EQUITY INCENTIVES LIMITED

news on share based rewards

The effect of corporate change on share plans

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Corporate change? – don't forget your share plans

If your company is undergoing a corporate reorganisation of any type, it is important to review its effect on your share plans.

This newsletter sets out some of the share plan issues you should consider at each stage of the reorganisation.

Preliminary investigations

1. What plans exist?

Your company could have any of a number of share plans in existence, ranging from, say, a Share Incentive Plan for all employees to unapproved share options for top executives.

Each of these plans needs to be considered separately in a reorganisation. Generally speaking, if an Inland Revenue approved plan is in place, it is likely to be much less flexible, and care will need to be taken to ensure that employees do not lose the tax benefits under the plan.

Similarly, plans involving options may be more complex than those involving share awards, because a reorganisation normally triggers the early exercise and lapse of options.

2. What type of re-organisation is planned?

Takeover? Liquidation? Scheme of reconstruction? These terms will typically be referred to specifically in the rules of your share plans – and each could result in different treatment of the participant.

Planning the reorganisation

1. HR implications

It is possible that the reorganisation may represent the plan's main objective – e.g. a sale of the company may be a long awaited realisation event. But the reorganisation may mean the rejection or refinement of a plan's objectives.

2. Tax pitfalls for participants

The structure or timing of the reorganisation may create unexpected tax charges or impose tax liabilities at a time when the participant is not ready to finance those liabilities e.g. if an SAYE option is exercised within three years of the date of grant by reason of the reorganisation, then instead of a tax-free exercise an SAYE option holder will have to pay income tax.

3. Identifying choices available to participants

The main choices for a share option holder, for example, are typically:

- Exercise the option if already exercisable and accept the takeover offer
- Exercise the option after an early exercise event (if possible) and accept the takeover offer
- Release the option for cash (if cash cancellation is offered)
- Rollover the option (if permitted)
- Do not exercise the option and (usually) allow it to lapse
- In certain circumstances, "top-up" payments can be used to compensate for a loss of benefits on the early exercise of an option

4. Amending the rules of a plan

Amendments to the rules of a plan may be necessary e.g. changing the early exercise provisions. Private companies may also need to consider changing their articles of association e.g. to ensure a purchaser can buy shares from employees following the exercise of share options.

Remember there is limited scope to alter the terms of an existing approved plan without losing Inland Revenue approved status.

5. Impact on performance conditions

The Association of British Insurers Guidelines for Share Incentive Schemes (February 2002) state that there should be no automatic waiving of performance conditions in the event of a change of control, and that in such an event, share based awards should vest on a pro-rata basis.

Notwithstanding the above guidance, many plans provide for performance conditions to fall away on the occurrence of defined reorganisation events. In some circumstances, directors may wish to make use of any powers they have to vary or waive performance conditions to take into account the reorganisation.

Implementation

Detailed information and instructions will be needed by and from participants during the implementation phase, unless the plan sets out an automatic procedure in relation to the particular reorganisation.

Post-implementation

1. Tax compliance

Any changes to an approved plan should be reported to the Inland Revenue to ensure that the plan retains its approved status. There may be other Inland Revenue reporting requirements.

2. Winding up redundant EBTs

There could be an EBT to wind up because the trust's purpose has now been achieved, or because it does not fit in with the new structure.

3. Making adjustments to awards

If there has been a variation of share capital as defined in a plan's rules then the necessary adjustments to existing awards should be made.

Conclusions

1. Plan ahead

You may not have contemplated a trade sale or other reorganisation when you first designed and implemented your share plans. Careful planning may be needed to co-ordinate the impact of the reorganisation on your share plans (and vice versa).

2. Employee incentive objectives

The employee incentive objectives of share plans should be remembered when planning the reorganisation – and going forward with the new business structure.

3. Flexibility versus uncertainty

When introducing an employee share plan there is a balance to achieve between certainty and flexibility in the event of a reorganisation.

More information

This newsletter is a summary of a presentation made by Graeme Nuttall, Managing Director of Equity Incentives Ltd, at an IIR Conference on "Tax planning for corporate reorganisations and M & A" on 17 and 18 September 2002. You can download the full text of the presentation by going to the following website link: *http://www.equityincentives.co.uk/content/resources/reports.htm*

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