Compensation

Extending the Life of Your Share Pool

Inducement grants are a way to attract talent without burning the share pool.

By Bob Romanchek and Don Kalfen

Imagine your organization is just about to hire a new CEO from outside the company. The prospective CEO's compensation offer includes a large grant of equity incentives. This grant includes two years' worth of normal annual cycle grants and a buyout of equity awards and retirement benefits that the prospective CEO will forfeit upon terminating employment with his current employer. Everyone is excited about the arrival of the new CEO, but there is one significant issue: the CEO's hiring grant will consume a large portion of your organization's share pool, leaving an inadequate number of remaining shares to fund anticipated grants to all other participants over the next year.

The next shareholders' meeting may be months away, and adding more shares may not be possible due to high dilution levels. What can be done to avoid this conundrum? A surprisingly easy (but rarely used) solution is available to NYSE- and Nasdaq-listed companies.

Generally, both stock exchanges require equity grants to be made under shareholder-approved equity plans. However, the exchanges exempt from this requirement "inducement" awards. This exemption is available to a listed company if the following fairly simple requirements are met:

- The equity award is made to an individual not previously an employee or director of the listed company (or being reemployed following a bona fide period of non-employment with the listed company) as an inducement material to the individual entering into employment with the listed company.
- The equity award is approved by either the listed company's independent compensation committee or a majority of the listed company's independent directors.
- Promptly following the grant of an inducement award, the listed company must disclose in a press release the material terms of the grant, including the recipient of the grant and the number of shares involved.

If these requirements are met, a company may grant an equity-based inducement award outside of its shareholder-approved equity plan so that the share pool is not depleted. The utility of the inducement award exemption goes beyond equity grants to a new-hire CEO since such inducement grants are available for awards made to any employee.

An inducement award may be made solely under an award agreement or under a non-shareholder approved equity plan. In the former case, care should be taken to ensure that the award agreement includes all the terms and conditions of an equity plan that are usually incorporated by reference into an award agreement. If a company routinely makes inducement awards and share pools are constrained, then the establishment of a non-shareholder approved equity plan could make sense under which such awards may be granted and funded.

The downside appears to be the loss of the "performance-based" exemption under Internal Revenue Code Section 162(m) million-dollar tax deduction rules if the grant would otherwise be performance-based. However, many times a new-hire grant takes the form of restricted stock/unit that would normally not be performance-based anyway.

Regardless of whether your organization's share pool is nearing depletion, taking advantage of the inducement award exemption for new hires offers several benefits, including extending the life of the existing share pool, mitigating the possibility of running out of shares prior to the next shareholder meeting, and ensuring that there will always be shares available to fund inducement awards.

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