

Employee Inducement Awards: No Need for Shareholder Approval

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Business Point

Public companies should consider employee inducement awards and inducement plans as a tool in its overall compensation and equity strategy. A public company can grant “inducement awards” of equity or equity-based compensation to newly hired employees (including with respect to employees of the target in M&A transactions) outside of the company’s shareholder-approved equity plan and without otherwise having such awards approved by shareholders, if certain requirements are met. In addition to not requiring shareholder approval, such awards will not count against the company’s equity plan share reserve or be subject to any individual share limits in the equity plan.

Technical Points

Generally, the NYSE and NASDAQ listing rules require that grants of equity compensation be made pursuant to a shareholder-approved equity plan. However, under NYSE Listing Company Manual Rule 303A.08 and NASDAQ Listing Rule 5635(c)(4), a public company can grant equity without shareholder approval if the following requirements are met:

- (i) the award must be a material inducement to the person being hired (or rehired following a bona fide period of non-employment),
- (ii) the award is granted only to a prospective employee (and not to a director or consultant),
- (iii) the award is approved by the company’s independent compensation committee or by a majority of the company’s independent directors, and
- (iv) promptly following the grant of an inducement award, a press release is issued disclosing the material terms of the award, including the recipient of the award and the number of shares involved. Note that the filing of an 8-K does not satisfy the press release requirement.

In addition to the requirements above, a company considering offering inducement awards or implementing an inducement plan should keep the following in mind:

- (i) shares related to these awards will not be covered under the shareholder-approved equity plan's S-8, so registration of such shares should be considered,
- (ii) the Section 16 insider trading rules are not affected by the exception,
- (iii) while shareholder approval is not required for the grant of these awards, it may be required if the award is later amended,
- (iv) the awards may be required to be disclosed in the company's 10-K and/or proxy statement, including, if granted to a named executive officer, disclosure in the compensation discussion and analysis portion of the proxy statement, and
- (v) while such awards will not be subject to individual grant limits under a shareholder-approved equity (which were historically included for purposes of qualifying for the exception to the \$1,000,000 limit on tax deductibility, which has since been repealed subject to limited grandfathering), such awards could receive increased scrutiny in the future from shareholder advisory firms such as Institutional Shareholder Services (ISS) in analyses of, for instance, shareholder value transfers and overall corporate governance.

A public company has flexibility in structuring these inducement equity arrangements, such as offering individual inducement awards or establishing an overall inducement plan, which can offer awards systematically and consistently to groups of prospective employees. Neither of these strategies, if the requirements above are met, would require shareholder approval. In addition, companies also can use almost all types of equity and equity-based compensation in these inducement awards, such as restricted stock, stock options, stock appreciation rights, phantom stock/restricted stock units and performance-based awards. However, a company could not grant incentive stock options, because, pursuant to federal law, such options must be granted pursuant to a shareholder-approved plan.

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