

Employee share ownership: Opportunities and pitfalls - A corporate law perspective

Although employee share ownership (“*Actionnariat salarié*”/“*Medewerker-aandeelhouderschap*”) remains rarely used amongst Belgian companies compared with other European jurisdictions, it has become increasingly popular over the last years including amongst small and medium sized companies (SMEs). This trend could be further enhanced in the near future as a reform of the Act of 22 May 2001 on employees’ participation (hereafter the **Employees Participation Act**) is on the agenda of the newly established Arizona Government.

The current legislative framework offers limited tools to companies willing to implement an employee share ownership scheme and contains several pitfalls, but some corporate law tools can be used to create *sui generis* employee share ownership schemes.

What stands for “Employee share ownership”?

Employee share ownership is a broad concept which spans all legal, tax and HR mechanisms aiming at allowing a company’s workers to have a direct or indirect participation in its shareholding structure.

For which purpose and context?

Employee share ownership can serve many different purposes, but the establishment of an employee share ownership is often driven by one of the following major goals.

First of all, the allocation of shares to employees may help to motivate and inspire loyalty amongst a company’s workforce. As a reward of their contribution to the development of the company’s activities and growth, employees are offered the possibility to participate to the company’s profits and eventually make a capital gain. This will not only boost loyalty amongst existing workforce, but it may also help the company to attract new talents.

In SMEs, the establishment of an employee share ownership scheme may serve as a transmission plan by allowing the (progressive) transfer of shares to (a group of) workers or the management.

On top of that, an employee share ownership scheme is a good way for companies to increase their ESG performance score.

How to implement? Which corporate law tools are available?

The Belgian Code for Companies and Associations (**BCCA**) contains mainly one tool dedicated to employee share ownership through the issuance of discounted shares as organized by Article 7:204. The Employees Participation Act on the other hand organizes a specific participation regime allowing the issuance of free shares to employees under strict conditions. In practice, companies often opt for *sui generis* employee share ownership schemes.

1. Issuance of discounted shares

A *société anonyme/naamloze vennootschap* (SA/NV) may opt in for the specific regime organized under Article 7:204 BCCA and hence proceed to a capital increase through the issuance of new voting shares to all or part of its employees.

This regime is available only to SA/NV and is subject to strict conditions, including the followings:

- the company must have distributed at least two dividends during the three preceding fiscal years;
- the total amount cannot exceed 20% of the share capital of the company. The 20% cap is calculated by combining all capital increases achieved during the current fiscal year and the four preceding fiscal years with the contemplated capital increase;
- the shares can be issued with a discount of maximum 20% on the fair market value as determined by the board of directors; and
- the shares so issued cannot be transferred or otherwise disposed of for a period of five years, save in specific circumstances.

The capital increase requires an extraordinary shareholders' meeting resolution adopted with a special majority or, as the case may be in the context of the authorized capital, a board of directors' resolution.

The regime organized by Article 7:204 BCCA is optional. A company could therefore decide to issue shares to its employees outside the conditions provided therein. The advantage of complying with this provision mainly lies in its tax consequences, as discounted shares issued in this context benefit from special tax treatment.

2. Issuance of free shares

The Employees Participation Act allows companies to implement a participation scheme pursuant to which the employees can participate in the share capital of the company through the allocation of shares free of charge, while benefiting from a special tax regime.

The act requires compliance with a number of strict conditions, including the followings:

- the participation scheme must be drawn up in a collective bargaining agreement (or in an adherence deed for companies without union delegation) detailing the terms and conditions of the scheme;
- all employees concerned shall have the possibility to participate. The scheme may apply certain criteria linked to the employees' seniority but without exceeding one year;
- thresholds apply to the total amount that can be allocated to the scheme. The total amount cannot exceed one of the followings limits: (i) 10% of the total gross payroll or (ii) 20% of the profit for the fiscal year (after tax);
- the shares cannot be transferred or otherwise disposed of during a period of minimum two years and maximum five years, save in certain circumstances specifically foreseen by the act.

From a corporate law perspective, the scheme shall be implemented through a capital increase in cash by capitalisation of reserves and the allocation of free shares with voting rights to the relevant employees. The capital increase in cash shall be completed in accordance with the provisions of Article 7:177 and subs. of the BCCA. The provisions of the Employees Participation Act can also be combined with the legal regime provided for by Article 7:204 BCCA, although there is no obligation to do so.

Although the regime offered by the Employees Participation Act may seem *prima facie* attractive, the strict conditions required for its implementation as well as the pitfalls that the act fails to address result in this regime being rarely used in practice.

3. Sui generis employee share ownership scheme

Due to the restrictive current legislative framework specifically dedicated to employee share ownership, a series of legal constructions, whose form and content greatly vary depending on the circumstances and set goals, have developed in practice.

One possible structuration consists for the existing (historic) shareholders of a company to incorporate a newco by contributing a certain percentage of the company's shares to newco. The shares in newco are subsequently (and progressively) sold to employees. Newco hence serves as a special purpose vehicle in which the participating employees are pooled and acquire an indirect participation in the company.

When implementing such *sui generis* scheme, several strategic corporate law features must be considered:

- **Choice of legal form:** Newco shall be incorporated in the form of a *société à responsabilité limitée/besloten vennootschap* (SRL/BV) for the flexibility offered by the latter notably in terms of exit rights.
- **Series of shares:** In principle, each share has the same voting and financial rights. The BCCA however offers great flexibility allowing for many variations that fit the needs of each specific situation. A company may issue different series of shares having different rights and advantages. In practice, two series of shares are generally created. Historic shareholders will typically hold shares offering a veto right on strategic decisions but no rights to dividends, while the employees will be pooled into the same series of shares offering a right to dividends and a right in the liquidation profit.
- **Governance:** Governance rules must be cautiously detailed in a shareholders' agreement and the articles of association of newco to allow the historic shareholders to keep a certain control over the governance of newco, while ensuring that the employees pooled in the newco are also involved in the governance of the company.
- **Newcomers:** The shareholders' agreement and articles of association shall also establish the applicable rules and relevant criteria that each employee must satisfy to be eligible and to become a shareholder of newco (e.g. seniority, position within the company, etc.). This will generally take the form of an approval clause. It might also be considered to set specific window periods during which the entry of additional employees will be assessed and approved.
- **Share transfers, exit rights and obligations:** The liquidity of shares and exit mechanism are key for any employee share ownership scheme. There are different tools (that can be combined as the case may be) to organise the liquidity of the shares. Here are some of the main tools that can be used to serve this purpose:
 - *Put and call options:* The historic shareholders may have a call option on shares held by the employees and the employees may have a put option on their shares towards the historic shareholders and/or newco, both being exercisable under certain conditions and at a predefined valuation or at a valuation to be determined on the basis of a predefined formula.

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- *Redemption of shares:* Under Article 5:145 BCCA, a SRL/BV may acquire its own shares under certain conditions. Note that a prior resolution of the general assembly of shareholders is not required if the shares are acquired to be distributed to employees. The redemption of shares mechanism can be used to facilitate the exercise of the put option by the employees and allow the company to have a pool of shares available for distribution to potential new eligible employees.
- *Resignation right:* Pursuant to Article 5:154 BCCA, shareholders of a SRL/BV may be entitled to resign in their capacity as shareholder against repayment of their shares by the company at a predefined valuation. The resignation may be limited to specific circumstances and specific conditions. Similarly, the articles of association of the company could also provide that upon occurrence of certain events, a shareholder will *de facto* be considered as having resigned from the company and will be entitled or not to the repayment of his/her shares.

The abovementioned features are not exhaustive. Corporate law offers various opportunities for creative *sui generis* schemes.