



Cooley

Compensation Challenges in M&A Transactions

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A photograph of a stage set. In the foreground, a black microphone on a stand is positioned on the right side. The stage floor is a light greenish-blue color. In the background, there are several vertical stage lights with blue and yellow patterns, and a central doorway with a white curtain. The overall lighting is warm and focused on the stage.

Setting the Stage

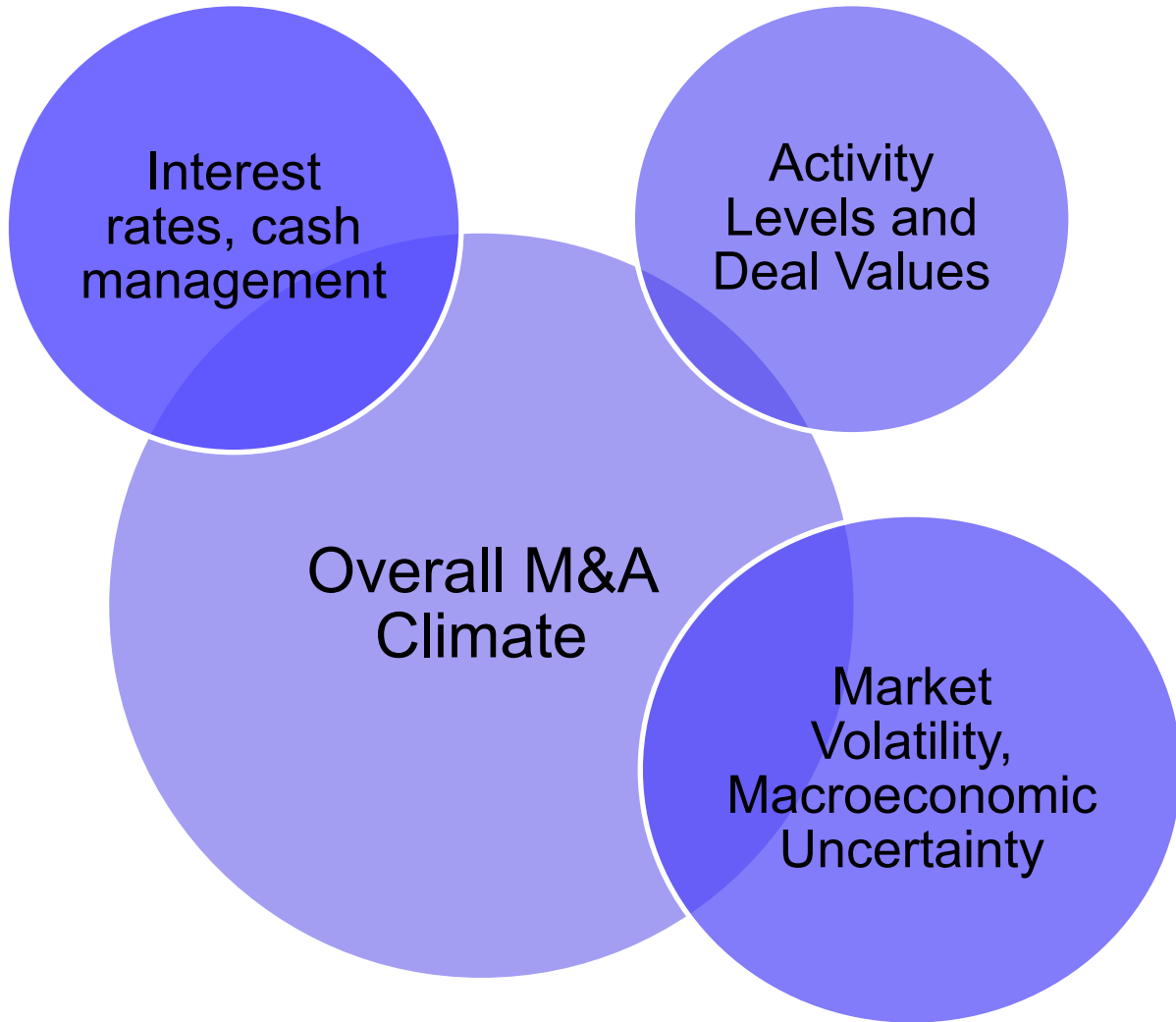
Setting the Stage

- Recent M&A Trends
- Managing Share Reserves
- Deal Level Issues
- Section 280G
- Compensation Disclosure



M&A Trends

Recent M&A Activity



Trends in M&A

- Cash Management / M&A Financings
- Stock-for-Stock Transactions
- Technology / Talent Acquisition

Managing Share Reserve



The Challenge

- Companies listed on Nasdaq or NYSE are generally required to seek shareholder approval of equity compensation plans
- Transactions often involve converting target equity awards into acquiror equity awards
- In addition, acquirors commonly grant new hire and retention awards to incoming employees
- Significant transaction-related equity grants may prematurely deplete the acquiror's equity plan share reserve

You've Got Options

Substitute Awards

Convert target equity awards into acquiror equity awards

Assume Unused Share Reserve

Assume unused share reserve under pre-existing target equity plan, which can be used for post-closing grants by acquiror, subject to certain limitations

Inducement Grants

Make grants to new employees under a non-shareholder approved equity plan

New Equity Plan

Adopt new or amended equity plan with a fresh share reserve

Substitute Awards

- Shareholder approval not required to convert, replace or adjust outstanding target equity awards to reflect the transaction
- Exemption covers both assumptions and substitutions of target equity awards
- Acquiror equity plan should be reviewed to understand treatment of substitute awards for purposes of share reserve
 - Equity plans commonly address substitute awards and may explicitly provide that substitute awards do not count against the share reserve
 - If, on the other hand, substitute awards would count against the share reserve under the acquiror plan, consider whether to assume target equity plan and adjust outstanding awards
- Target equity plan should be reviewed to confirm assumption and/or substitution are permitted actions

Assume Target Equity Plan

- Shares available under equity plans acquired in M&A transactions may be used for certain post-transaction grants without further shareholder approval
- Applies to situations where target company has shares available for grant under pre-existing plans that meet requirements of Nasdaq Rule 5635(c) and IM-5635-1 / NYSE Listed Company Manual Rule 303A.08
- Shares may be used for post-transaction grants of equity awards (after appropriate adjustment), either under the pre-existing plan or another plan, provided:
 - The time during which those shares are available for grants is not extended beyond the period when they would have been available under the pre-existing plan, absent the transaction, and
 - The awards are not granted to individuals who were employed by the acquiror at the time the merger or acquisition was consummated.

Inducement Grant Exception

- Shareholder approval exception for issuances to a person not previously an employee or director of the Company (including following a bona fide period of non-employment) as an inducement material to the individual's entering into employment with the Company.
- Must be approved by either the Company's independent compensation committee or a majority of the Company's Independent Directors.
- Promptly following an inducement grant, a Company must disclose in a press release the material terms of the grant, including the recipient(s) of the grant and the number of shares involved.
- Form 8-K may be required for awards to executive officers.

New Equity Plan Proposal

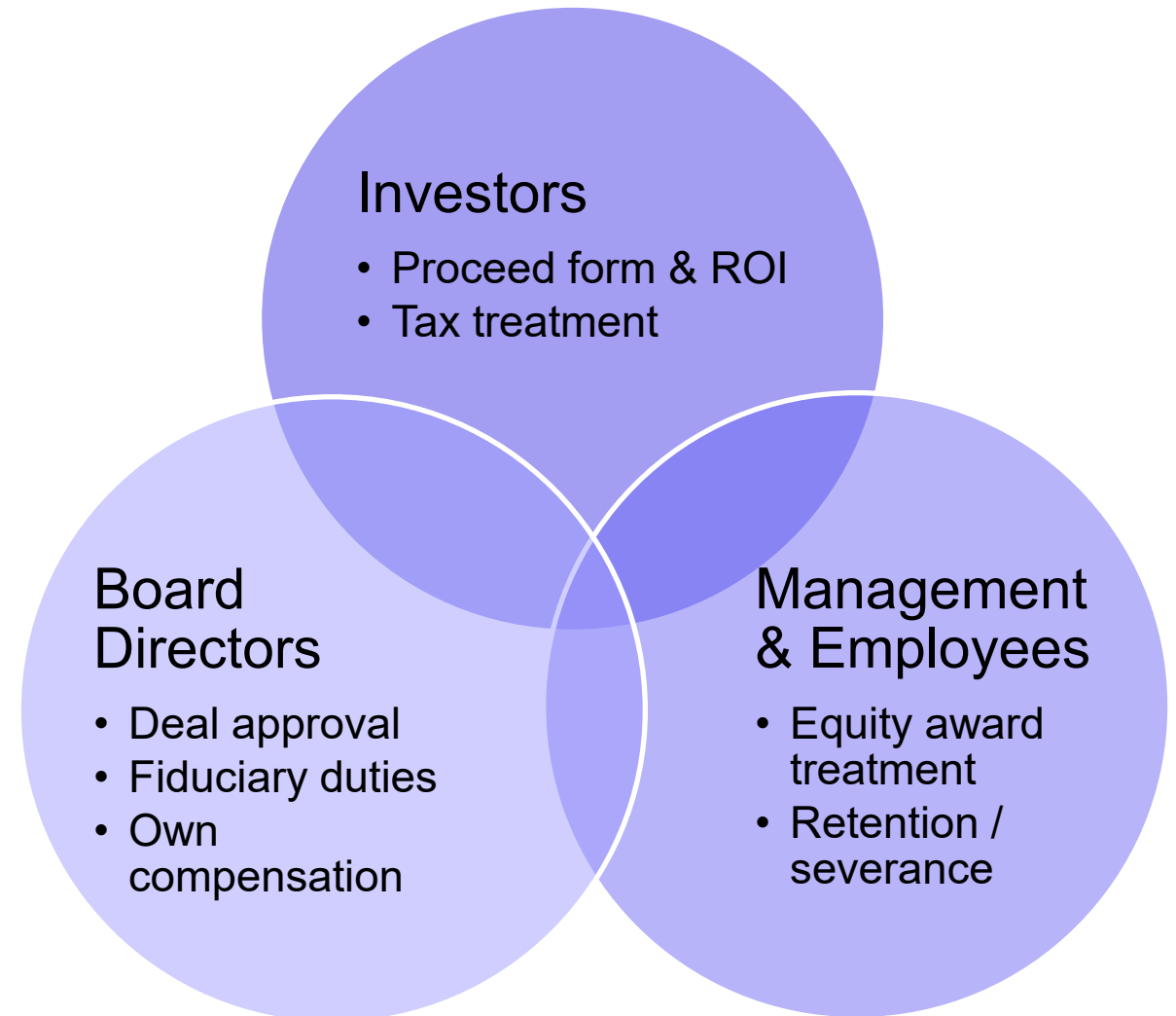
- In certain cases, adopting brand new equity plan, subject to shareholder approval, may be the preferred approach
- Consider hiring plan, compensation benchmarking and go-forward grant practices in determining adequacy of share reserve.
- Also consider whether putting up a new equity plan for shareholder approval may be a good opportunity to include certain company-friendly / shareholder-disfavored provisions
 - e.g., evergreen, ability to reprice options without shareholder approval
- Understand influence of proxy advisory firm recommendations in light of shareholder base.

An aerial photograph of a lush green landscape featuring terraced rice fields. A winding river flows through the center of the terraces, surrounded by palm trees and other tropical vegetation. The terraces are arranged in a series of concentric, curved steps that follow the contours of the land. The overall scene is vibrant and verdant, with various shades of green dominating the palette. The text 'Deal Level Issues' is overlaid in white on the lower-left portion of the image.

Deal Level Issues

Deal Level Hot Topics

- Alignment of interests
- Treatment of equity award considerations
- Retention go-forward
- Discussions around executive arrangements





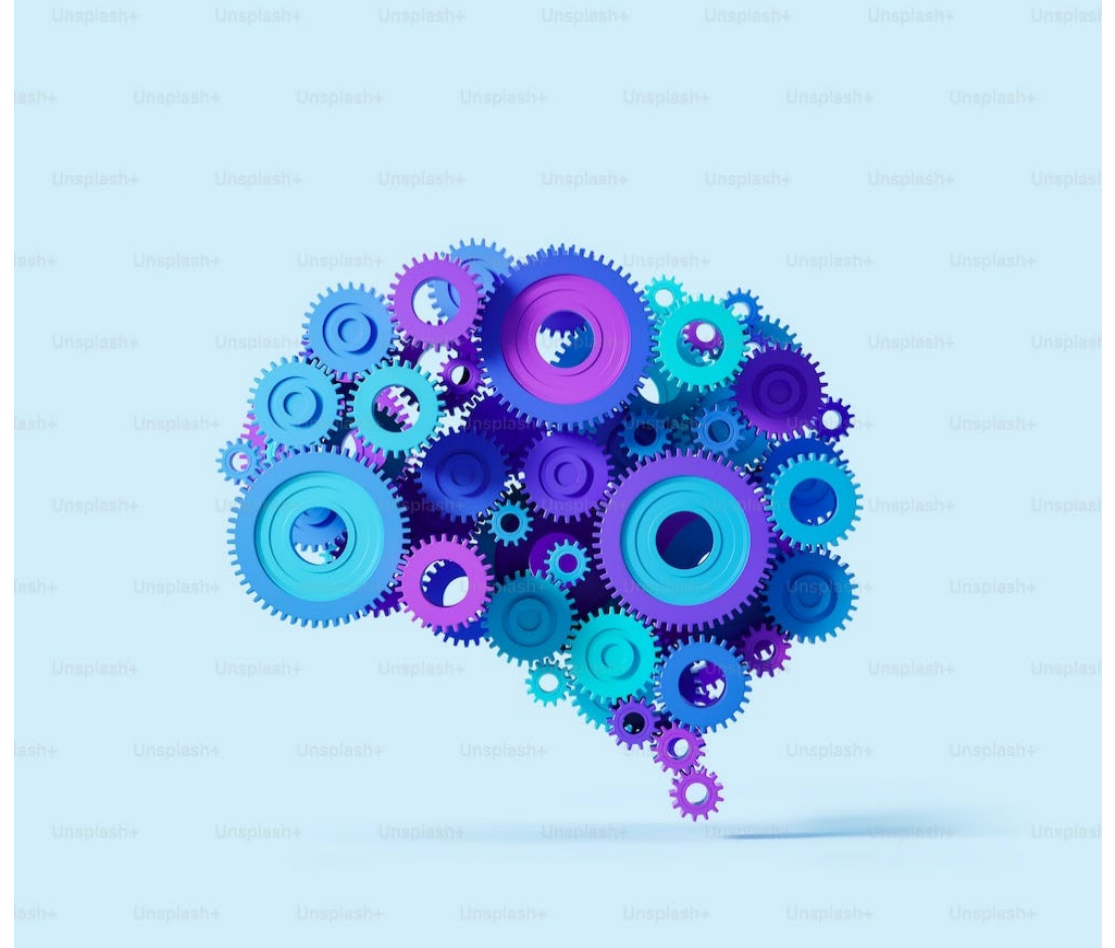
Section 280G

Section 280G Basics

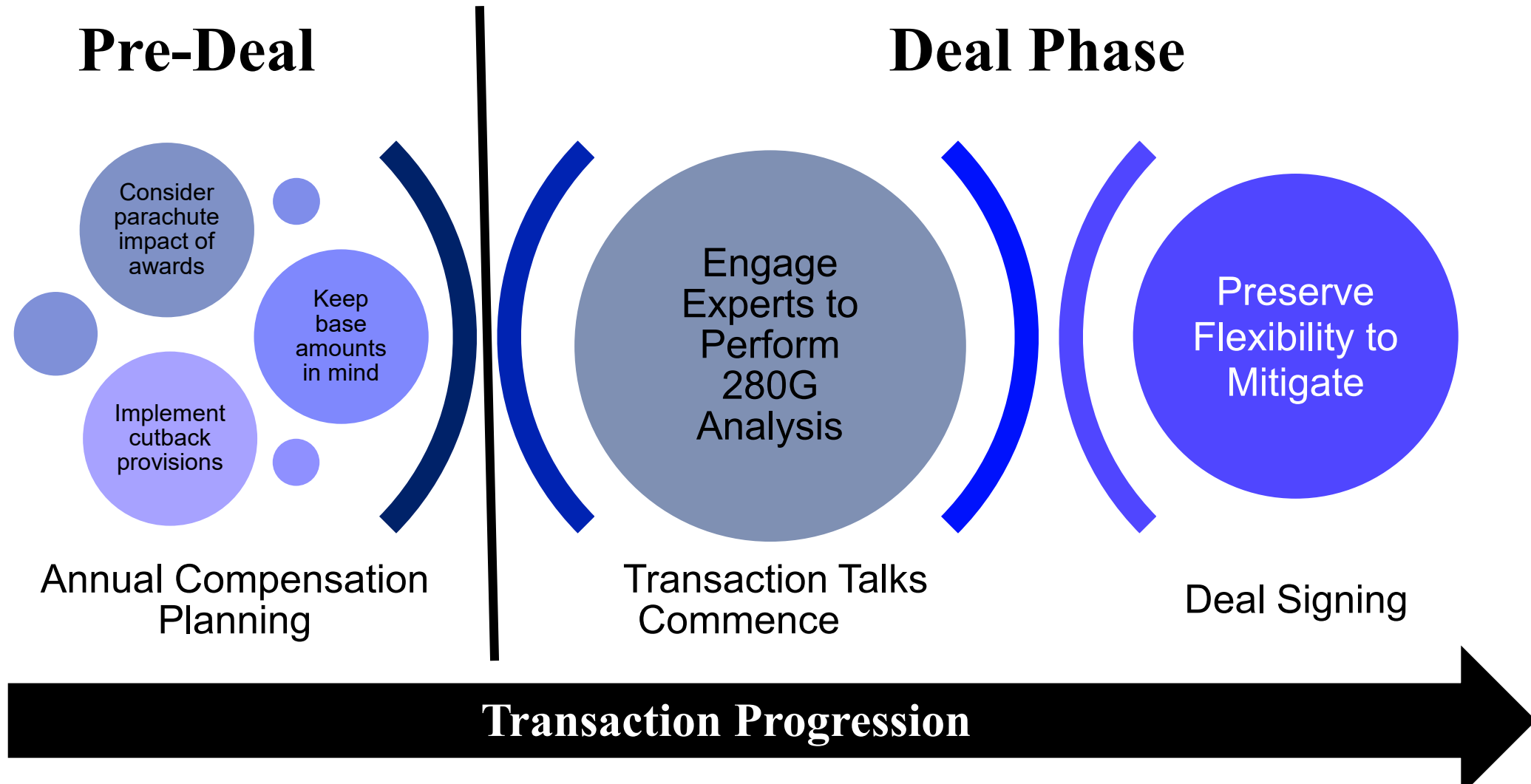
- Applies to **excess parachute payments** paid to a **disqualified individual** that are **contingent** on a **change in ownership or control** of a **corporation**
- Related Section 4999 imposes **20% excise tax** on disqualified individuals who receive excess parachute payments
 - Paying corporation **loses compensation tax deduction** under Section 280G
- Section 280G imposes a cliff:
 - **If** a disqualified individual receives payments or benefits *as a result of a CIC* that **equal or exceed three times (3x)** his or her average compensation for the five calendar years preceding the year in which the CIC occurs (the base amount)
 - **Then** the 20% excise tax applies to the value of the payments or benefits that exceed one times (1x) his or her base amount

Deal Decisions and 280G

- Go-forward arrangements with salary increases, bonus increases and/or new equity grants **may be included** as parachute payments under Section 280G **if executed or significantly negotiated prior to closing**
- Post-closing arrangements may be excluded from 280G, so long as they were **not significantly negotiated prior to closing**
- **280G mitigation strategies may be available, some of which are specific to transactions that sign in one year and close in another**

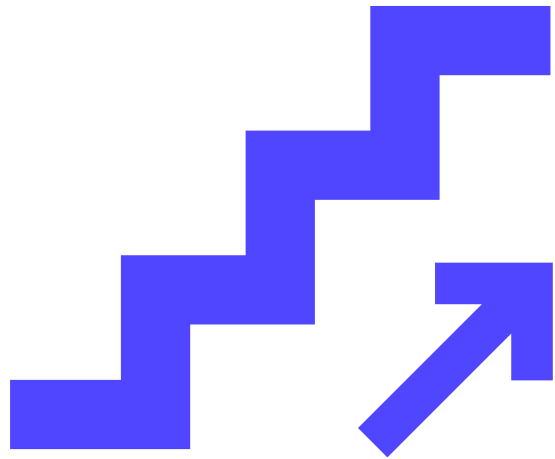


Ensuring Successful 280G Outcome

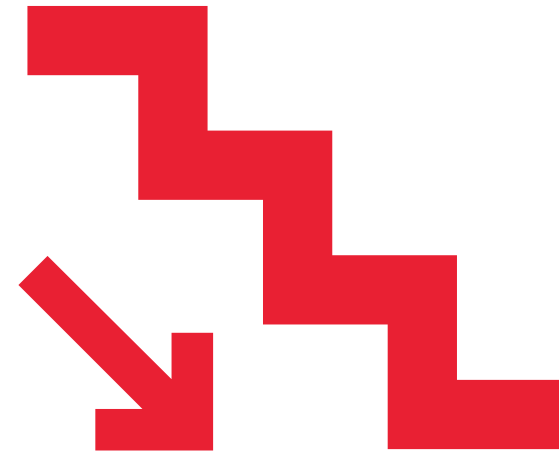


Mitigation Objectives

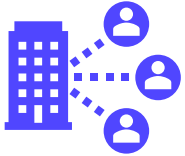
- Increase 280G Safe Harbor



- Decrease Parachute Payments



Potential Mitigation



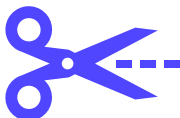
Excess parachute payments are reduced by “**reasonable compensation**”

- **For personal services rendered before date of CIC**
 - e.g., prorated annual bonus and performance-based incentives
- **For personal services to be rendered on/after date of CIC**
 - e.g., payment for noncompete, consulting agreements, retention bonuses
- “Reasonable compensation” **must be established by clear and convincing evidence**



Pull compensation into earlier tax year in order to increase base amount

- e.g., **accelerating payment of annual, transaction bonuses and/or vesting/settlement of equity awards**



Cut-back, modified cutback or “best net after-tax”

Section 280G: Private Company Shareholder Approval

If stock of the corporation is not publicly traded, shareholders may approve parachute payments to avoid 20% excise tax and loss of tax deduction

Requirements:

- **Approval by more than 75% of shareholders entitled to vote**

Disqualified individuals with excess parachute payments that are shareholders are not entitled to vote – shares are excluded from calculation

- **Waiver agreements – vote determining right of DQIs to retain payments**
- Must waive all potential payments that exceed 3x base amount, minus \$1
- If shareholders do not approve, waived payments cannot be made
- **Adequate disclosure** of all material facts to all shareholders entitled to vote

When does compensation get disclosed in the transaction context?

- Shareholder solicitation filings
 - E.g., merger proxy
- Form 8-K
- 280G Shareholder Vote (private companies)



Interests of Directors and Executive Officers

- Item 5 of Schedule 14A requires companies to briefly describe **any substantial interest**, direct or indirect, **of each** person who has been a **director or executive officer** of the registrant at any time since the beginning of the last fiscal year
- Tabular disclosure not mandated by the rules
- **Disclosure not limited to named executive officers**

Say-on-Golden Parachute



- If shareholders asked to approve a transaction, company must provide a **separate shareholder vote to approve any agreements** or understandings **between the target or the acquiror and each named executive officer**
- Arrangements must relate to the transaction

Scope of Say-on-Golden Parachute Disclosure

- Disclosure is required to be provided in both tabular and narrative forms

Golden Parachute Compensation

Name	Cash (\$)	Equity (\$)	Pension/ NQDC (\$)	Perquisites/ Benefits (\$)	Tax Reimbursement (\$)	Other (\$)	Total (\$)
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
PEO							
PFO							
A							
B							
C							

- Emerging Growth Companies are exempt

Form 8-K

- Transaction announcement commonly describes treatment of equity awards
- Go-forward arrangements with named executive officers are separately required to be disclosed
- Certain actions taken prior to deal announcement (e.g., retention arrangements, CIC severance agreements) may require disclosure



Key Takeaways



The background of the left side of the image is a dark blue field with a network of red lines connecting various points, creating a complex, geometric pattern. Small blue and white plus signs are scattered throughout the background.

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Appendix

Section 280G: Change in Ownership or Control

- A “Change in Ownership or Control” for 280G purposes occurs if:
 - a person or group **acquires stock** that (together with previously-held stock) **represents more than 50%** of the total fair market value or total voting power of the stock of the Corporation
 - a person or group **acquires assets** of the corporation representing **one third or more** of the fair market value of the corporation’s assets during a 12 month period (note that this can occur upon sale of a significant subsidiary)
 - a person or group **acquires** stock possessing **20% or more of the total voting power in a 12 month period** + control actually changes

Section 280G: Disqualified Individuals

- **1% shareholders**
 - Hold at least 1% of FMV of outstanding shares - **vested stock options are included**
 - Can pick up directors and consultants
- **Officers**
 - Greater of (i) 10% of highest number of employees in prior 12 months and (ii) 3 employees; maximum of 50
 - **In practice limited to employees with VP title or higher**
 - Other employees included if facts & circumstances ≈ authority of an officer
 - Rank based on most highly compensated
- **Highly compensated employees**
 - **Highest paid 1% with compensation ≥ \$155,000** (for 2024), with a limit of 250
 - Can pick up consultants

Section 280G: Parachute Payments

- **Parachute Payments**

≈ Any payment or benefit **contingent on the closing of the CIC** (or event closely associated, e.g., **termination of employment**)

- **One-Year Lookback Presumption**

Any payment or benefit made or received under agreement entered into within 12 months before or after closing is a parachute payment

- **Examples**

- Transaction bonuses
- Severance (cash severance, COBRA reimbursements)
- Accelerated vesting of equity awards or other benefits
- Pro-rated annual bonuses
- Increased compensation or equity grants under buyer offer letters

Section 280G: Excess Parachute Payments

- **Excess Parachute Payments** occur if the **value of all CIC payments equals or exceeds three times the individual's base amount**



- Base amount – **average taxable compensation (W-2 or 1099) over 5 year period** prior to year in which closing occurs



- Safe harbor – **3x base amount minus \$1**



- *Excess parachute payment – amount by which the actual value of all payments and benefits exceed 1x base amount*

- Conservative calculation – assume any payment or benefit that could be made or received will be made or received for purposes of calculations

Inducement Grant Exception

- Pursuant to the Nasdaq FAQs, for grants that take place within a two-week period, the Company may disclose, on an aggregate basis:
 - (1) the total number of inducement awards granted,
 - (2) the total number of shares made subject to those awards and
 - (3) the total number of newly hired employees who received the inducement awards.
- If the grants take place over a longer period, the grants may not be aggregated and must be separately announced. For example, if inducement awards are granted to employees on January 15, 2025 and then additional inducement awards are granted to employees on January 25, 2025, the disclosure of such awards may be aggregated and disclosed in one press release issued no later than January 29, 2025
- Aggregated disclosure of multiple awards is not permitted for individually negotiated awards and awards to executive officers (i.e., Section 16 officers)

Inducement Grant Exception

- Employment offer letter should reference reliance on the inducement grant exception
- Shares should be registered on Form S-8 and awards described in accompanying prospectus
- Notify exchange of inducement grant
 - Nasdaq Listing of Additional Shares (LAS) Notification
 - NYSE Supplemental Listing Application (SLAP)
- ISOs not available under non-shareholder approved plans