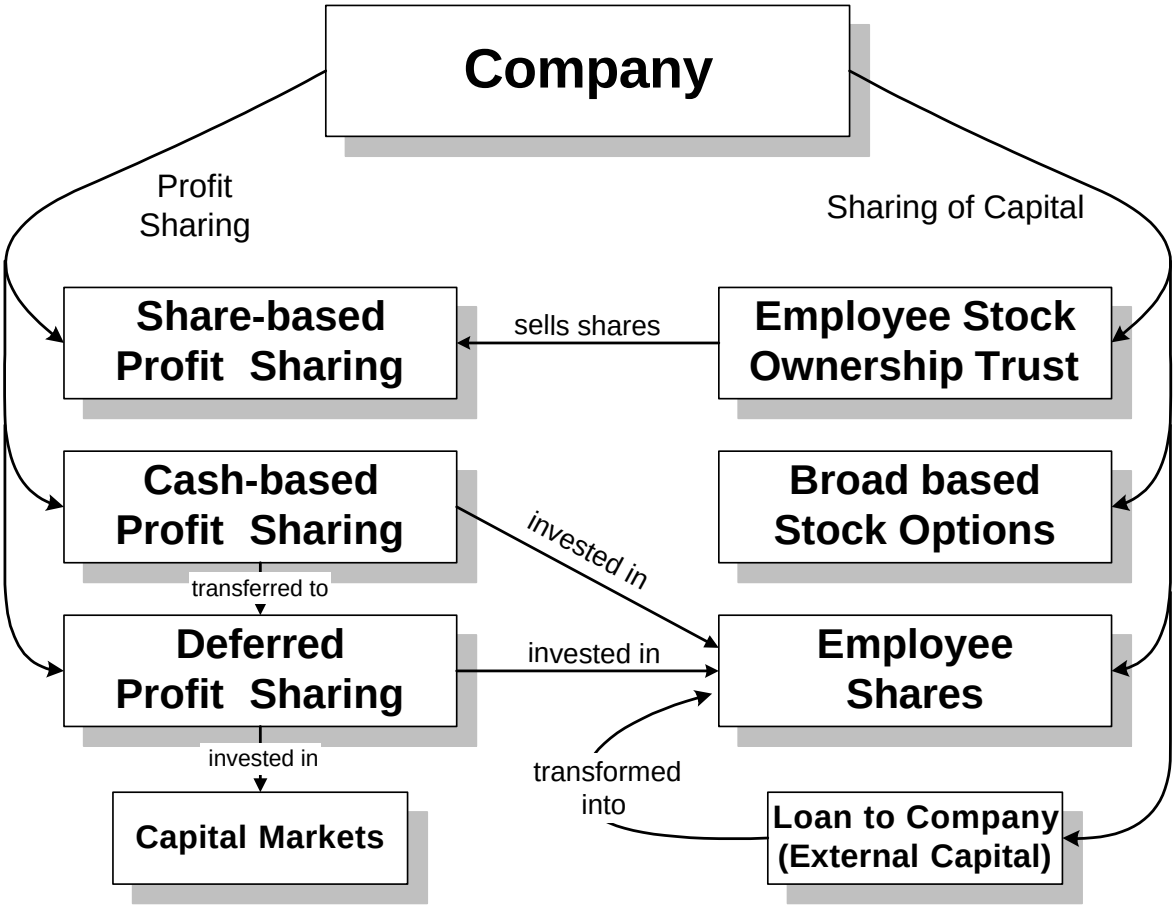
[25] For Ireland, see J. Shanahan and L. Hennessy, "Underpinning Partnership at the Workplace – An MSF Guide to Profit Sharing, ESOPs and Equity Participation", Dublin, 1998, pg. 9.

[26] One of the key areas defined in the Final Report of the MAP 2002 Project, European Commission Enterprise Directorate-General, "Transfer of Businesses – Continuity Through a New Beginning", 2003.

[27] From an entrepreneurial point of view, see D. Ackermann, "How to Cash Out Tax-Free, Yet Keep Your Business . . . ESOPs – A Practical Guide for Business Owners and Their Advisors", Conference Paper for the National Center for Employee Ownership, San Francisco, California, 2002.

infrastructure) would be compatible with a supranational platform resting basically on the two forms of employee share ownership: individually held or held through a trust. Therefore the building blocks should consist of the three basic PEPPER elements:[28]

- Profit Sharing (Cash-Based, Deferred and Share-Based);
- Individual Employee Share-holding (Stock Options and Employee Shares);
- Employee Stock Ownership Plans as Collective Schemes.



Referring to the catalogue of minimum requirements (e.g., transparency, being broad based, etc) the base scheme reflects the existing postulates of the European Policy makers (see above 1.3.) and neither relies on nor excludes tax incentives. All of the different elements are voluntary for both enterprises and employees. They can be put together in any combination with the different building-blocks tailored to the specific need of the given enterprise.

3. Implementing a European Platform for Financial Participation

3.1. Problems related to the Legal Framework and Trans-national Obstacles

As already mentioned, so far, the only explicit support for a framework for financial participation is to be found in Part 7-II of the Action Programme for Implementing the Community Charter of the Fundamental Social Rights of Workers. The Charter of 9

[28] For a detailed technical description of the different mechanisms and schemes see M. Uvalic, PEPPER I Report, 1991.

December 1989, signed also by the United Kingdom in 1998, is neither a binding legal act, nor a treaty among the signatory states.[29] Together with the action programme, which has also been approved by the Heads of State or Government, it is used by the Commission as a basis for justifying many of the directives it proposes. Overall, the community law seems to be deficient in respect to employee participation in general, and financial participation in particular.

A second deficiency is that the development of financial participation schemes across the EU is strongly influenced by national policies, in particular by the availability of an appropriate legal framework, tax incentives and other financial advantages[30]. As a result, different laws, and sometimes mandatory rules in the different countries, often require specific forms of financial participation, forcing companies to tailor the design of an international plan accordingly[31]. In the end of 2003 a High Level Group of independent experts[32] has classified the barriers to cross-border plans for financial participation into seven broad categories:

- **Existing legal framework:**
  - employee involvement in the introduction of plans;
  - legal statute of companies or groups;
  - plan coverage, limits, thresholds and criteria for the calculation;
  - eligibility criteria;
  - fixing of withholding or retention periods as well as rules and vehicles for investment and administration of any funds.

- **Taxation and social security issues:**
  Diverse tax treatment of the various types of financial participation plans across the EU, linked to general differences in taxation systems, represent another very important barrier to the implementation and spread of plans. Combined with the existence or absence of tax-favoured plans, the differences most importantly concern incidence and timing of taxation, uncertainty and/or complexity of fiscal treatment, and differences in tax treatment and social security contributions for employers and/or employees as well as double taxation or double exemption.

- **Securities laws:**
  Different securities laws can impose substantially different obligations on enterprises to provide information to employees when offering shares in different Member States.

- **Labour or employment laws:**
  The necessity of consulting with employee representatives, trade unions or Works Councils and negotiating plans with them at the company level as well as of providing information to employees; also the definition of pay, the impact of plans on pension rights, the existence of "acquired rights" and employee data protection rights.

[29] It is merely a solemn declaration which should nonetheless be used as an aid to the interpretation of the provisions of the EC Treaty, since it reflects views and traditions common to the Member States and represents a declaration of basic principles which the EU and its Member States intend to respect.
[30] In some countries however, financial participation schemes have developed without specific tax incentives or when incentives have been reduced (Germany, Italy, the Netherlands, Canada): see "Employee participation in profit and ownership: A reviews of the issues and evidence" European Parliament, Working paper, Social Affairs Series, SOCI 109 EN, 01-2003
[31] Ibid., p.22-27
[32] Report of the High Level Group of independent experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, Dec. 2004, p.17ff.

- **Financial market regulations:**
  Different requirements regarding Stock exchange disclosure rules and levels of compliance; shareholder and regulatory approval; entitlement of the employees' legal representatives to information.
- **social and cultural traditions:**
  Differences in industrial relations practice as well as cultural differences relating to savings patterns and risk aversion which affect the willingness of employees to invest in their employer firm.
- **introduction and operating costs:**
  Financial design and company appraisal, employee communications, legal and tax advice, compliance obligations and annual administration.

3.2. Recommendation according to Art. 249 par. I, 1 ECT

The European Platform could be framed as a Recommendation according to Article 249, paragraph I, 1 ECT. The downside of such a solution, however, is that Recommendations according to Article 249, sentence 5, ECT are not legally binding and thus an implementation in the Member States would be more than questionable. On the other hand, legislating such schemes in whatsoever form is a major step forward, it sets up a distinct legal entity for companies to refer to and provides a framework for company decisions and actions in those countries that approve the European Platform.

One possible solution to the problem of national implementation would be a recognition procedure by Member States for financial participation similar to that proposed by the High Level Group of Independent Experts.[33] As a result of this procedure, single Member States would recognise single elements from the European Platform drawn up in the Recommendation as equivalent to a plan drawn up under its own laws and provide equivalent benefits. In this way they would provide companies operating under their legislation with a legal framework that delineates what is possible without invoking sanctions from regulatory, legal and taxation authorities. Recognition is nonetheless a major step and would require considerable co-operation between the Member States and the Commission.

3.3. Directive-Level: Amending existing European company law

Considering the difficulties in passing and implementing European Directives, especially in sensitive areas where unanimous decisions may be required, it seems preferable to amend existing European legislation. Since employee share ownership fits into the framework of company law, rules to implement it could be proposed as an amendment of the "European Company" legislation. Like the European Company Statute[34] (ECS), which provides an option for forming a supranational company, there could be an amendment to the ECS permitting such companies to create "European Employee Shareholding" as an option.[35] This option could be easily

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[33] Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, December 2003, p. 52ff.

[34] Council Regulation (EC) No. 2157/2001 of 8 October 2001 on the Statute for a European company (SE); OJ, L 294/1.

[35] Like the Council Directive 2001/86/EC of 8 October 2001, "supplementing the Statute for a European company with regard to the involvement of employees" but with regard to financial participation.

extended to other companies which do not fall under the ECS, provided that national legislation would then be adapted to the requirements of the supranational statute.

The EU Member States would have an incentive to implement legal rules pertaining to the "European Employee Shareholding Statute" as an amendment to the ECS, choosing from a variety of incentives, possibly including tax breaks as well as other preferential treatment:

- Unlike the supplementary rules to the ECS concerning participation in decision-making, those on "European Employee Shareholding" would be totally voluntary; they would apply only if the company decides to adopt one of the existing models of financial participation.
- As in the case of the supplementary rules to the ECS on participation in decision-making,[36] the scheme would be, at first hand, proposed by the employers to their employees; in other words, a negotiated proposition. If the proposed scheme does not correspond to a catalogue of minimum requirements, or the parties so decide, a statutory set of standard rules would apply as a "safe harbour".

The mechanism of the "default standard rules" concerning participation in decision-making, foreseen in the ECS for resolving potential conflict while at the same time not imposing a solution, would even be suitable in the field of financial participation:

- As for the "standard rules" for private and/or unlisted SMEs, an ESOP-trust would seem to be the most feasible vehicle since it may provide a relatively non-controversial solution to the question of employee voting rights and may buffer potential risk more easily, while at the same time solving the problem of business succession.
- As for the "standard rules" for quoted middle sized and large enterprises, a restricted broad-based employee stock option scheme (as practised in the United Kingdom) seems to be feasible since there has already been substantial development in European harmonisation on the one hand, and a remarkable initiative put forward by the Enterprise Directorate-General on the other.[37]

3.4. National-Level: Building on Existing National Company Law

Given the above described difficulties in arriving at a supranational compromise either in the Commission or in the Council, in order to reach a regulation at the Supranational level, the most simple solution is to build on existing national legislation originating in the Acquis Communautaire. A rare example of such a legal "common ground" are some of the national rules on open and closed joint stock companies originating in the implementation of European Law i.e., the second Council Directive on Company Law 77/91/EEC, dating back to 13 December 1976. Arts. 19 para. 3; 23 para. 2 and 41, para. 1 and 2 of the Directive allow Member States to deviate from the European legal framework of Joint Stock Companies in order to encourage employee financial participation. Although primarily referring to share ownership schemes these – optional – regulations also leave room for combination with profit sharing schemes.

[36] Here it is the result of negotiations between employer and employee representatives.

[37] "Employee Stock Options: The Legal and Administrative Environment for Employee Stock Options in the EU", European Commission Enterprise Directorate-General, 2003.

Table – Implementation of the 2nd Council Directive no Company Law 77/91/EEC

Country	Art.19 III permission to acquire companies own shares for its employees, limit: 10% of equity capital	Art.23 permission to advance funds, make loans, provide security, with a view to acquisition	Art. 41 I derogation to encourage financial participation in case of capital Increases	Other general provisions in Company Law to promote financial participation
Cyprus	Without decision of General Assembly	Advance funds and make loans to employees	No	No
Czech Republic	Without General Assembly decision provided for reserve	In accordance with articles of association	Financing from company profits or profit-sharing; no public offering	Discount limit: 5% of equity capital, covered by firms own resources
Estonia	Not spec. for employees, generally possible	No	No	No
Hungary	Not spec. for employees, generally possible	Also employees of controlled firms or organisations founded by employees	Both, free / discounted special "Employee Shares", no public offering	Spec. Free/discounted "Employee Shares"; limit: 15% equity capital; not transferable; obligation to sell back
Latvia	Firm may fully pay up stock, not transferable; for max. 6 months	No	Non-voting shares,max 10% of equity capital, covered by firms profit; no public offering	"Employee shares" municipal state / firms; not transferable; obligation to sell back
Lithuania	Not spec. for employees, generally possible	Advance funds or loan paid back by deductions from employees' salary	Non-voting shares for max. 3-year period in which share sale only to other employees	No
Malta	Without decision of General Assembly	For employees/of group firm; provided for does not endanger firm own funds	No	Free/discounted shares of mother firm for employees; no prospectus needed
Poland	Also retired employees/ affiliated firms; reserve needed	Reserve needed, also employees of affiliated companies	Financing from firms' profits / profit-sharing; no public offering	No
Slovak Republic	In acc. with articles of association	Provided for this does not endanger companies' own funds	By General Assembly decision	Preferential share offers, discount max. 70% covered by firms' own resources
Slovenia	Also retired employees and of associate firms	Also employees of associate companies	Financing from profit-sharing possible	No
Bulgaria	Not spec. for employees, generally possible	No	No	No
Croatia	Also employees of associated firms; reserve from profits needed	Reserve needed; must not endanger equity capital	Among others to fulfill employees' claims to acquire shares	No
Romania	Financed by profits and/ or distributable reserves	Yes	No	No
Turkey	Not spec. for employees, generally possible	No	No	No
Belgium	Without decision of General Assembly	Also firms founded by employees who hold more than 50% of voting rights	5years not transfe-rable, limit: 20% of equity capital; max. 20% discount	No
Den-mark	Limit: equity capital exceeds distributional dividend; share capital less own shares held must amount to not less than DKK 500,000	Also acquisition from employees; to extent that shareholders' equity of firm exceeds amount of not distributable dividends	Acc. to Art. of Asso-ciation issue of new / bonus shares; also subsidiary employees; authorisation up to 5 years each; also other than by cash payment	Deviation from subscription/ pre-emption rights by decision of General Assembly (2/3 of votes and equity capital) for benefit of employees
Ger-many	Without decision of General Assembly; also (former) employees / affiliated firms; reserve fund necessary without reducing of equity capital	Yes	Stock options for firms /affiliated employees; General Assembly de-cision; nominal amount of options restricted to 10%, that of increase to 50%of	In firms with individual share certificates number of shares to be increased to the same extent as equity capital is increased

	or reserve funds		equity capital	
Greece	Also personnel of ancillary firms	No	Shares / stock options, free / discounted; 3 years not transferable without General Assembly approval	No
Spain	Also for stock options	Yes	No	No
France	In context of share-based deferred profit-sharing scheme, share savings plan or stock option scheme	Also in subsidiaries or companies included in a group savings scheme	For all schemes; General Assembly decision required; no public offering; no voting rights	Employee stock options; Share-based deferred profit-sharing; Save-as-you-earn schemes
Ireland	Not spec. for employees, generally possible	Firm / group firm; provision of money / loans under share scheme; present / former employees and members of families	No	Finance Acts: Deferred share-based profit-sharing; Save-as-you-earn / Share purchase schemes
Italy	No	Value of assistance within distributable reserves	Pre-emptive right of shareholders can be suspended for up to 25% of new shares with majority General Assembly vote; more than 25% require majority of capital held	Special "Employees shares" can be issued in capital increase with specific rules for form, tradability and rights
Luxem-bourg	Yes, as minimum requirements of Directive	Limit: net assets of firm not lower than amount of subscribed capital plus reserves	No	No
Nether-lands	Also employees of group firm; without decision of General Assembly, if Articles provide; equity capital reduced by acqui-sition price not less than amount paid for shares plus reserve funds	Yes	No	No
Austria	Also employees of affiliated firms; reserve fund for own shares to be established without reducing of equity capital or other reserve funds; Stock options without decision of General Assembly, but consent of supervisory board	No	Stock options for firms /affiliated employees; General Assembly de-cision; nominal amount of options restricted to 10%, that of increase to 50%of equity capital ; limit of 20% of equity capital for total amount of shares receivable	In firms with individual share certificates the number of shares has to be increased to the same extent as equity capital is increased
Portugal	Not spec. for employees, generally possible, if partnership contract does not provide for anything else	Also to employees of affiliated firms; liquid assets mustn't become less than subscribed capital plus not distributable reserves	General ass may limit/abolish pre-emptive right of shareholders for "social reasons"	No
Finland	Not spec. for employees, generally possible	No	No special regulation with a view to employees	Act on Personnel Funds
Sweden	Not spec. for employees, generally possible	employees of firm/ group firm; total value limited; min.1/2of firms employees covered; advance/loan to be repaid within 5 years	General Assembly can suspend share-holders pre-emptive right of; also group firm; also wife / husband / children	No
UK	Not spec. for employees, generally possible	Firm / group firm; provision of money / loans under share scheme; present / former employees and members of families	No	Finance Acts: Deferred share-based profit-sharing; Save-as-you-earn / Share purchase schemes

Art. 19 para. 3 allows Member States to deviate from the restrictive rules governing exemptions from the general prohibition against a company acquiring its own stock. When the shares acquired by the company are earmarked for distribution to that company's employees or to the employees of an associate company, a general shareholders assembly decision is not obligatory although such shares must be distributed within 12 months of acquisition.[38] Art. 23 para. 2 allows, as an exception to the general prohibition against leveraging the acquisition of its own shares, to permit companies to advance funds, make loans, and provide security, with the intention of selling these shares to company employees. Art. 41 para. 1 further allows for deviations from general rules and restrictions to encourage employee financial participation during the process of raising additional capital. An example is the financing of the share issue from the companies' own funds or through a profit-sharing scheme. Finally, the opening clause of Art. 41 para. 2 of the Directive providing for the possibility of suspension of Arts. 30, 31, 36, 37, 38 and 39 for companies under a special law issuing collectively held workers' shares, has not been used except in the case of France[39].

As the table illustrates, surprisingly, a large majority of Member States adopted national legislation permitting a company to acquire its own shares in order to transfer them to its employees, and to facilitate this acquisition by financial assistance. Despite the fact that this legislation was rarely used in some countries, the existence of corresponding regulations across the EU may serve as a foundation for a European platform.

4. Compliance with the postulates of the European policy makers

4.1. Achieving competitiveness while maintaining diversity

Financial participation of employees is closely linked to the objectives of the Lisbon summit for making the European economy "the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion".[40] Our proposed European Platform refers – as does the Commission[41] – particularly to the experience of the U.S. that demonstrates the important impact such a model can have "in terms of economic growth, fostering industrial change and making sure that all workers participate in this growing prosperity". Therefore, in order to harness the potential – still largely unexploited in Europe – of the further development of financial participation as part of an overall strategy for stimulating the growth of new, dynamic companies as the Commission requires, we advocate the development of ESOPs.

Although the thesis that democracy requires a broad distribution of wealth is widely accepted, present social policy has not yet responded to the growing concentration of

[38] The general rules that (i) limit the nominal value of the acquired shares, including shares previously acquired by the company and held by it, and shares acquired by a person acting in his own name but on the company's behalf, to 10 % of the subscribed capital, (ii) require that the acquisitions may not have the effect of reducing the net assets below the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes and (iii) require that only fully paid-up shares may be included in the transaction still apply across the board.

[39] See Art. L.225-259 to L.225-270 of the French Commercial Code: Employee shares collectively owned by paid personell in a workers' commercial co-operative.

[40] See point 1.5 of the Presidency Conclusions of the Lisbon European Council (23-24.3.2000).

[41] Commission communication seeking "a framework for the promotion of employee financial participation", COM(2002)364 Final, 5 July 2002, pp. 3 and 10.

wealth; no regulations have come into force either on a national or a European level. Social attention so far has been focused on the growing wealth of the few (e.g., anti-monopoly legislation). Given this context, an open platform model ideally responds to the need for developing regulations concerning financial participation at the Directive level in order to support financial participation more actively and to overcome national differences in taxation policy. At the same time, such a legal framework, while providing a broader incentive system, delineates what is possible for companies without inviting sanctions from regulatory, legal and taxation authorities.

A legal foundation at the European level has to focus on “majority vote” regulations if it is to be successful. Thus it should encompass a broad incentive system which provides different and flexible solutions compatible with those already established in the Member States:

- Relatively widespread in the European Union are profit-sharing schemes, stock options and employee shares.
- In countries with an Anglo-American tradition, e.g., the United Kingdom and Ireland, ESOPs are also to be found;
- Central and Eastern European countries have developed share ownership systems (rather than profit-sharing schemes) with shares being distributed free or being sold at the market price or under preferential conditions.

The apparent difference in legal and political priorities between East and West is due to the fact that the first priority of post-socialist legislators is to change the socialist economic system through privatisation and re-privatisation. Therefore the development of these schemes does not necessarily constitute a progressive evolution of their pay system or their work organisation process.

The Building Block Approach reflects this diversity, while opening national practise to new forms of financial participation.

4.2. Meeting essential principles and overcoming transnational obstacles

The proposed European Platform fully complies with the essential principles of financial participation schemes which the Commission sets forth in the cited communication:

- All elements of the base scheme are voluntary for both enterprises and employees.
- The building blocks can be put together in any combination depending on the specific needs of the given enterprise so as to produce individually tailored, clear and comprehensible plans.
- Discrimination, e.g., against part-time workers or women, would exclude any national company scheme from being integrated into the supranational European Platform. The proposed share ownership schemes that have been established in the United States and the United Kingdom for decades include adequate training programs and educational materials which allow employees to assess the nature and details of the schemes.
- Unreasonable risks for employees are buffered by the diversity of the scheme. The dissemination practices for employee information aim at, among other objectives, raising the awareness of the risks of financial

participation resulting from fluctuations in income or from limited diversification of investments.

- By collecting the best practise of national legislation and customs, the rules on financial participation at the company level are based on a predefined formula clearly linked to enterprise results.
- The scheme is a complement to, not a substitute for, existing pay systems.
- It is the explicit aim of the scheme to be used throughout the European Union and as such to be compatible with worker mobility both internationally and between enterprises.

At the same time, the scheme seeks to address transnational obstacles identified by the Commission and Parliament[42] as imposing barriers to the development of a European model and to cross-border plans for financial participation:

- By providing a broad incentive system going beyond the classical instruments of tax legislation, the base scheme neither relies on nor excludes tax incentives.
- In spite of the difficulty of implementing tax incentives, these still remain a powerful tool for enhancing and broadening financial participation. They could be voluntarily granted by countries singly or in groups, creating in the process an increasingly favourable environment. The pro-activism of countries with an advanced tradition like France or the United Kingdom would at the same time encourage others to emulate them.
- Employee ownership in general, and the ESOP model in particular, are more likely to be independent of differences in fiscal systems and in social security contributions on income because the level of European harmonisation concerning share ownership is more advanced than in the field of profit-sharing.
- The research we are undertaking in the new Member and Candidate Countries[43] with reference to the experience of the EU–15 is helping to facilitate the avoidance of transnational obstacles, e.g., blocking periods when employees may not dispose of their shares.
- Our project, by providing information in a systematic way, is also helping to overcome the cultural differences in the social partnership as well as raising the new member countries' awareness of employee.

4.3. ESOPs: Giving innovation a thrust

In addition to well known forms of financial participation (e.g., employee shares and profit-sharing), the Building Block Approach introduces a lesser known but flexible form of collective share ownership: the ESOP. While, for example, share-based profit-sharing schemes have only one source of funds (i.e., the direct contributions

[42] Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a transnational dimension, Brussels, December 2003, p. 17ff.

[43] "The PEPPER III Report – Financial Participation of Employees in the New Member and Candidate Countries of Central and Eastern Europe" is an EU funded comparative study coordinated by the Inter-University Centre.

from the employer company), the ESOP can obtain financing from such different sources as:

- a loan from the employer company, a selling shareholder or from a financial institution such as a bank;
- dividend earnings;
- sale of shares to its related share-based profit-sharing scheme;
- contributions from the employer company.

A full or partial ESOP buy-out provides an ideal vehicle to facilitate transitions in ownership and management of closely-held companies. This field of action has recently been highlighted by the European Commission. In this context, having an internal market for stock is of major importance in unlisted SMEs having no other ready source of liquidity.

Furthermore, the capacity of ESOPs to easily buy-out one or more shareholders while permitting other shareholders to retain their equity position is one major advantage from the shareholders' perspective. The ESOP creates a market for retiring shareholders' shares at a price acceptable to the owner -- a market which otherwise might not exist. The result is the opportunity for shareholders to cash out gradually without giving up immediate control. The great virtue of an ESOP is that it can easily accomplish a 100% buy-out over time without subjecting the company at any given moment to 100% leverage.

While share ownership generally involves additional risk for employees, the ESOP avoids this consequence. Although employees, as in other share ownership schemes, are encouraged to allot part of their wealth into the shares of their own companies rather than other companies, resulting in concentrated rather than diversified risk, there is this fundamental difference: ESOP debt is funded by appropriately timed contributions from the company to the ESOT. Thus the scheme only provides an additional benefit to basic wages. The employee's salary remains untouched. There is an additional advantage to the company: Shares are not sold to outsiders; thus there is no risk of loss of control.

Finally, ESOPs make employees more motivated and productive while at the same time making enterprises more competitive.

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