Equity Comp Awards Traps for the Unwary: Did I or Didn't I Just Grant an Award?

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PRACTICES Employee Benefits and Executive Compensation

Companies that sponsor equity compensation plans often include provisions related to future equity awards for service providers in non-plan related documents such as offer letters, employment agreements, and agreements with other service providers (*e.g.*, consultants or non-employee directors). Usually, the references to these future grants are intended to memorialize the service provider's compensation and are not intended to affect the actual grant. However, whether or not the grant is intended to be made in the non-plan related document may not matter if the recipient relies on the promises made in the document. For instance:

- If the provisions are too specific, the provisions could be interpreted by the recipient (or a court) as making the grant of the award. This is problematic if the company's board or compensation committee did not actually approve the grant (or the agreement that included the reference to the grant). Moreover, the non-plan related document likely does not include any of the provisions routinely included in plans and grant agreements relating to securities laws, tax withholding, or key definitions of terms that would impact vesting, like "change in control."

- If the provisions are too vague, there could be a disagreement between the company and the recipient when the award is actually granted as to what the terms and conditions of the award were intended to be. Even if the underlying award is granted by an award agreement, if that award agreement does not include very clear language stating that it is the final agreement and supersedes all prior agreements, the recipient may try to argue that the terms that are most favorable to recipient should apply (which may be the terms in the offer letter, employment agreement, or consulting agreement). Moreover, if the company never issues the award, a host of other issues can arise, including the intended recipient demanding years later that the company honor the award (which usually occurs when a change in control is announced and the promise of equity did not require continued employment for the award to vest).

Regardless of whether the terms are too specific, too vague, or "just right", if the company and recipient never enter into a formal grant agreement, besides the risk of litigation from a disgruntled service provider, there are risks that the company's cap table could be incorrect (which could impact capital raises or funding rounds), the company could grant shares in excess of plan limits, or that a potential buyer could raise issues during due diligence in connection with a corporate transaction that negatively impacts the purchase price.

While it is easy to see how what was intended to be an innocuous equity comp provision can lead to such unintended consequences, there are some simple steps, as outlined below, that companies can take to help protect themselves against such negative results. Before any provisions are added to non-plan related documents regarding equity grants, the company's HR department should confirm that there are sufficient shares available under the company's equity comp plan for the

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grant and should let in-house or outside legal counsel know of the desire to grant an equity award so that they can prepare the necessary approvals and award documents.

- Equity-related compensation provisions in non-plan related agreements should include consistent, form language that conditions the award on subsequent board/committee approval and the recipient's execution of the relevant plan documents (*e.g.*, an award agreement). If the company uses a form award agreement, the company should also consider attaching the form award agreement as an exhibit to the offer letter, employment agreement, or consulting agreement.

- The company's HR department should adopt a standardized practice related to equity awards during a new employee's or other service provider's onboarding with the company, as well as around equity grants generally.

- The company should work with its in-house or outside counsel to ensure that its equity award procedures comply with the relevant employment, tax, and securities rules.

By taking such steps, and any other steps the company considers, with the advice of counsel, to be prudent, the company can help mitigate, or even avoid altogether, traps for the unwary related to its equity comp practices.

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