



LexisNexis®

Employee Memorandum: Explanation of Equity Award Cash-out in Corporate Transaction

A Lexis Practice Advisor® Annotated Form by
Henrik P. Patel and Victoria Rosamond, White & Case LLP



Henrik P. Patel



Victoria Rosamond

FORM SUMMARY

Use this form as an explanatory memorandum outlining the mechanics of a cash-out 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 accelerate the vesting of all unvested awards and to cash out all vested and unvested awards in connection with the transaction, (2) the cash-out is provided for in the purchase agreement and permissible under the terms of the applicable equity incentive plan(s) and the related award agreements, and (3) the consideration paid to equity holders is not subject to an escrow arrangement.

For a memorandum outlining the mechanics of an equity award rollover in a corporate transaction, see Employee Memorandum: Explanation of Equity Award Rollover 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: Cash Out 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 be cancelled in exchange for a cash payment made to you, as further described below. Your cash payment will be based on the per share acquisition price paid by the Purchaser in the transaction (the “**Per Share Consideration**”), and will be made to you no later than *[10]* business days following 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 triggered a change in control. The first and second alternate first paragraph herein, describe a merger agreement and asset purchase agreement, respectively.

First Alternate to 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 be cancelled in exchange for a cash payment made to you, as further described below. Your cash payment will be based on the per share acquisition price paid by Purchaser in the transaction (the “**Per Share Consideration**”), and will be made to you no later than *[10]* business days following 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 to 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 be cancelled in exchange for a cash payment made to you, as further described below. Your cash payment will be based on the per share acquisition price paid by Purchaser in the transaction (the “Per Share Consideration”), and will be made to you no later than [10] business days following 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”).

A. Treatment of Option Awards

As of the Closing Date, each of your then outstanding Options, whether vested or unvested, will be cancelled in exchange for a lump sum cash payment equal to (i) the Per Share Consideration minus the exercise price of such Option, (ii) multiplied by the number of shares of Company Stock subject to such Option. If the exercise price of any Option you hold is equal to or greater than the Per Share Consideration, then such Option will be cancelled as of the Closing Date, and no cash payment will be made with respect to such Option.

Note that if any of your Options are incentive stock options under Internal Revenue Code Section 422, those Options will be treated as nonqualified stock options because the holding period will not have been satisfied. Therefore, the payment made in exchange for the cancellation of your Options will be subject to ordinary income, Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes, which will be withheld from your payment in accordance with the Incentive Plan(s) and as required by law.

Drafting Note to Section A: This section addresses the cash out of nonqualified stock options (NQSOs) and incentive stock options (ISOs). NQSOs represent the right to purchase shares of a company at a specified exercise price after certain vesting conditions are satisfied. ISOs are like NQSOs but, if they satisfy various requirements under I.R.C. §§ 422 and 423, no tax event occurs at exercise and, if certain holding requirements are satisfied following exercise, all income receives capital gains treatment. Short-term capital gain treatment applies to shares held for less than 12 months and long-term capital gain treatment applies to shares held for 12 months or longer.

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.

For more information on ISOs and NQSOs, see [Equity Compensation Types and Tax Treatment](#).

B. Treatment of Stock Appreciation Right Awards

As of the Closing Date, each of your then outstanding SARs, whether vested or unvested, will be cancelled in exchange for a lump sum cash payment equal to (i) the Per Share Consideration minus the exercise price of such SAR, (ii) multiplied by the number of shares of Company Stock subject to such SAR. If the exercise price of any SAR you hold is equal to or greater than the Per Share Consideration, then such SAR will be cancelled as of the Closing Date, and no cash payment will be made with respect to such SAR.

The payment made in exchange for the cancellation of your SARs will be subject to ordinary income, FICA and FUTA taxes, which will be withheld from the payment in accordance with the Incentive Plan(s) and as required by law.

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. For more information on SARs, see [Equity Compensation Types and Tax Treatment](#).

C. Treatment of Restricted Stock Awards

As of the Closing Date, each of your unvested Restricted Stock Awards *[and any accrued but unpaid dividends]* will become fully vested. If you hold Restricted Stock Awards that are subject to the achievement of performance criteria, performance shall be deemed achieved at *[Target OR Maximum (as defined in the Incentive Plan(s))]*. All of your then outstanding Restricted Stock Awards will be cancelled in exchange for a lump sum cash payment equal to *[any accrued but unpaid dividends plus an amount equal to]* the Per Share Consideration multiplied by the number of shares of Stock represented by such Restricted Stock Award, less any applicable withholdings.

If you made a valid election under Internal Revenue Code Section 83(b) (a “Section 83(b) Election”) at the time of grant with respect to your Restricted Stock Awards, then your payment will not be subject to ordinary income, FICA or FUTA taxes. Instead, you will recognize capital gain or loss on (1) the difference between the Per Share Consideration and the fair market value of a share of Company Stock at the time your Restricted Stock Awards were granted to you, multiplied by (2) the number of shares of Company Stock represented by your Restricted Stock Awards. If you held your Restricted Stock Awards for more than 12 months, you will recognize long-term capital gain. Otherwise, you will recognize short-term capital gain. The Company will not withhold any capital gain that you recognize.

If you did not make a valid Section 83(b) Election with respect to your Restricted Stock Awards at the time of grant, then the payment made to you in exchange for the cancellation of your Restricted Stock Awards is subject to ordinary income, FICA, and FUTA taxes, which will be withheld from the payment in accordance with the Incentive Plan(s) and as required by law.

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). 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.

If a participant made a valid Section 83(b) Election within 30 days of the date of grant, the cash payment will not be subject to withholding for ordinary income tax, as well as Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes, as required. If the participant did not make such an election, then withholding for these taxes will be required.

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 of your unvested RSU Awards *[and any accrued but unpaid dividend equivalents]* will become fully vested. If you hold RSU Awards that are subject to the achievement of performance criteria, performance shall be deemed achieved at *[Target OR Maximum (as defined in the Incentive Plan(s))]*. Each of your then outstanding RSU Awards will be cancelled in exchange for a lump sum cash payment equal to *[and accrued but unpaid dividend equivalents plus an amount equal to]* the Per Share Merger Consideration multiplied by the number of shares of Company Stock represented by such RSU Award.

The payment made in exchange for the cancellation of your RSU Awards will be subject to ordinary income, FICA and FUTA taxes, which will be withheld from the payment in accordance with the Incentive Plan(s) and as required by law.

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).

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). RSUs that are immediately cashed out upon settlement (i.e., within two and a half months following the closing date) would qualify as short-term deferrals exempt from I.R.C. § 409A. US C.F.R. § 1.409A-1(b)(4). Additional consideration will need to be given with respect to RSUs that are subject to I.R.C. § 409A. Such awards will generally need to be settled on the original settlement date provided for in the award agreement (which may or may not be the closing date). This form assumes that RSUs are not subject to I.R.C. § 409A and that cash out of such awards is permissible. For more information on RSUs, see [Equity Compensation Types and Tax Treatment](#).

Also check the change-in-control definition in the equity plan documents and confirm whether it conforms to the I.R.C. § 409A definition. Keep in mind that if an equity award granted under the plan constitutes nonqualified deferred compensation subject to I.R.C. § 409A, the company's ability to pay such award at the time of an event other than a change in control or change in effective control under I.R.C. § 409A may be restricted. For more information on change-in-control issues, see [Change-in-Control Arrangement Drafting Considerations](#), [Section 280G Parachute Payment Rules](#), [Section 409A Fundamentals](#), and [Section 409A Change-in-Control Payment Events](#).

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 Equity Awards

Stock Option Awards

Number	Grant Date	Original Vesting Date	Exercise Price

Stock Appreciation Right Awards

Number	Grant Date	Original Vesting Date	Exercise Price

Restricted Stock Awards

Number	Grant Date	Original Vesting Date

Restricted Stock Unit Awards

Number	Grant Date	Original Vesting Date

Henrik P. Patel

Global Head of the Employment, Compensation & Benefits Practice, White & Case LLP

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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