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Time for a Checkup for Your Equity Incentive Plan?

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Let’s take a break from worrying about the global pandemic to check on the health of your equity incentive plan. While we recommend that clients conduct a checkup every year, it is even more important when the economy is less stable.

The following outlines some of the best practices in reviewing equity incentive plans maintained by privately held companies. Publicly traded companies should engage in the same exercise, but are advised to consider slightly different issues in light of the impact of Institutional Shareholder Services (ISS) and/or Glass Lewis, securities regulations, and listing requirements.

- **Review the Share Reserve** – Review your share reserve to confirm that the plan has a sufficient number of shares remaining for future awards. Some companies may know exactly how many shares they will need for the upcoming year. Others may prefer to rely on metrics like burn rate (generally, the rate of share usage) over the past three years to help project future usage. If the company anticipates a need to replenish the equity plan reserve, then review plan documents and governing law to determine what is required for board of directors and/or shareholder approval.

- **Check the Expiration Date.** New awards may not be granted under an expired plan, so confirm whether the plan has an expiration date. If the plan is expired, the term will have to be extended or a new plan should be adopted. The best approach depends on the types of awards to be issued and corporate governance requirements (and sensitivities).

- **Repricing?** Some companies are realizing that options granted in early years may be “underwater” – i.e., the exercise price is greater than the current fair market value of the underlying stock. In that case, there may be a desire to reprice the awards because underwater options do not provide the intended incentives to executives. Be sure to review plan documents to determine whether repricing is permitted in this situation and whether shareholder approval is required. Also, consult your advisors to be sure that the repricing does not interfere with ISO treatment or violate Section 409A of the Internal Revenue Code.

- **Review Performance Metrics.** If vesting of any outstanding awards is contingent on the attainment of certain performance metrics, review the metrics to determine if they are still reasonable and sufficiently motivating to executives. If the recent economic slowdown significantly impacted an executive’s ability to hit certain targets, then the award will no longer provide the desired incentives. As with repricing, be sure to review plan documents to determine whether (and how) performance metrics can be modified.

- **Governance.** Double-check plan/corporate governance and documentation requirements. For example:
    - Review the plan document and award agreement to determine what needs to be approved by the board of directors and/or shareholders and check corporate records to confirm that such approvals have been sufficiently documented.
    - Confirm receipt of fully executed award agreements and, if required, shareholders agreements for all outstanding awards.

Review delegation provisions in the plan document to confirm that the document is consistent with your company’s practice. Has the Board of Directors delegated authority to a committee or individual? If so, was that delegation lawful under corporate law?

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