

UK Companies: Guide to Granting Share Options in the US

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This alert serves as a guide for UK and non-US clients wishing to grant options to employees and other service providers in the US.

There are 5 key steps in the process (each discussed below):

1. Board approval
2. Shareholder approval
3. 409A valuation
4. US securities law requirements
5. Grant process and documentation

1. Board approval

The company's board of directors must first adopt a share plan, which will provide the framework for the US option grants and a set of template documents to be used to make those grants (notice of grant, option agreement and exercise notice).

If there is a plan already in place, a US sub-plan to that plan should be adopted to ensure the options function properly with regard to US tax and securities law, and that leaver provisions work in the context of US employment arrangements (likely to be "at will" rather than subject to an employment contract with a notice period).

2. Shareholder approval

The share plan and US sub-plan, together with a limit on the number of shares issuable upon exercise of ISOs, will need to be approved by the shareholders within one year of adoption.

Generally, option grants can be made before this shareholder approval is obtained.

3. 409A valuation

To avoid significant adverse tax consequences under Section 409A of the US tax code, each option needs to have an exercise price of not less than the "fair market value" of the company's ordinary shares at the time of grant.

Companies operating an EMI option plan in the UK will not be able to rely on the HMRC-approved EMI valuation for US purposes as the valuation principles are very different.

Best practice is for companies to engage a third party to perform a "409A valuation".

In order for the 409A valuation to be valid, it must among other things, be performed:

- not less than annually; or
- if earlier, after any material event that may impact the value of a company's ordinary or common shares (such as financing, a partnership, etc.).

Many high-growth companies obtain quarterly (or more frequent) 409A valuations. Valuation providers typically agree to provide this service during the year on a packaged basis.

4. US securities law requirements

Before granting options in the US, it is important to check whether any filings, fees and/or notifications are required in the US state in which each option recipient resides (**not** the state in which they are working).

Many states require an inexpensive and simple filing to be made, and penalties may be levied for non-compliance.

Companies will also need to determine which US (federal) securities law exemption can be relied on for the option grants. Many companies will use Rule 701 under the US Securities Act of 1933, as amended.

5. Grant process and documentation

The board of directors (or remuneration/compensation committee if authority has been delegated to them) must formally approve the options – the date of this approval will be the grant date.

The action (board minutes, resolution, consent or similar as required by applicable law and the company's constitution) granting the option will need to include at least the following:

- a. the name of the individual being granted the option;
- b. the number of shares subject to the option;
- c. whether the option is intended to be a tax favourable incentive stock option (ISO). If not, it will be a nonqualified, or NQ, option;
- d. the per share exercise price;
- e. the vesting (including any vesting acceleration) terms;
- f. whether the option can be exercised over unvested shares subject to post-exercise vesting; and
- g. the maximum term of the option (generally 10 years, but certain ISOs may only have a five-year term).

The recipient of the option must be actively employed/engaged at the time of grant. The grant cannot be approved in anticipation of a future start date.

How Cooley can help

Counsel who understand the US intricacies (including tax and securities laws) should be consulted in order to ensure that the company's existing share plan and US sub-plan together meet all the necessary US federal and state specific requirements and all necessary ancillary actions are undertaken in a compliant manner.

We'd be happy to discuss extending share-based awards to your US workforce. We are experienced in advising on the key issues and steps for adoption and implementation.

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