The New German Law on Employee Capital Participation

- The rules on Special Funds for Employee Participation in a European Comparison

- Employee Stock Ownership Plan (ESOP) as an Alternative for SMEs

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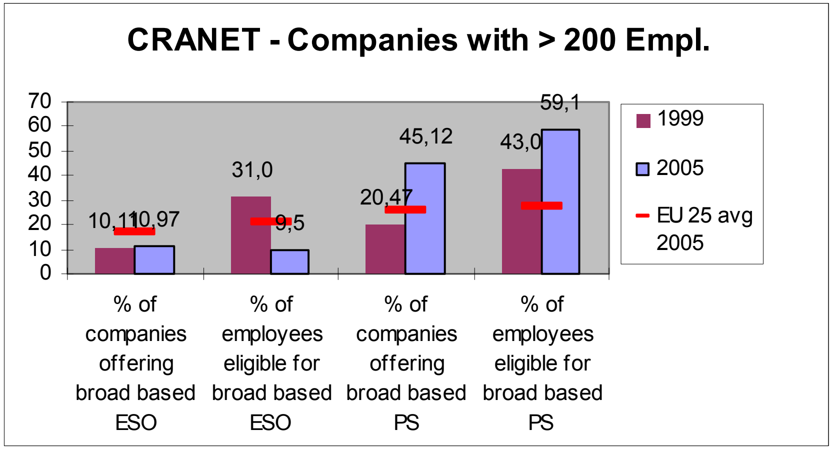
Germany: Dynamics of Employee Shareholding is Negative

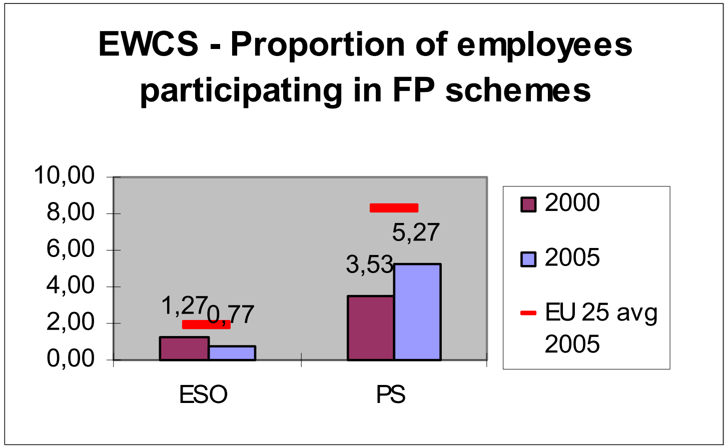
Profit Sharing (non-subsidized) more disperse than Employee Shareholding:

- PS 2005: 9% IAB-Study / 11% BISS-Project
- ESO 2005: 2% IAB-Study / 3% BISS-Project

Employee shareholding:
(AG = listed joint stock company / GmbH = unlisted limited liability company)

- Plans 2006: 620 AG 1.4 Mln. Emp. / 250 GmbHs 8.000 Emp. (AGP)
- Decrease of Employee Shareholders from 1.6 Mln 1998 to 1 Mln 2008 (DAI)





New Law on Employee Capital Participation

Art. 1 – Amendment of Personal Income Tax Law (PITL)

- Tax/SSC exempt Employer Allowance risen: Euro 135,- to 360,-
- Scheme must be offered „on top" to all Employees >1Year with firm

Art. 2 – Amendment of Law on Asset Formation (5.AssFL)

- State Savings Bonus risen: 18% to 20% (max. Euro 80 / year)
- Eligibility Income-limits altered: Euro 17.900/35.800 to 20.000/40.000

Art. 3 – Amendment of Investment Law (InvL)

- Introduction of new „Special Fund for Employee Participation"
- Non-bonded Holdings / Non-listed Securities, including Silent Partnerships eligible "Assets" according to InvL
- For Enterprises that grant their Employees Employer Contributions to acquire Shares in the Special Fund

Composition of the German Special Fund for Employee Participation

(Limits for certain types of assets / issuers in % of total value of the Special Fund)

Funds governed by Investment Law (InvL) / Target Group: esp. SME

<table>
<tr>
<td colspan="2">min. 60%
qualified assets of enterprises that grant their employees contributions in order to acquire shares in the Special Fund
max. 20% of a single Enterprise/Group</td>
<td>max. 40%
qualified assets of other enterprises / other investments</td>
</tr>
<tr>
<td>up to 100%
• listed securities
• selected financial instruments
• non-bonded loan-claims</td>
<td>max. 25%
• non-bonded holdings
• non-listed securities</td>
<td>max. 5%
of each Issuer / Investment fund:
• Listed securities
• Blocked current account
• Money market: cash equivalents
• Investment shares
• Derivatives</td>
</tr>
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Each Fund for many SMEs / no Choice for Employees
Focus SME: Investment in 5 Enterprises each 20% theoretically possible
Limits for issuers for Diversification 20% / 5%
Max. ceiling for investments in illiquid assets 25% / in liquid assets 40%

Necessity to create „Special Fund“ Vehicle

Specific Structure of German Economy / high share of SME

1987 extension of Matching Contribution to GmbH shares boosted ESO

GmbHs: 28% of Enterprises but create 50% of employment (see Austria)

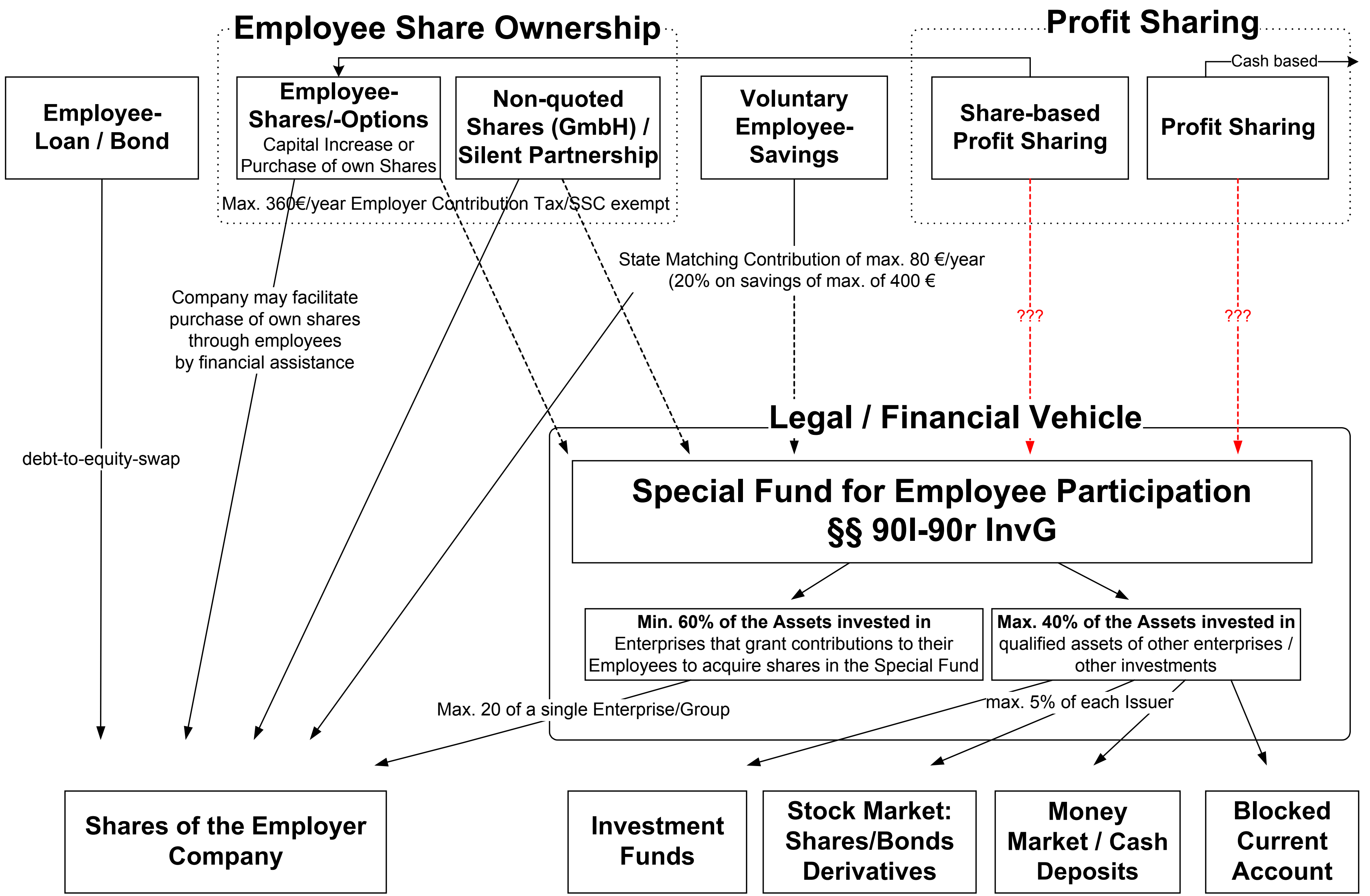
P: Minimum Re-Investment quota 60% / Law does not specify:

- Who will set up the Special Funds and whether participating Companies choose Fund-Managing-Firm or vice versa
- Single company may apply for Re-Investment, but has no right to actually receive financing from a Special Fund
- Special Funds may be Branch-Funds / set up in cooperation with Employers Association and/or Trade Unions

Solution left to ”invisible hand of the market“ / Vital questions:

- Is the model suitable to convince interested Companies?
- What are the advantages to existing Investment Funds?

The German System of Financial Participation



Model of „Special Fund“ not feasable

Inherent Contradiction between aims to:

- enhance ESO in employer company, as a source of finance for SME
- ensure the independent investment policy of the Special Fund aiming at maximum return

as well as with regard to rules of Investment Law (InvL):

- Composition of Special Fund invested largely in illiquid assets of SMEs
- Principle of “Maintenance of Liquidity” of the Special Fund

- **Illegitimate Risk Concentration**: § 90m II S. 1 InvL, Investment of up to 100% of funds assets in only 5 Enterprises
- **Limitations for certain types of assets questionable:** min.60% largely illiquid assets / max. 40% quoted securities
- **Who actually participates?** Economies of Scale: need to reach „critical mass“ to ensure reasonable Administration Cost

Crucial point: Sufficient number of interested Companies/Investment Funds?

Financing of the Special Funds Assets

each Fund\ 830€ p.a	2 Mln. participating Employees (today)	3 Mln. participating Employees (Plan)
25% Quote of Particiaption (4 Funds)	420 Mio	630 Mio
10% Quote of Particiaption (10 Funds)	168 Mio	252 Mio
5% Quote of Particiaption (20 Funds)	84 Mio	126 Mio

Best Case Scenario: After 3 years an allocation of Euro 5-7.5 Bln. totalling in a number of approximately 30 Special Funds

each Fund\ 360€ p.a	2 Mln. participating Employees (today)	3 Mln. participating Employees (Plan)
25% Quote of Particiaption (4 Funds)	180 Mio	270 Mio
10% Quote of Particiaption (10 Funds)	72 Mio	109 Mio
5% Quote of Particiaption (20 Funds)	36 Mio	63 Mio

Optimistic Scenario: After 3 years an allocation of Euro 2-3 Bln. totalling in a number of approximately 15 Special Funds

The Problem: „Mature market economies“ have massive Business Succession Problem

- **Commission Communication 2006**

Due to aging of Europe’s population

30% of entrepreneurs will withdraw within next 10 years

mainly those running family enterprises

This affects affect up to 690,000 SMEs and 2.8 million jobs across EU *every year*

Primily mature market economies: 610.000 in EU-15

- **Study Deutsche Bank Research May 2007**

less than 50% of Firms will find a successor in the family

10% plan EBO

21% look at sale to outsiders

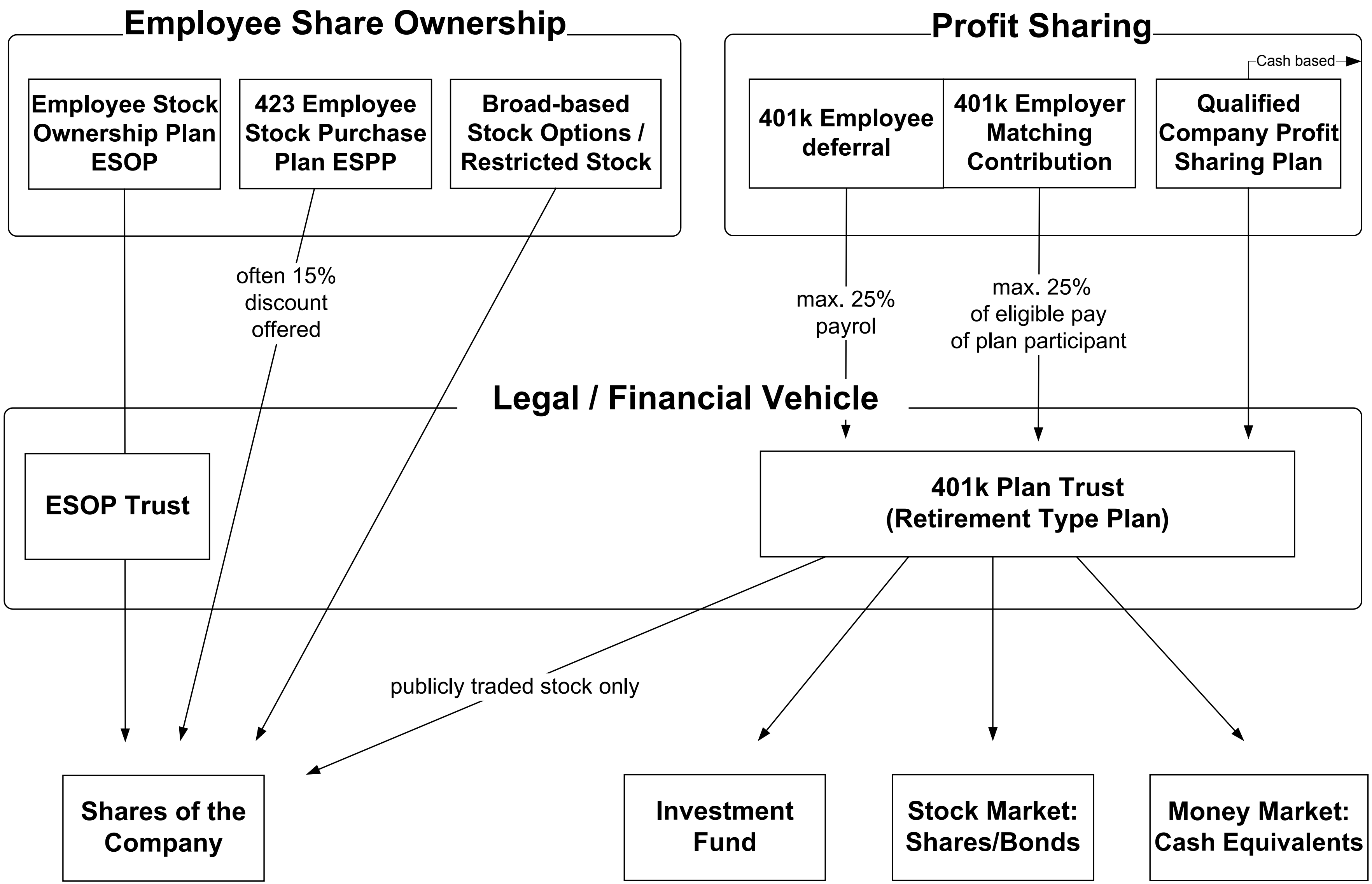
Growing interest of international investors in German SMEs

process threatens successful regional structure of European (family-owned) businesses

U.S.-Alternative: Diversified Fund (401k) <u>and</u> Employee Stock Ownership Plan (ESOP)

- **Company establishes Employee Share Ownership Fund**
  - Continental Europe: Corporation/Foundation/Association
  - Anglo-american law: as a rule a Trust
- **Usually financed by a Combination of**
  - Company Contributions and Borrowings
  - Credit directly from Bank or from Company, which in turn takes Loan from a Bank or other Lender
- **Loan may be repaid by**
  - direct cash contributions from the company to the trust ESOP,
  - monies from sale of shares to the share-based profit-sharing scheme
  - dividends on the shares held by ESOP
- **ESOP-Fonds holds Shares in Trust for Employees**
  - Shares allocated to individual accounts/distributed after holding period
  - Period determined by Trustee, driven by the need to repay borrowings

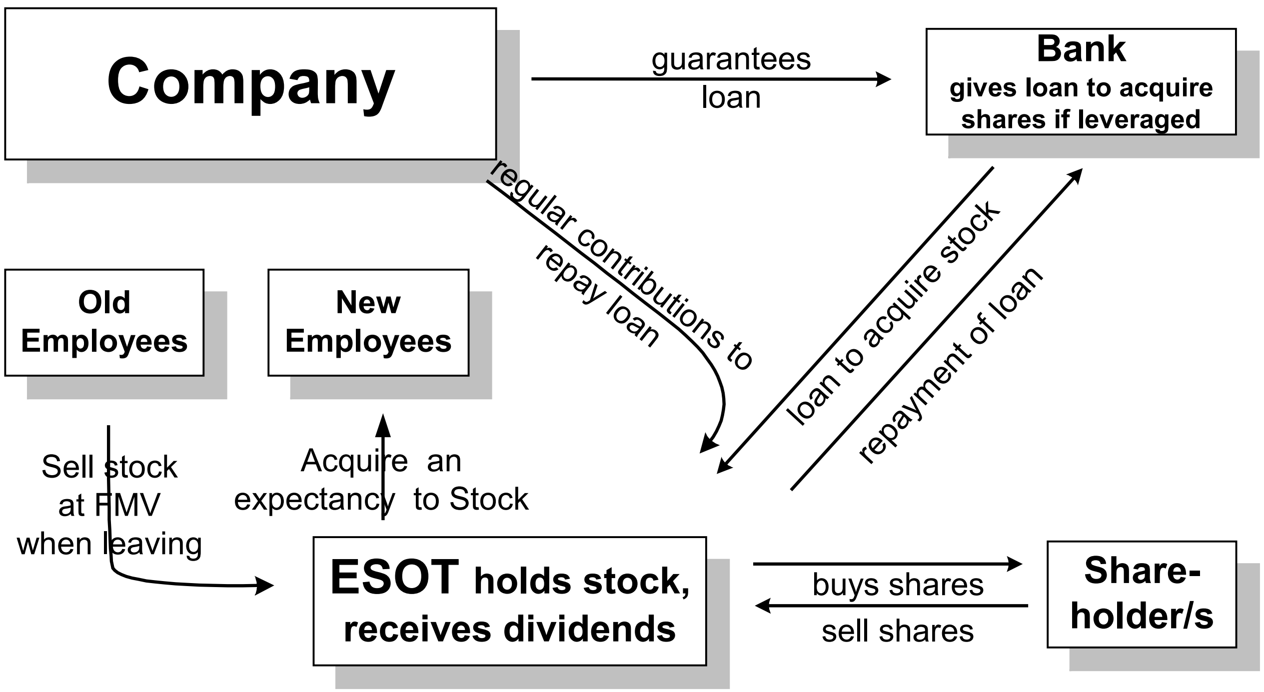
U.S. System of Financial Participation



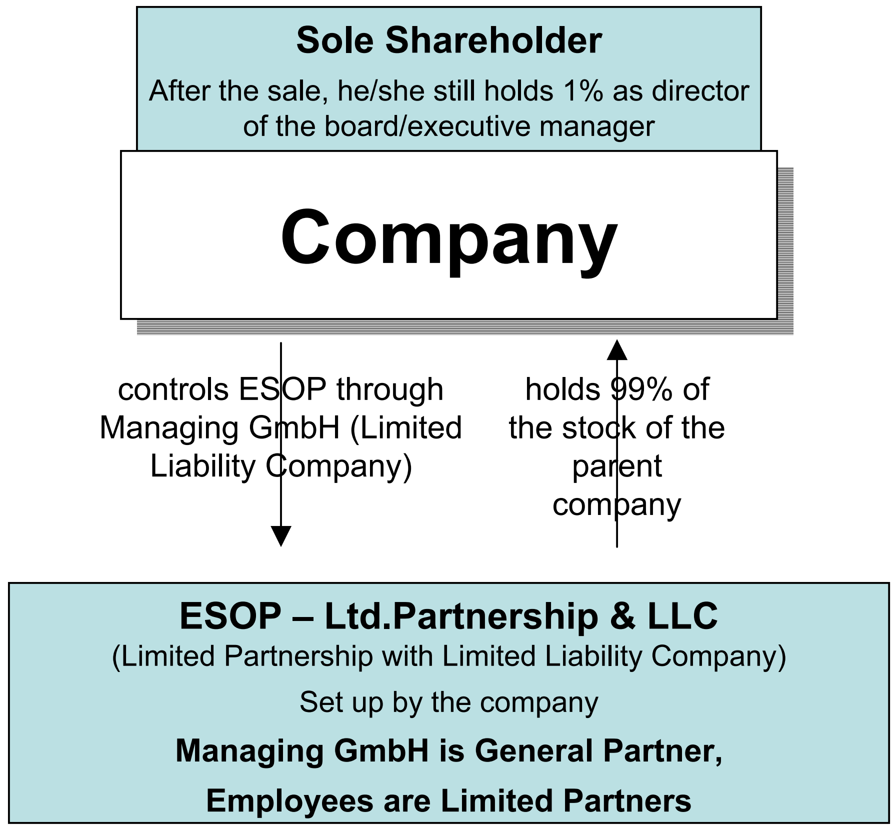
ESOP as a Vehicle for Business Succession in SMEs

- **Internal Market in unlisted SMEs without source of Liquidity**
  - All shares are bought at Fair Market Value
  - Owners may diversify Investment Portfolios without going public
- **No Dilution in Equity per Share of current Stockholders**
  - No new Shares are issued
  - Buy-out Shareholder, permitting others to retain their Equity Position
- **Attractive Alternative to selling the Business to Outsiders**
  - Keeping Control of Business within a Family or a Key-Employee Group
  - Opportunity of gradually cashing out without giving up immediate Control
- **Creates Market for retiring Shareholders at acceptable Price**
  - Ownership is transferred gradually to motivated Employees
  - Who have a vital Interest in the Company’s long-term Success
  - The Company remains local

ESOP as a Vehicle for Business Succession in SMEs

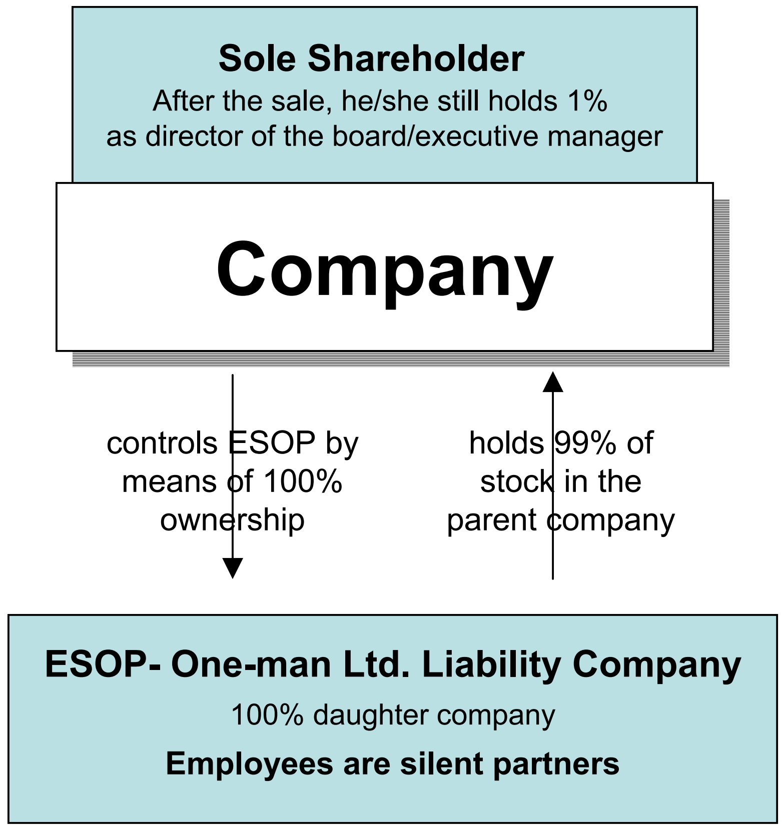


EU-Model 1
ESOP-Ltd. Partnership with Ltd. Liability Company



The ESOP has the right to pre-empt the sole shareholders' 1% share in the event of his death.
Then the company will be managed by a management board consisting of (1) representatives of the employees and of (2) the management and a neutral third person (e.g., AGP).

EU-Model 2
ESOP - Limited Liability Company Daughter



The ESOP has the right to pre-empt the sole shareholders' 1% share in the event of his death.

Problem: In this case, the ownership of ESOP–Limited Liability Company and the ownership of the parent company are concentrated in one entity.

EU-Model 3
ESOP – Limited Liability Company Trusteeship