Published on *The National Law Review* https://natlawreview.com

Who Can Approve Equity Awards?

Article By:

Joshua A. Agen

A multitude of questions over who must approve the grant of equity awards frequently arise when designing equity compensation programs. Do shareholders need to approve the grant? Is approval from the Board of Directors required? Or, is approval from the Chief Executive Officer or another executive sufficient?

The answers to the questions presented above can vary depending on the law and documents that apply to the company and the specific scenario. This article summarizes six sources of authority that a company should consult to determine the level of approval required when making equity grants.

1. State Corporate Law

The first source of authority for granting equity awards is the corporate law of the state in which the company is incorporated. These laws will frequently indicate that the Board of Directors must approve the issuance of stock and specify what consideration must be paid for the stock. Because the issuance of new stock can dilute the existing shareholders, the Board of Directors' fiduciary duties to the shareholders are involved in a decision to issue new stock. When approving the issuance of stock, the Board of Directors should evaluate what consideration (services or cash) the company will receive, determine that the consideration will be adequate and that, as a result, the stock will be validly issued, fully paid and non-assessable.

Some state corporate laws allow the Board of Directors to delegate its authority to issue stock. For example, Delaware recently amended the Delaware General Corporation Law to authorize broad delegation for stock awards, within certain limitations:

"A resolution of the board of directors may delegate to a person or body, in addition to the board of directors, the authority to enter into 1 or more transactions to issue stock, and with respect to such transactions, shares of stock may be issued in the numbers, at the times and for the consideration as such person or body may determine; provided the resolution fixes (i) a maximum number of shares that may be issued pursuant to such resolution, (ii) a time period during which such shares may be issued and (iii) a minimum amount of consideration for which such shares may be issued. No such resolution shall permit a person or body to issue stock to such person or body."

Delaware General Corporation Law §152(b). The Delaware General Corporation Law likewise

authorizes delegation for grants of stock rights and stock options under Section 157(c).

Under this delegation authority, the Board of Directors may delegate to a *person or body* the authority to grant stock. It is worth noting that the delegation is not limited to executives, or even employees, of the company. However, in delegating, the Board of Directors must specify three parameters:

1. The maximum number of shares that may be issued under the delegation

2. The time period in which the shares may be issued under the delegation

3. The minimum consideration to be received for the shares

Any delegation of authority approved by the Board of Directors of a Delaware corporation should, therefore, specifically address these three categories.

Companies incorporated in states other than Delaware should consult their states' laws to determine whether delegation is permitted and whether there are limits on that delegation.

2. Securities Laws and Stock Exchange Rules

For publicly traded companies, another consideration in determining who must approve equity awards is the Securities Exchange Act of 1934, as amended (Exchange Act). Section 16 of the Exchange Act governs transactions by i*nsiders*, such as officers and directors, in company stock. One part of Section 16 requires insiders to repay to the company any profit made on matchable purchases and sales of company stock within a six-month period (known as the *short-swing profits rule*). Equity awards could be seen as involving a *purchase* of company stock, and withholding shares from equity awards to cover taxes or an exercise price could be seen as a *sale* of company stock, meaning that equity awards could risk triggering the short-swing profits rule.

One way to exempt these types of transactions between an insider and the company from the short-swing profits rule is to have a committee of non-employee directors, or the full board of directors, pre-approve the transaction. This pre-approval is often secured by having the compensation committee approve the grant of equity awards to insiders.

For publicly traded companies, in addition to the Exchange Act, the listing standards of the NYSE and NASDAQ impose approval requirements that apply to equity compensation. Specifically, both of these securities exchanges require that any equity compensation be approved by shareholders and that the compensation of executive officers – including equity compensation – be approved (or recommended to the full board) by a committee of independent directors. Typically, these requirements are addressed by obtaining shareholder approval of an equity incentive plan that authorizes a share reserve from which shares may be granted, and by having the compensation committee approve (or recommend to the full board) equity awards to executive officers.

3. Tax Laws

The US federal tax laws do not generally address the level of approval required for equity awards, but the tax rules that govern the qualification of so-called *incentive stock options* require that the options be granted under a shareholder-approved plan. This shareholder approval must be obtained within 12 months before or after the plan is approved by the Board of Directors.

4. Articles or Certificate of Incorporation and Bylaws

Some companies' articles, certificate of incorporation, or bylaws will address the level of approval required for equity awards, or impose other limitations on equity awards, so it is advisable to review these documents in determining the level of approval required for equity awards.

5. Shareholders Agreements

Some companies have agreements with shareholders, or among shareholders, that will impose limitations or approval requirements on the grant of equity awards. For example, the grant of equity awards over a specified amount may require consent from a significant shareholder or group of shareholders.

6. Delegation Policies

To the extent the statues and documents above allow a delegation of authority, it may be desirable for a company's Board of Directors to establish a policy allowing the CEO or other appropriate person (for example, the CHRO) to make awards to non-insiders within prescribed parameters. Such a policy can permit the company's management to respond in real-time to rapid developments, such as a recruitment or retention need, without having to wait for compensation committee or Board approval. Such delegation policies should specify appropriate parameters, such as the number of shares that may be granted in any year, and provide for appropriate accountability, such as reporting back to the Board of Directors or compensation committee on grants made between meetings under the policy. In light of the increasing scrutiny of grant timing practices, it may also be advisable to include provisions in a delegation policy that will guard against opportunistic timing of grants, such as a requirement for publicly traded companies that all grants made under the policy will become effective shortly after the next quarterly earnings release.

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National Law Review, Volumess XIII, Number 172

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