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Advil Alert – How to Address Complex Share Plan Issues

Barbara Klementz, Baker McKenzie LLP

Wendy Jennings, CEP, AppDynamics

Stacy Fox, CEP, Salesforce

David Thomas, Wilson Sonsini Goodrich & Rosati



**CERTIFIED EQUITY
PROFESSIONAL INSTITUTE**

CEP Institute
500 El Camino Real,
Santa Clara, CA 95053
(408) 554-2187 | cepi.scu.edu



NASPP
P.O. Box 60865
Sunnyvale, CA 94088
(408) 704-1071 | naspp.com/siliconvalley

Agenda

- Leaves of Absence
- Retirement Provisions
- Restrictive Covenants / Clawbacks
- Total Rewards Statements
- Treatment of Terminated Employees
- Electronic Acceptance



Leaves of Absence

- Two Main Issues
 - When is an employee considered terminated?
 - Suspension of vesting during leave



Leaves of Absence

Termination of Employment

- Employees on approved LoA, or on protected LoA, are not considered terminated for purposes of awards in many plans
- Continued qualification as ISO and as option under Section 423 provided leave is for less than 3 months or re-employment guaranteed by contract / statute



Leaves of Absence

Termination of Employment (continued)

- Employment terminated if employee does not return from approved/protected LoA
- What constitutes protected LoA?
 - If individual still considered employee for local labor law purposes, does the same apply for purposes of award?
 - Egregious circumstances outside the U.S.
 - Important to add language to award agreement giving company the flexibility to consider employee terminated for purposes of award



Leaves of Absence

Suspension/Tolling of Vesting

- “Earning of award” vs. administrative effort required to suspend vesting
- Not reasonable to administer suspended vesting for short-term LoAs
 - On the other hand, continued vesting for non-performing employees may be considered windfall



Leaves of Absence

Suspension of Vesting (continued)

- If suspending vesting, need to carve out LoAs that are statutorily protected
- Must review on a country-by-country and leave-by-leave basis
 - Not all protected leaves require continued vesting during leave
 - Complicated administration of carve-outs
 - If suspension only occurs in case of lengthy LoA, will be less complicated



Leaves of Absence

Practical Challenges

- Tolling of vesting may create new RSU vesting dates outside of regular schedule and vesting in closed windows
- Tolling of vesting will extend compensation expense
- HR often does not notify Stock Admin of leaves in timely manner
 - Results in incorrect administration of leaves (RSUs vest/options can be exercised)
 - Creates accounting issue
- Creating a global leave policy that is aligned with award agreement can be challenging



Leaves of Absence

Suspension of Vesting – Best Practices

- Do not hardwire suspension into plan document
- Prepare global LoA policy and refer to same in award agreement
 - Don't mix with LoA policy related to employment benefits – should be specific to equity awards and be prepared / administered by parent company
- Regular communication with local HR to be informed of applicable LoAs
- Implement automated reporting through HRIS systems
- Ensure that the right body has approved the LoA policy and its effect on equity



Retirement Provisions

Retirement:

- Reaching certain age (e.g., 65)
- Age + service (e.g., 55 + 10)
- Retirement as defined under local law (often also tied to age)

Terms That Provide Favorable Treatment to Employees who Terminate Due to Retirement

- Extended post-termination exercisability (for options)
- Accelerated (full or partial) vesting (for options/RSUs)
- Continued vesting (for options/RSUs)
 - More accurately: vesting/non-forfeitability occurs when employee becomes retirement-eligible but exercise not allowed / shares not delivered until original vesting date(s)



Retirement Provisions

Issues

- Accelerated vesting upon retirement results in RSUs becoming subject to Section 409A (relevant for U.S. employees)
 - Vesting for key employees might have to be delayed for six months after termination to avoid 409A violation
 - There should be 409A violation if RSUs continue to be paid on original vesting date(s)
 - Can also help companies avoid bad behavior during vesting period



Retirement Provisions

Issues (continued)

- Continued vesting of RSUs can result in taxable event when retirement-eligible even though shares not delivered
 - In the U.S., FICA due when retirement-eligible; income tax due at delivery of shares
 - But may rely on “rule of administrative convenience” and withhold FICA only at year-end
 - Outside the U.S., treatment often not clear
 - Potential problem countries: Australia, Denmark, Ireland, Italy, Mexico, Singapore, UK



Retirement Provisions

Issues (continued)

- Age discrimination if favorable treatment upon retirement is based on age or age + service
- Risk of claims by younger employees to be treated in the same manner as retirement-eligible employees
- Particularly relevant in EU / EEA countries, but also in some other countries (e.g., Australia, NZ)
 - Little case law to date in EU, but one case settled in favor of employee
 - Better argument if age + service because could be objectively justifiable



Retirement Provisions

Practical Challenges

- Lack of automation in stock plan database can lead to inaccurate determination of retirement eligibility
- Need to have correct birthdates and hire dates in system
- Need to code employees who meet criteria and set up administrative procedures to audit data results



Retirement Provisions

Tips

- Retain flexibility to accelerate vesting upon termination in countries outside the U.S.
- Include savings clause in award agreements (but will not protect from initial claims)
- Consider not offering favorable retirement treatment in EU / EEA
- Consider tying favorable retirement treatment to retirement under local law, not age or age + service



Restrictive Covenants

- Non-compete
- Non-solicitation
- Confidentiality
- Non-disparagement



Restrictive Covenants

Violation of Restrictive Covenant can Result in Forfeiture of Award or Clawback of Award / Shares

- Forfeiture of award requires that violation occur during employment (unlikely for non-compete/non-solicitation) or award continues to vest after termination
- In some cases, violation has no impact on award, but award is consideration for enforcement of restrictive covenant (e.g., injunctive relief)



Restrictive Covenants

Issues

- Restrictive covenants may not be enforceable (e.g., non-compete in California and in many countries outside the U.S.)
- Impact on award agreement?
 - Severability clause should protect company and ensure enforceability of remaining provisions
 - Risk: Court will set aside all provisions unfavorable to employee
- **Keep provision as deterrent even if potentially not enforceable?**
 - Acceptable in most countries, but, could create liability as unfair business practice (CA)



Restrictive Covenants

Issues (continued)

- Including restrictive covenants related to employment relationship in award agreement jeopardizes argument that awards not part of employment relationship
 - Important to mitigate joint employer liability, entitlement/vested rights, severance claims, to avoid translation or works council consultation requirements, etc.
 - Risk difficult to quantify but can (and has) become relevant in disputes with terminated employees



Restrictive Covenants

Alternatives

- Include restrictive covenants (not customized for compliance with local law) and hope for deterrent effect (and live with associated risks)
 - Do not enforce covenants without checking with counsel
- **Customize restrictive covenants to be enforceable in each country and state**
 - Will result in country-specific agreement for each country and state
 - To be enforceable, many countries require payment of additional post-termination compensation (i.e., award income not sufficient)
 - Clawback provision still may not be enforceable in many countries



Restrictive Covenants

Alternatives (continued)

- Customize restrictive covenants to be enforceable in each country and include in amended employment agreement or separate Restrictive Covenant Agreement (effectively amending employment agreement)
 - Use awards as incentive / consideration to get employee to agree to restrictive covenants
 - Remedy for violation not related to equity awards (e.g., no forfeiture or clawback)
 - Need to pay post-termination compensation in many countries to ensure enforceability



Total Rewards Statements

Push by HR to communicate all compensation items to employees in one statement, including equity awards

Issues:

- Advise to separate equity awards from employment relationship
 - To mitigate joint employer liability, entitlement / vested rights, severance claims, to avoid translation or works council consultation requirements, etc.
- Positions cannot be reconciled, but HR usually “wins”



Total Rewards Statements

Practical Challenges

- Need to establish overall statement “vision”
 - Financial wellness?
 - Retirement?
 - Retention?
- Costly to implement – typically takes longer than anticipated and costs more than expected
- Administratively burdensome to update frequently unless an automated process is created
 - But difficult to automate international benefits into online statement
- Data becomes out of date quickly unless a nightly feed is done with an online statement
- Employee engagement tends to fade over time



Total Rewards Statements

Tips

- Push for separate statements
- If equity awards are included, insert prominent disclaimers
- Carefully review how value of award is communicated to avoid creating expectations as to award income



Terminated Employees

- Depending on award terms, taxable event may occur (long) after employee has terminated employment
- Tax withholding / reporting and social tax obligations may be different for current and former employees
 - Social taxes may no longer have to be withheld or paid (Netherlands, Germany)
 - Special withholding obligations may apply (e.g., Singapore)
- **Administrative challenges to keep terminated employee on payroll to effect withholding / reporting post-termination**
 - In some countries, all tax-related items must be regulated through last paycheck (Argentina, Chile)
- Different regulatory treatment for terminated employees (e.g., China)
- Termination results in taxation (e.g., Australia)



Terminated Employees

Practical Challenges

- Local HR does not enter terminations timely
- Accommodate different treatment for terminated employees (e.g., in China)



Terminated Employees

Tips

- Analyze tax treatment, withholding / reporting obligations for terminated employees – make sure covered by matrices provided by broker or advisor
- Discuss payroll process with local payroll
- Stress importance of timely termination data from non-U.S. HR departments



Electronic Acceptance

- Affirmative acceptance strongly recommended, especially for non-U.S. participants and / or if special award terms (e.g., restrictive covenants)
- Can be difficult to obtain for RSUs / RSAs / PRSUs
- Consider forfeiting awards if acceptance not provided within a certain period after grant
 - Discuss with accountants to ensure no fixed grant date issue
- At a minimum, include negative / implied consent



Electronic Acceptance

Electronic vs. Written Acceptance

- No prohibition against electronic acceptance ANYWHERE
- In some countries, hard copy acceptance required, or strongly recommended, to deal with particular issues (*e.g.*, door-to-door exemption in Italy)
- Issue is enforceability of terms electronically accepted
evidentiary weight of electronic acceptance
- Almost never as sound as written acceptance, except if meets very stringent requirements (impracticable for award documents)
- What are the electronic acceptance procedures (*e.g.*, double-click acceptance)?



Electronic Acceptance

Practical Challenges

- Chasing down employees to accept award is administratively burdensome especially if employee is on LoA
 - Follow up of hard copy acceptance even more burdensome
- If acceptance required prior to vesting of RSUs, can cause issues with processing vesting and depositing shares for employee
- Can make it difficult to provide agreements in due diligence/transaction (does form of agreement suffice?)
- May want to carve out Section 16 officers/directors from electronic acceptance process



Electronic Acceptance

Tips

- Ask employee to consent to electronic acceptance process (in writing), e.g., as part of equity new hire letter
- Ensure records / logs of electronic acceptance can be kept
- In select countries or for select employees / grants, follow up with hard copy acceptance



Thank you!

- **Barbara Klementz, Baker McKenzie LLP**
 - barbara.klementz@bakermckenzie.com; 415.591.3211
- **Wendy Jennings, CEP, AppDynamics**
 - wendy.jennings@appdynamics.com; 415.442.3088
- **Stacy Fox, CEP, Salesforce**
 - stacy.fox@salesforce.com; 415.547.8257
- **David Thomas, Wilson Sonsini Goodrich & Rosati**
 - dthomas@wsgr.com; 650.849.3261

