



Employee Memorandum: Explanation of Equity Award Rollover in Corporate Transaction

A Lexis Practice Advisor® Annotated Form by
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FORM SUMMARY

Use this form as an explanatory memorandum outlining the mechanics of a rollover of outstanding equity awards held by your employees in connection with a corporate transaction. This form contains drafting notes and alternate clauses.

This form assumes that (1) the parties have agreed to rollover all vested and unvested awards, (2) the rollover is provided for in the purchase agreement and permissible under the terms of the applicable equity plan documents, and (3) the consideration paid to equity holders is not subject to an escrow arrangement.

For a memorandum outlining the mechanics of a cash-out of equity awards in a corporate transaction, see [Employee Memorandum: Explanation of Equity Award Cash-out in Corporate Transaction](#). For information on the treatment of equity awards in a corporate transaction, see [Equity Award Treatment in Corporate Transactions](#). For information on equity awards generally, see [Equity Compensation Types and Tax Treatment](#).

CONFIDENTIAL
ATTORNEY CLIENT-PRIVILEGE
ATTORNEY WORK PRODUCT

TO: [employee's name]

FROM: [attorney's name, law firm name]

DATE: [date]

SUBJECT: Rollover of Equity Awards in Connection with Corporate Transaction

As you may know, [company name] (the “**Company**”) has entered into a Stock Purchase Agreement, dated as of [date] (the “**Agreement**”), with [purchaser name] (the “**Purchaser**”), pursuant to which the Purchaser is expected to acquire all of the outstanding shares of common stock of the Company (the “**Company Stock**”) on or about [date] (the “**Closing Date**”). In connection with this transaction (the “**Proposed Transaction**”), each equity award you hold under the [incentive plan(s) name(s)] (the “**Incentive Plan(s)**”) will convert into equity awards of the Purchaser and remain subject to terms and conditions identical or substantially similar to those terms and conditions provided under the Incentive Plan(s). The conversion will be based on a ratio (the “**Exchange Ratio**”) that equals the per share acquisition price paid by the Purchaser in the transaction (the “**Per Share Consideration**”) divided by the average closing price of a share of common stock of the Purchaser (“**Purchaser Stock**”) on the [name of stock exchange] for each of the [number] consecutive trading dates immediately before the Closing Date. If the Proposed Transaction is not consummated, your equity awards will continue to remain subject to the terms and conditions of the Incentive Plan(s) and the related award agreement(s).

Drafting Note to First Paragraph: This first paragraph describes a stock purchase agreement as the type of acquisition agreement the parties entered into that triggers a change in control. The first and second alternate first paragraph herein, describe a merger agreement and asset purchase agreement, respectively.

First Alternate First Paragraph: As you may know, [company name] (the “**Company**”) has entered into a Merger Agreement, dated as of [date] (the “**Agreement**”), with [purchaser name] (the “**Purchaser**”), and [name of merger subsidiary], a wholly owned subsidiary of the Purchaser (“**Merger Sub**”), pursuant to which Merger Sub will be merged with and into the Company on or about [date] (the “**Closing Date**”). In connection with this transaction (the “**Proposed Transaction**”), each equity award you hold under the [incentive plan(s) name(s)] (the “**Incentive Plan(s)**”) will convert into equity awards of the Purchaser and remain subject to terms and conditions identical or substantially similar to those terms and conditions provided under the Incentive Plan(s). The conversion will be based on a ratio (the “**Exchange Ratio**”) that equals the per share acquisition price paid by the Purchaser in the transaction (the “**Per Share Consideration**”) divided by the average closing price of a share of common stock of the Purchaser (“**Purchaser Stock**”) on the [name of stock exchange] for each of the [number] consecutive trading dates immediately before the Closing Date. If the Proposed Transaction is not consummated, your equity awards will continue to remain subject to the terms and conditions of the Incentive Plan(s) and the related award agreement(s).

Second Alternate First Paragraph: As you may know, [company name] (the “**Company**”) has entered into an Asset Purchase Agreement, dated as of [date] (the “**Agreement**”), with [purchaser name] (the “**Purchaser**”), pursuant to which the Purchaser is expected to acquire [all of OR a portion of] the Company’s assets on or about [date] (the “**Closing Date**”). In connection with this transaction (the “**Proposed Transaction**”), each equity award you hold under the [incentive plan(s) name(s)] (the “**Incentive Plan(s)**”) will convert into equity awards of the Purchaser and remain subject to terms and conditions identical or substantially similar to those terms and conditions provided under the Incentive Plan(s). The conversion will be based on a ratio (the “**Exchange Ratio**”) that equals the per share acquisition price paid by the Purchaser in the transaction (the “**Per Share Consideration**”) divided by the average closing price of a share of common stock of the Purchaser (“**Purchaser Stock**”) on the [name of stock exchange] for each of the [number] consecutive trading dates immediately before the Closing Date. If the Proposed Transaction is not consummated, your equity awards will continue to remain subject to the terms and conditions of the Incentive Plan(s) and the related award agreement(s).

As set out in Exhibit A to this letter, as of [date], you hold [number] outstanding stock options (the “**Options**”) to purchase shares of Company Stock, [number] stock appreciation rights representing the right to receive a payment in cash or shares of Company Stock (the “**SARs**”), [number] awards of restricted Company Stock subject to future vesting conditions (the “**Restricted Stock Awards**”), and [number] restricted stock unit awards subject to vesting conditions (the “**RSU Awards**”). The number of equity awards you will be expected to receive in connection with the Proposed Transaction is also set forth in Exhibit A.

A. Treatment of Option Awards

As of the Closing Date, each of your then outstanding Options, whether vested or unvested, will be assumed by the Purchaser and will convert into an option (each, a “**Purchaser Option**”) to purchase the number of shares of Purchaser Stock equal to the number of shares of Company Stock underlying the Option immediately prior to the Closing Date multiplied by the Exchange Ratio and rounded down to the nearest whole number of shares. The per share exercise price of each Purchaser Option will be equal to the per share exercise price of the applicable Option immediately before the Closing Date divided by the Exchange Ratio and rounded up to the nearest whole cent.

Drafting Note to Section A: In a rollover, the company will adjust the exercise price and number of shares underlying an executive's existing options to a new exercise price and number of shares of the buyer based on a ratio that maintains the same economics from immediately prior to the corporate transaction. Most commonly, assuming the purchaser is a public company, the parties will use the average of the closing price of the purchaser's common stock on a series of consecutive days before the closing date of the transaction.

Note that if the options that will be converted were initially intended to qualify as incentive stock options (ISOs) and the parties desire to preserve the qualified status of the ISOs, the conversion of the ISOs must be done in compliance with I.R.C. § 424. If the terms of an ISO are modified, extended, or renewed, such modification, renewal, or extension is treated as the grant of a new option. I.R.C. § 424(h)(1). Modification generally means any change in the terms of an option which gives the grantee additional benefits under the option. I.R.C. § 424(h)(3). Exceptions to this definition include a change in the terms of an option attributable to a substitution or an assumption. I.R.C. § 424(h)(3)(A). Eligible corporations may, by reason of a corporation transaction, substitute a new ISO for an outstanding ISO or assume an old ISO without the substitution or assumption being considered a modification of the old ISO. 26 C.F.R. § 1.424-1(a)(1). For more information on ISOs in a transaction, see [Equity Award Treatment in Corporate Transactions](#). For more information on ISOs and nonqualified stock options generally, see [Equity Compensation Types and Tax Treatment](#).

Any adjustments to rolled-over nonqualified stock options should be structured to comply with the adjustment rules under I.R.C. § 409A, which are generally based on the adjustment rules for ISOs. See 26 C.F.R. § 1.409A-1(b)(5)(ii). Any changes that would result in a modification under Section 409A (where the terms of the award are changed in such a way as to provide a direct or indirect reduction in the purchase price) should also be avoided. For more information on Section 409A, see [Section 409A Fundamentals](#).

Make sure that the relevant plan and award agreements permit the cancellation of underwater options for no consideration. If not, an option holder may have a claim against the company for cancelling the options without his or her consent. This is true despite the fact that the options are underwater since a court may determine that the possibility of their regaining in-the-money status, however unlikely, is still worth something. The company may seek to obtain written consents from the company's equity holders. However, such a process can be extremely difficult and time consuming, especially where there are a large number of equity holders.

B. Treatment of Stock Appreciation Right Awards

As of the Closing Date, each of your outstanding SARs, whether vested or unvested, will be assumed by the Purchaser and converted into a stock appreciation right (each, a "**Purchaser SAR**") with respect to the number of shares of Purchaser Stock equal to the number of shares of Company Stock that were underlying your SAR immediately before the Closing Date multiplied by the Exchange Ratio and rounded down to the nearest whole number of shares. The per share exercise price for each Purchaser SAR will be equal to the per share exercise price of the underlying SAR immediately before the Closing Date divided by the Exchange Ratio and rounded up to the nearest whole cent.

Drafting Note to Section B: A SAR gives the holder the right to receive the excess of the fair market value of the underlying share of stock over the exercise price of the SAR. Conceptually, SARs are very similar to options, except that no actual purchase of shares occurs in the exercise of a SAR and the company may pay out the value of a SAR in cash as well as stock. However, the value gained by the holder of a SAR upon exercise is the same value that the holder gains when exercising an option—the spread. As with stock options, make sure that the relevant plan and award agreements permit the cancellation of underwater SARs for no consideration. As noted above with respect to options, any adjustments to rolled-over SAR should also be structured to comply with the adjustment rules under Section 409A, and any changes that would result in a modification under Section 409A should also be avoided. For more information on SARs, see [Equity Compensation Types and Tax Treatment](#).

C. Treatment of Restricted Stock Awards

As of the Closing Date, each Restricted Stock Award shall be converted into an award of restricted stock covering the number of shares of Purchaser Stock equal to the number of shares of Company Stock underlying your Restricted Stock Award multiplied by the Exchange Ratio.

Drafting Note to Section C: Shares of restricted stock are actual shares of the company’s common stock that carry restrictions on transfer and sale that lapse (usually, but not necessarily, in installments) over a specified vesting period or upon the achievement of specified vesting conditions.

Restricted stock is generally not taxed on grant. Instead, the holder will recognize taxable income if and when the shares no longer face a substantial risk of forfeiture (i.e., on vesting). In a rollover, the converted restricted stock will continue to remain subject to a substantial risk of forfeiture and the holder will therefore not recognize taxable income upon conversion. However, an award holder may elect to recognize taxable income in the year of grant in an amount equal to the fair market value of the shares at the time of grant, by filing an election under I.R.C. § 83(b) (a Section 83(b) Election) with the Internal Revenue Service and the company within thirty days of the grant date. If the holder properly and timely files this election, the holder will immediately recognize income equal to the difference, if any, between the fair market value of the shares upon grant and the price paid for the shares. Making a Section 83(b) Election benefits the award holder in that the subsequent vesting of the stock will not result in a taxable event, because the holder has already paid the required tax. Further, if the holder later sells the vested shares in a taxable transaction, any appreciation in the value of the shares since the grant date will be taxed at capital gains rates, rather than the typically higher rates applicable to ordinary income. Since restricted stock is considered “property” subject to I.R.C. § 83, the requirements of I.R.C. § 409A do not apply.

For more information on restricted stock, see [Equity Compensation Types and Tax Treatment](#). For a sample Section 83(b) election form, see [Section 83\(b\) Election Form \(Restricted Stock\)](#).

D. Treatment of Restricted Stock Unit Awards

As of the Closing Date, each outstanding RSU Award, whether vested or unvested, shall be converted into a restricted stock award covering the number of shares of Purchaser Stock equal to the number of shares of Company Stock underlying your RSU Award multiplied by the Exchange Ratio.

Drafting Note to Section D: An RSU represents the right to receive an amount equivalent in value to a single share of stock (which can be paid in cash, actual shares, or a combination thereof) on a future date, subject to vesting over a specified time period or upon the achievement of specified performance conditions. Holders of RSUs are not treated as shareholders unless and until a share of stock is distributed in payment of a vested RSU (they will not be treated as shareholders at all if the RSU only pays out in cash). In a rollover, vesting conditions continue to apply so the holder will therefore not receive any distributions.

Like restricted stock, RSUs are generally not taxed on grant. Instead, the holder will recognize taxable income when he or she receives the cash or underlying shares upon settlement. In the case of stock-settled RSUs, any gain or loss realized upon the holder's subsequent transfer of received shares will be treated as long-term or short-term capital gain or loss. The holder of an RSU cannot file a Section 83(b) election because I.R.C. § 83 applies to "property" and an RSU is not considered property (because it is not actually a share).

This memorandum is for explanatory purposes only and does not create or modify any legally binding right with respect to your equity awards under the Incentive Plan(s); nor does it create a contract of employment or otherwise alter your at-will status with the Company.

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

EXHIBIT A: Outstanding Awards

The Purchaser is currently expected to pay a Per Share Consideration of \$[number]. Based on that price, your equity awards will be converted as set forth below.

Nonqualified Stock Option Awards

Grant Date	Vesting Date	Original Number of Options	Estimated Adj. Number of Options	Original Exercise Price	Estimated Adj. Exercise Price

Incentive Stock Option Awards

Grant Date	Vesting Date	Original Number of Options	Estimated Adj. Number of Options	Original Exercise Price	Estimated Adj. Exercise Price

Stock Appreciation Right Awards

Grant Date	Vesting Date	Original Number of SARs	Estimated Adj. Number of SARs	Original Exercise Price	Estimated Adj. Exercise Price

Restricted Stock Awards

Grant Date	Vesting Date	Original Number of Restricted Stock	Estimated Adj. Number of Restricted Stock

Restricted Stock Unit Awards

Grant Date	Vesting Date	Original Number of RSUs	Estimated Adj. Number of RSUs

Henrik P. Patel

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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.

Victoria Rosamond

Counsel, White & Case LLP

Victoria specializes in executive compensation and employee benefits. Her experience includes the drafting and design of compensation and benefit arrangements for US and multinational public and private companies including incentive and deferred compensation, bonus, stock option, profits interests, restricted stock and other equity and non-equity-based arrangements, including advising on benefits-related tax and securities law.

Victoria is also experienced in the drafting and negotiation of executive employment, severance, retention, change-in-control, non-competition and waiver and release agreements.

Victoria advises on a variety of compensation, benefit and employment issues raised in the context of corporate transactions, including merger, acquisition, joint venture and other business combinations and has worked on a number of notable cross-border transactions.

Victoria advises clients on compliance with ERISA fiduciary and plan asset requirements including the structure and offering of various securities and financial products, the formation and ongoing compliance of private equity and hedge funds, and compliance with ERISA's various prohibited transaction rules and exemptions.

She received her LLM from Fordham University School of Law; LPC from BPP Law School; GDL from BPP Law School; and BA from University of Bristol. She is licensed to practice both in New York State and as a Solicitor of the Senior Courts of England and Wales.

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