

Employee Memorandum: Explanation of Equity Award Treatment in IPO

A Lexis Practice Advisor® Annotated Form by Henrik Patel, White & Case LLP



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FORM SUMMARY

Use this Employee Memorandum: Explanation of Equity Award Treatment in IPO as an explanatory memorandum outlining how an upcoming initial public offering (IPO) will affect the outstanding equity awards of employees of a privately-held corporation. This form contains practical guidance, drafting notes, and alternate and optional clauses.

The default language in this form assumes that the employee holds nonqualified stock options, incentive stock options, stock appreciation rights (SARs), restricted stock, and/or restricted stock units (RSUs) of a privately held corporation and that the awards will continue in effect following the IPO.

For other memoranda describing the effect of a corporate transaction on outstanding equity awards, see [Employee Memorandum: Explanation of Equity Award Rollover in Corporate Transaction](#), [Employee Memorandum: Explanation of Equity Award Cash-out in Corporate Transaction](#), [Employee Memorandum: Explanation of Equity Award Treatment in Spin-Off \(Parent Employees\)](#) and [Employee Memorandum: Explanation of Equity Award Treatment in Spin-Off \(Spinco Employees\)](#). For information on the treatment of equity awards in a corporate transaction, see [Equity Award Treatment in Corporate Transactions](#). For information on equity award generally, see [Equity Compensation Types and Tax Treatment](#). For information on compensation considerations in an IPO, see [Executive Compensation Considerations in IPOs](#). For information on steps to take before an IPO, see [Going Public: Client Preparations](#) available in the Capital Markets and Corporate Governance practice area.

CONFIDENTIAL

TO: *[employee's name]*

FROM: *[contact name, title, company name]*

DATE: *[date]*

SUBJECT: Effect of an IPO on Outstanding Equity Awards

As you know, *[company name]*, a *[state of incorporation]* corporation (the "Company"), is in the process of implementing an initial public offering of its common stock (the "IPO") that is currently expected to occur on or about *[date]* (the "IPO Date"). In connection with the IPO, the Company will sell shares of its common stock ("Shares") to the public at a price per Share which is currently expected to be between *[\$amount]* and *[\$amount]*. The Shares are expected to begin trading on the *[exchange name]* on the IPO Date.

Drafting Note to First Paragraph: This opening paragraph provides a brief description of the company's upcoming IPO. The description assumes that prior to the IPO, the company is private C-corporation and that no reincorporation will be effected in connection with the IPO.

This memorandum describes how the IPO will affect the outstanding equity awards you hold under the Company's *[names of the Company's equity incentive plan(s)]* ("Equity Awards"), as well as a summary of certain rules applicable to the resale of Shares acquired pursuant to your Equity Awards following the IPO.

A. General Treatment of Equity Awards

The number of Shares and exercise price per Share (if applicable) of your Equity Awards will not be affected by the IPO. Except as otherwise described below, the other terms and conditions of your Equity Awards, including the vesting schedule, are also not affected by the IPO. Exhibit A: attached hereto lists your outstanding Equity Awards, along with the number of Shares underlying each award and exercise price (if applicable).

Drafting Note to Section A. You should review the applicable plans and agreements evidencing the outstanding equity awards, to confirm whether an IPO will have effects other than as described below. If, for example, the vesting of certain awards will accelerate upon the consummation of the IPO, you should tailor this section to describe which awards are subject to accelerated vesting and which are not, as well as other related conditions affecting the awards. If the company is performing a reverse stock split in connection with the IPO, use the language in Alternate Section A. instead.

Alternate Section A.:

A. Adjustment of Equity Awards

In connection with the IPO, the Company will be effecting a [number]:1 reverse stock split (the "Reverse Split"), pursuant to which [number] Shares will be converted into one Share. Pursuant to the terms of the applicable Company equity plans and the agreements evidencing your outstanding Equity Awards, the awards will be adjusted ratably to reflect the Reverse Split. Accordingly, after the Reverse Split, the number of Shares subject to your Equity Award will be equal to the number of Shares subject to the Equity Award that were outstanding immediately prior to the Reverse Split, divided by [number], with the result rounded down to the nearest whole Share.

In addition, to the extent that an Equity Award is a stock option or a stock appreciation right (SAR), the per Share exercise price applicable to the Equity Award will be equal to the original exercise price per Share, multiplied by [number], with the result rounded up to the nearest whole cent.

For example, if the Company effects a 1:2 Reverse Split and, prior to the Reverse Split, you had an option to purchase 1,000 Shares at a price of \$1 per Share, then, after the Reverse Split, you would have an option to purchase 500 Shares (1,000 Shares divided by 2) at a price of \$2 per Share (\$1 per Share multiplied by 2).

Exhibit A: attached hereto lists the number of Shares subject to each Equity Award (prior to giving effect to the Reverse Split as well as after giving effect to the Reverse Split) and the exercise price per Share (if applicable) with respect to your Equity Awards (prior to giving effect to the Reverse Split as well as after giving effect to the Reverse Split).

Except as otherwise described below, the other terms and conditions of the Equity Awards, including the vesting schedule, are not affected by the IPO.

Optional Section B.:

B. Treatment of Restricted Stock Units ("RSUs")

The Company previously granted you one or more RSUs which have both a time-based vesting requirement and a performance requirement that a liquidity event, such as an acquisition or a public offering must occur prior to a specified expiration date in order for the underlying shares to vest. The performance requirement was included in order to try to ensure that the income recognized upon the vesting and settlement of the RSUs would occur when there is a public market for the Shares (rather than resulting in tax liability for RSU holders at a time when there is no liquidity with respect to the Shares).

In order to avoid adverse tax consequences to you under the complicated deferred compensation rules of Internal Revenue Code Section 409A, the settlement date that follows the liquidity event in the award agreement was specified as the earlier to occur of March 15 of the year following the year in which the liquidity event occurs or the date occurring [six] months after the liquidity event (i.e., after the lockup period during which you would not be able to sell Shares, which is required by an agreement between the Company and the underwriters of the IPO). See Section E. (Lock-Up of Shares Following the IPO) below.

Accordingly, upon the effective date of the IPO, the liquidity requirement will be satisfied and to the extent that you have satisfied the time-based vesting requirement as of the IPO Date, your RSU Shares will be settled on the earlier to occur of March 15 of the year following the year in which the IPO occurs or the date occurring [six] months after the IPO Date. To the extent that you subsequently satisfy the time-based vesting requirement for your RSU Shares following the IPO Date, such Shares will vest on the applicable time-based vesting date and be settled on a date determined in accordance with the agreement evidencing your RSU.

For example, on September 1, 2018, the Company granted an employee an RSU for 100 Shares with a four year time-based vesting schedule (with time vesting in four equal annual increments) and a performance liquidity event (including an IPO) vesting condition that requires the liquidity event to occur within seven years after the grant date (with settlement to occur on the earlier of March 15 of the year following the year in which the liquidity event occurs or the date occurring six months after the liquidity event). If the Company's IPO is effective on January 1, 2020, the 25 Shares for which the time-based vesting requirement was previously met on September 1, 2019 would vest on the effective date of the IPO and be settled July 1, 2020 (the date six months after the IPO Date), and subject to the employee's continued service, 25 Shares subject to the RSU would vest on September 1 of 2020, 2021, and 2022.

Optional Section C.:

B. Section 83(i) Tax Deferrals

If you made an election pursuant to Section 83(i) of the Internal Revenue Code to defer income from an option exercise or an RSU settlement which occurred after December 31, 2017 (a "Section 83(i) Election"), the IPO will cause the deferral period under each Section 83(i) election you made to cease on the IPO Date. Accordingly, the income previously deferred pursuant to the Section 83(i) Election will be recognized as of the IPO Date and such income will be subject to withholding. [Pursuant to the terms of the agreement evidencing your Equity Award covered by the Section 83(i) Election, you will be required to remit the applicable amount of the withholding taxes to the Company in connection with the recognition of such income.]

B. Expiration of Right of First Refusal and Put and Call Rights

Prior to the IPO, Shares acquired pursuant to your Equity Awards were subject to (i) a right of first refusal (i.e., prior to a proposed transfer of the Shares, you were required to notify the Company and offer the Company the right to purchase such Shares on the same terms prior to consummating any such sale), (ii) call rights, which gave the Company the right, in certain circumstances, such as a termination of employment, to repurchase your vested Shares, and (iii) a put right, which allowed you, in certain circumstances, such as a termination of employment, to put vested Shares to the Company and require the Company to repurchase such Shares. Following the IPO, in accordance with the terms of the applicable agreements governing the transfer of your Shares, these provisions will no longer be applicable to Shares you acquired pursuant to your Equity Awards. As the Shares will be publicly-traded after the IPO, there will now be a market in which you may sell the Shares you acquired pursuant to your Equity Awards (subject to the restrictions described in Section D. (Resale of Shares Following the IPO) and Section E. (Lock-Up of Shares Following the IPO)).

Please note that the forfeiture and Company's right to repurchase or reacquire any unvested Shares that you hold upon a termination of employment or service will still remain in effect following the IPO Date.

Drafting Note to Section B.

Employee-shareholders of a private company are typically subject to a right of first refusal, which requires the employee to notify the company of a proposed transfer of the shares and give the company a right to purchase the shares on the same terms as the proposed transfer instead of allowing the employee to transfer such shares. In addition, the shares acquired pursuant to equity awards may also be subject to call rights, which allow the company to repurchase vested shares upon a termination of employment and/or put rights, which allow the employee to put the shares to the company at a set price during a specified period. These provisions are intended for use prior to an IPO (e.g., a right of first refusal allows the company to control who its stockholders are when there is no public market for the shares and a put right allows the employee to put the shares to the company in order to provide liquidity). These provisions typically expire once the shares are publicly-traded, and accordingly they will not be applicable following an IPO. You should review the applicable agreements (e.g., equity award agreements and/or any stockholders' agreement) to determine which types of provisions apply and revise this section accordingly.

Optional Section C.:

C. Shares Acquired with Promissory Notes

The Securities Exchange Act of 1934 (the “Exchange Act”) prohibits public issuers which are subject to the Exchange Act reporting requirements from maintaining credit, arranging for the extension of credit, or renewing an extension of credit, in the form of a personal loan to or for any director or executive officer. This prohibition applies to promissory notes which an executive officer used to purchase Shares pursuant to an Equity Award. Accordingly, the terms of our promissory notes require that an executive officer will need to repay any note used to purchase Shares prior to the Company’s filing of the Form S-1 registration statement with the SEC in connection with the IPO.

C. New Equity [Plan OR Plans]

In connection with our IPO, the Company expects to adopt the [name of equity plan] (the “New Plan”), pursuant to which the Company will grant equity awards to employees and other service providers after the IPO. The New Plan includes terms and provisions which differ from the terms of the Company’s current equity plans, as the Company will have to comply with securities laws applicable to public companies (e.g., the New Plan will be administered in accordance with such securities laws with respect to grants made to directors and certain executive officers). The Company will also have to obtain approval of certain amendments to the New Plan from a broad base of public stockholders. To reduce the need to obtain stockholder approval of share reserve increases, the New Plan provides that the share reserve will automatically increase each year by a specified percentage of the Company’s outstanding Shares.

In addition, agreements evidencing grants pursuant to the New Plan will reflect that the underlying Shares are publicly-traded (e.g., the award agreements will not include a right of first refusal provision that was included in agreements evidencing your current Equity Awards). If the Company grants you an award pursuant to the New Plan, you will receive an applicable award agreement and a copy of the New Plan.

Please note that your existing Equity Awards will continue to be subject to the terms and conditions of the applicable equity plan pursuant to which they were granted and the New Plan has no effect on your existing Equity Awards.

Drafting Note to Section C.

Most companies adopt a new omnibus equity plan to evidence equity awards granted to employees and other services providers after an IPO. Review the terms of any new equity plan and revise this section accordingly. In addition, use the language in the Optional Section C., Fourth Paragraph regarding an employee stock purchase plan if the company intends to adopt one in connection with the IPO.

Optional Section C., Fourth Paragraph:

In addition to the New Plan, the Company intends to adopt the [insert name of employee stock purchase plan] (the “ESPP”) in connection with the IPO. The ESPP is intended to qualify under I.R.C. § 423 and to allow eligible employees to purchase Shares with payroll deductions that are accumulated during a [six]-month offering period. The offering periods are scheduled to start on the first trading day on or after [month, date] and [month, date] of each year, except for the first offering period, which will commence on the first trading day on or after the IPO Date and will end on the first trading day on or after [month, date]. The purchase price for the Shares will be [85%] of the lesser of (i) the fair market value of a Share on the first day of the offering period, or (ii) the fair market value of a Share on the last day of the offering period. Note that participation in the ESPP will have no effect on your existing Equity Awards.

D. Resale of Shares Following the IPO

Shares Issued Prior to the IPO. In general, the Securities Act of 1933 (the “Securities Act”) allows you to resell Shares issued prior to the IPO pursuant to your Equity Award agreements beginning 90 days after the IPO Date. However, to the extent that you are an “affiliate” for purposes of Rule 144 promulgated under the Securities Act (generally, “affiliates” include officers, directors or other individuals who have control over the Company), your resale of shares acquired prior to the IPO Date will need to comply with additional volume and notice requirements under Rule 144.

Shares Acquired Following the IPO. The Company intends to file a registration statement on Form S-8 with the SEC with respect to Shares subject to outstanding Equity Awards (as well as shares reserved for future issuance pursuant to the New Plan [and ESPP]). Because Shares subject to your outstanding Equity Awards will be registered on this Form S-8, you will be able to resell those Shares into the market while the Form S-8 registration statement is in effect. Following the filing of the Form S-8, the Company will provide you with a related prospectus which includes information about the applicable equity plan and a summary of the tax consequences regarding awards granted pursuant to the plan.

Additional Restrictions. In addition to the restrictions set forth above, please note that any sale of Shares will be subject to the lock-up provisions described in Section E. (Lock-up of Shares Following the IPO) as well as any applicable laws or Company policies which restrict trading of securities on inside information.

Drafting Note to Section D.

This section assumes that shares issued pursuant to equity award agreements prior to the IPO were exempt from the registration requirements of the Securities Act of 1933 (15 U.S.C. § 77a) (Securities Act), pursuant to Rule 701 promulgated thereunder, which provides an exemption for compensatory equity awards granted to employees and other service providers. Rule 701(g)(3) provides that 90 days after an issuer becomes subject to the reporting requirements of the Securities Exchange Act of 1934, securities issued to an employee in a Rule 701 transaction may be resold pursuant to Rule 144 promulgated under the Securities Act (17 C.F.R. § 230.144) (1) by a person who is not an affiliate of the issuer in reliance on Rule 144, subject only to the manner of sale requirement of paragraph (f) of Rule 144, and (2) by affiliates, subject to compliance with the volume, manner of sale and notice requirements of paragraphs (e), (f) and (h) of Rule 144.

E. Lock-up of Shares Following the IPO

In connection with the IPO, Shares acquired pursuant to your Equity Awards will be subject to a lock-up provision immediately following the IPO.

The lock-up provision prohibits you from selling Shares acquired pursuant to your Equity Awards for a period of [180] days following the IPO Date.

Drafting Note to Section E.

A privately held company's employee-shareholders are typically subject to a lock-up provision (either in the equity award agreement or a separate lock-up agreement). The purpose of a lock-up provision is to help ensure an orderly market in the company's stock following an IPO by preventing employees (and other stockholders bound by similar provisions) from selling shares into the market shortly after the IPO. The lock-up period is specified in the applicable agreement, although in some cases, the underwriters of the IPO may waive the lock-up period prior to its expiration date with respect to sales by certain parties. You should review the applicable lock-up provisions and insert the applicable length of the lock-up period and add any other applicable terms to the summary of the lock-up provision.

If the Company does not consummate the IPO, your existing Equity Awards will continue to remain subject to the terms and conditions of the applicable equity plan(s) and the related award agreement(s) as in effect on the date hereof.

This memorandum is for explanatory purposes only and does not create or modify any legally binding right with respect to your existing Equity Awards, nor does it create a contract of employment or otherwise alter your [at-will] employment status with the Company.

If you have any questions, please contact [name of contact person] at [contact information].

EXHIBIT A: Outstanding Equity Awards

The table below shows a summary of your outstanding equity awards (as of [date]), including the number of shares underlying each award and the exercise price (if applicable).

Nonqualified Stock Option Awards

Grant Date	Number of Shares	Exercise Price

Incentive Stock Option Awards

Grant Date	Number of Shares	Exercise Price

SAR Awards

Grant Date	Number of Shares	Exercise Price

Restricted Stock Awards

Grant Date	Number of Shares

Restricted Stock Unit Awards

Grant Date	Number of Shares

Alternate Exhibit A:

EXHIBIT A: Outstanding Equity Awards

The table below shows a summary of your outstanding equity awards (as of [date]), including the number of shares underlying each award and the exercise price (if applicable), as adjusted to reflect the reverse stock split to be effected in connection with the IPO.

Nonqualified Stock Option Awards

Grant Date	Number of Shares (Pre-Split)	Number of Shares (Post-Split)	Exercise Price (Pre-Split)	Exercise Price (Post-Split)

Incentive Stock Option Awards

Grant Date	Number of Shares (Pre-Split)	Number of Shares (Post-Split)	Exercise Price (Pre-Split)	Exercise Price (Post-Split)

SAR Awards

Grant Date	Number of Shares (Pre-Split)	Number of Shares (Post-Split)

Restricted Stock Awards

Grant Date	Number of Shares (Pre-Split)	Number of Shares (Post-Split)

Restricted Stock Unit Awards

Grant Date	Number of Shares (Pre-Split)	Number of Shares (Post-Split)

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Henrik P. Patel is the Global Head of the Employment, Compensation & Benefits Practice at the global law firm, White & Case LLP. Henrik advises numerous US and non-US clients (including public and private companies, boards of directors and executives) on executive compensation and employee benefits aspects of various corporate transactions, including mergers, acquisitions, divestitures, spin-offs, succession planning, debt and equity financings, initial public offerings, private equity and leveraged buyout transactions and banking transactions. He has extensive experience with financial services institutions, private equity and hedge fund clients.

Henrik also provides ongoing counsel to public and private companies, compensation committees and executives with respect to day-to-day executive compensation and employee benefits matters, including corporate governance matters and best practices, executive compensation plan design, employment contracts and equity incentive compensation arrangements, as well as advising on related regulatory, securities, tax, public disclosure and ERISA issues. He negotiates and drafts employment, retention, separation, change of control, non-competition, non-solicitation and other compensation-related agreements, plans and provisions, as well as relevant sections of proxy statements, periodic and current reports (e.g., Forms 8-K, 10-K and 10-Q) and registration statements.

Henrik is a frequent contributor and speaker at Global Equity Organization (GEO) and National Association of Stock Plan Professional (NASPP) conferences. He was named to the "40 Under 40" list of outstanding M&A lawyers by The M&A Advisor and has been named a recognized individual by Legal 500 in Employee Benefits & Executive Compensation.

He received his JD from New York University School of Law and BA in Political Science from Tufts University.

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