Why Companies Should Now be Implementing “Net Exercises” —Everything You Need to Know

A Word from the Publisher

As our readers may have noticed, now that David Lynn, former SEC Chief Counsel, has joined the team—providing important proxy disclosure guidance and other critical practical guidance—The Corporate Executive has become a “must” for an even larger audience.

As demonstrated by the lead article in this issue, we continue to provide you with the latest developments and innovations impacting your most important “clients.” We are devoting this entire issue to net exercises and their alternatives because this exciting new trend is so important and will affect so many companies.

For those of you on the fence about net exercises, we start the article by enumerating the many advantages these programs offer over traditional cashless/same-day-sale exercises. Starting on page 2, we provide an in-depth explanation of the mechanics of net exercises and their various alternatives: stock-settled SARs and pyramid and swap exercises. On page 4, we discuss practical solutions for handling the tax withholding required for these transactions and, on page 6, we explain why ISS’s position on liberal share-counting provisions shouldn’t discourage companies from implementing net exercise, etc., programs. We conclude the article with step-by-step instructions for implementing your own net exercise program.

Based on the SEC’s most recently published rulemaking agenda, it appears that the agency is poised to take a fresh look at the executive compensation disclosure rules. This latest effort is necessitated by the SEC’s adoption of relatively unusual “interim final” rules back in December 2006—and creates a perfect opportunity to address some aspects of the rules that could use clarification or improvement now that the Staff has completed its targeted review of proxy disclosures. In a Special Supplement to this issue, we outline four critical fixes that the SEC may want to consider to make the rules operate as effectively as possible—and provide the type of disclosure that investors and others are actively seeking about executive compensation. We certainly hope that the SEC will consider these fixes in fine-tuning the rules for next year’s proxy season so that the momentum toward improving executive compensation transparency and practices continues.

—Eds.

Net-Settled Options: The Silver Lining in FAS 123(R)

While opinions may vary as to whether FAS 123(R) overall has been good or bad for business, we think that everyone can agree that one silver lining in the standard is the elimination of adverse accounting treatment for stock-settled stock appreciation rights and pyramid and net exercises. Under APB Opinion No. 25, all forms of stock appreciation rights, whether settled in cash or stock, were subject to variable plan accounting. Ditto for any option exercise that did not involve either an inflow of cash to the company (either from an open market sale or the employee’s pocket) or tender of shares that had been owned for at least six months to cover the exercise price.
Under FAS 123(R), all this noise goes away, provided that the option or right will ultimately be settled in stock. The requirement that shares tendered to cover the exercise price be held for six months is eliminated, enabling net exercises, as well as pyramid exercises and stock-settled SARs, to receive the same accounting treatment as cashless/same-day-sale exercises.

**Time to Switch from Cashless Exercises to Net Exercises**

With the accounting treatment no longer an obstacle, we think it’s time for all companies to consider implementing “net exercises”—or stock-settled stock appreciation rights—as these arrangements offer considerable advantages over traditional cashless exercise/same-day-sale programs, including:

- Net exercises and SSARs, etc. provide the very same economic benefit to employees as cashless exercises but result in fewer shares issued and sold into the market. (The economic benefit to employees is actually slightly better because the brokerage commission is saved.)
- By reducing the number of shares issued, net exercises and SSARs reduce plan dilution. (One issuer has calculated a savings of 70% fewer shares over the life of the plan—see pg 7.)
- The reduced flow of shares into the market also alleviates the need for company repurchase programs, which can be administratively burdensome and often require execution under Rule 10b5-1 plans and compliance with Rule 10b-18.
- With net exercises and SSARs, companies may be able to disclose a lower number of the shares as outstanding under Reg S-K Item 201 (the stock plan table).
- Switching to net exercises or SSARs can extend the life of your stock plan by increasing the number of shares available for grant (if the plan includes a net counting provision).
- Net exercises and SSARs can eliminate the many administrative hassles and fees involved in same-day-sale exercises—including the headache of employees having to report capital gains or losses due to differences between the actual sale price and the reported FMV.
- Net exercises and SSARs can mitigate insider trading compliance concerns (both short-swing profits recovery and insider trading considerations) by eliminating open market sales to fund exercises.
  - For insiders/affiliates, net, pyramid, swap and SSAR exercises are not reported as an open market sale on Form 4. Instead, provided that no shares are sold to cover taxes, the settlement is reported as a simultaneous exercise and disposition of shares to the company and does not require a Form 144.
  - Net exercises can result in executives holding the net shares for the long-term (and can facilitate “hold-till-retirement” policies for top executives).

**What You Need to Know About Net Exercises and SSARs**

Net exercises and SSARs provide the same economic benefit to employees as cashless exercise/same-day sales, but do so with fewer shares. Just as with cashless exercises, upon exercise, employees receive the stock price appreciation that has accumulated in the option since it was granted. But with stock options, employees must first pay the exercise price to receive the stock underlying the option (which is sold immediately into the market to cover the cost of the transaction). In the case of a net exercise, the employee simply receives the net shares representing the “gain” on the option—the difference between the exercise price and the current FMV, thus eliminating the need for an immediate open market sale (except possibly to cover taxes, see below).

For example, assume an option for 100 shares is granted when the FMV is $10 per share and exercised when the FMV is $25 per share. To exercise the stock option under traditional methods, the employee must come up with $1,000 to pay the company, almost always selling the exercised stock in a cashless exercise/same-day sale to do so. The company then issues all 100 shares underlying the option—but the shares are issued to the employee’s broker and immediately used to settle the employee’s trade—the employee sells them before even owning them. The employee would have realized approximately $2,500 on the sale, resulting in a profit of $1,500 (less any brokerage commissions, etc.).

On the other hand, with a net exercise or an SSAR, the employee pays nothing for the exercise; instead, the employee simply receives $1,500 worth of stock, or 60 shares ($1,500...
divided by $25). Instead of issuing 100 shares, the company issues only 60 shares. There is no need for a sale into the market to pay the exercise price, increasing the likelihood that employees will hold on to their shares (and facilitating hold-til-retirement policies for top executives). No sale also means no Form 4, no sale reported on Form 4 (although it would still be necessary to file a Form 4), and fewer concerns over insider trading.

With only 60 shares issued instead of 100, the net exercise is less dilutive to shareholders. In addition, if dilution is not a concern, the 40 unissued shares could potentially be returned to the plan reserve and made available for new grants.

Net Exercises vs. SSARs. Both net exercises and SSARs deliver the same economic benefit in essentially the same manner; the difference between the two rights is really more in semantics. We prefer net exercises over SSARs. With net exercises, employees have traditional options; there is no separate instrument to deal with administratively and no learning curve for employees to understand the new instrument. Upon exercise, the company essentially withholds shares sufficient to cover the exercise price. The net exercise in our example involves the deemed exercise of the employee's entire option for 60 shares of $25 stock (the exercise price of an option for 100 shares). There is no additional payment to the employee because the difference between the exercise price and market value of the underlying stock is deemed paid in stock.

The net exercise in our example involves the deemed exercise of the employee's entire option for 60 shares of $25 stock (the exercise price of an option for 100 shares). There is no additional payment to the employee because the difference between the exercise price and market value of the underlying stock is deemed paid in stock. In an SSAR, there is some question as to whether the built-in appreciation in the right funds the exercise price of an option (see our November-December 2004 issue at pg 9). By granting it in tandem with a stock option, SSARs can be granted in tandem with a stock option.

Automatic Net Exercise at Expiration. We have noted that net exercises don't actually have a right to receive the appreciation accumulated in the stock underlying the right. In a stock-settled SAR, this appreciation is paid out in stock, based on the current FMV. Thus, the employee ends up with the same number of shares in the money and continues to have unlimited leverage. In a stock-settled SAR, an employee is entitled to a payment of $25 (the spread at exercise) on 40 shares if the stock price at expiration is at least six months to avoid mark-to-market variable accounting (see our January-February 1998 issue at pg 5).

With SARs, employees don't actually have a right to purchase stock; instead, they have the right to receive the appreciation accumulated in the stock underlying the right. The same rule applies to net exercise. Because this is essentially the same as exercise, but now net settlement seems like a better alternative. It avoids the waste of expired options (with no reversal of previously recognized expense), without the hassles (and commissions) of a same-day-sale exercise and delivers shares (rather than cash) to employees.

Other Alternatives—Swap and Pyramid Exercises. 123(R)'s elimination of the mature share requirement also facilitated the tender of already-

Do not be without The Corporate Executive for the critical days ahead.

With net exercises, the company could continue to permit alternative exercise methods, such as paying cash to exercise the option. The same objective could be accomplished with an SSAR by granting it in tandem with a stock option.

Not permissible for ISOs? We have noted that net exercises don't actually have a right to receive the appreciation accumulated in the stock underlying the right. In an SSAR, the net exercise is less dilutive to shareholders. In an SSAR, there is some question as to whether net-settled options can be ISOs. At a minimum, a net exercise would be ISOs. At a minimum, a net exercise would be ISOs. At a minimum, a net exercise would be ISOs. At a minimum, a net exercise would be ISOs.
owned shares to pay the exercise price of an option (a stock “swap”) and clears the way for pyramid exercises.

Swap Exercises. A swap exercise is a stock option exercise where employees tender more shares than they actually own—say, 40 shares to exercise 100 shares of an ISO. In other words, the employee would own 40 shares and would tender those shares in exchange for the ISO shares. If the shares are exchanged for less than ownership, then employees simply tender the shares—no compensation. The exercise will be treated as a straight-forward exercise, if the option is an ISO. Instead of the option price, the tax basis and character of the tendered shares will be used to determine the tax consequences. The exercise will be treated as a straight-forward exercise, if the option is an NQSO. In this case, the employee will recognize ordinary income equal to the exercise price of the option, the property proceeds equal to the exercise price, and the basis will be the lower of the exercise price or the fair market value of the stock at the date of exercise. (See the March-April 1982 issue of The Corporate Counsel at pg 8.)

Pyramids. A pyramid exercise is a form of swap exercise that is useful when the employee doesn’t have enough already-owned shares to exercise the option. In a pyramid exercise, the employee tenders shares (see our March-April 1987 issue at pg 2). The employee simply attests to owning these shares, and the company issues only the net 60 shares (see our November-December 1996 issue at pg 6). In practice, all the tenders happen virtually, so the employee doesn’t pay to swap (or owns no shares). The employee in a pyramid exercise, the employee has to either exercise and net exercise or SSARs, is that with already-owned shares to purchase the remaining shares in the company, but because the option retains its ISO character (a stock "swap") and clears the way for pyramid exercises. The tender is viewed as a tax-free exchange of the shares. Of course, if the option is an NQSO, the sale price and the original basis of those shares acquired on exercise, the employee will recognize a capital gain on the difference between the tax basis and character of the tendered shares, to the number of shares tendered take on the tax basis complications for pyramids, particularly of NQSOs, they are subject to the same tax treatment as SSARs. Outcomes and Considerations."

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.
ment. The ordinary income recognized upon exercise is subject to the same tax withholding that applies to cashless/same-day-sale exercise of NQSOs (including FICA), and reported on Form W-2 for employees (Form 1099-MISC for outside directors and other non-employees).

The tax withholding could be paid in one or more installments that are witheld as the exercises occur or on a single day when the options are exercised. Of these three alternatives, share withholding is the easiest from an administrative standpoint. Payment is made at withholding from the exercise proceeds to cover the tax liability. The employee is not required to file a separate Schedule D, or a tax return. The amount withheld from the exercise proceeds is taxed as ordinary income.

Share withholding avoids the administrative overhead inherent in issuing the shares and the administrative costs and time associated with open market sales. The exercise price is subject to the same tax withholding as the sale price. The value used to determine the employee's ordinary income is the option exercise price. This creates a discrepancy between the sale price and the option exercise price. This creates a discrepancy between the amount used to compute the taxable gain and the FMV of the exercised shares and the option exercise price. This creates a discrepancy between the FMV of the exercised shares and the option exercise price. This creates a discrepancy between the amount used to compute the taxable gain and the FMV of the exercised shares and the option exercise price. This creates a discrepancy between the amount used to compute the taxable gain and the FMV of the exercised shares and the option exercise price.

A Big Administrative Advantage Over Cashless Exercises. Share withholding resolves these issues. In our example, the company would simply hold back an additional 15 shares to cover the withholding. This is an efficient and cost-effective way to cover the tax withholding, and the employee is still subject to the same administrative costs and time associated with open market sales.

Avoiding an open market sale can also ease compliance with insider trading blackouts (depending on the language of the company's insider trading policy) and mitigate Rule 10b-5 concerns and the need for complicated Rule 10b5-1 trading plans. [Note also that, as long as the tax withholding right was approved in advance by the board of directors, a committee]
The Corporate Executive
March-April 2008

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.
Do not be without

The Corporate Executive

for the critical days ahead.

The impact of net exercises, etc., on basic earnings per share, however, could be quite different. In our earlier example, we contrasted a same-day-sale exercise with a net exercise: the same-day sale resulted in the issuance of 100 shares vs. 60 shares for the net exercise. Once these shares are issued, the Treasury Stock Method no longer applies. Instead, the shares are included in the denominator for basic EPS on a share-for-share basis. Thus, the same-day sale in our example increases the denominator for basic EPS by 100 shares; the net exercise increases the denominator by only 60 shares.

Over time, shares issued under plans add up. For most public companies, their stock plans are the predominant source of shares flowing into the market; many have to implement costly repurchase programs to offset the shares issued. With net-settled options and their alternatives, this flow of shares into the market is markedly diminished. Duke Realty implemented a program that allowed optionees to repurchase the company's stock on the open market. The company assumes the full option is exercised on the critical days ahead. The options were exercised on a cashless basis for ISS to approve for the plan back up to what would have been approved before net exercises. In terms of the shares available for grant under the plan, the company would be no worse off than with traditional stock options but the company would still enjoy the other benefits of net-settled options, etc., (reduced or eliminated flow of shares into the market, lower dilution, less pressure to repurchase shares, streamlined plan transactions, fewer insider trading concerns, etc.).

Keep in mind that this issue only arises if and when a new plan or amendment is submitted for shareholder approval.

Real EPS Impact—Another Plus for Net Exercises. The impact of net exercises and their alternatives on diluted earnings per share is the same as that of traditional option exercises. For example, had Duke Realty implemented requests that net-settled options, etc., on par with cashless exercise/same-day-sale options in ISS’s analysis and would have increased the number of shares ISS would approve for the plan back up to what would have been approved before net exercises. In terms of the shares available for grant under the plan, the company would be no worse off than with traditional stock options but the company would still enjoy the other benefits of net-settled options, etc., (reduced or eliminated flow of shares into the market, lower dilution, less pressure to repurchase shares, streamlined plan transactions, fewer insider trading concerns, etc.).

Keep in mind that this issue only arises if and when a new plan or amendment is submitted for shareholder approval.

Real EPS Impact—Another Plus for Net Exercises. The impact of net exercises and their alternatives on diluted earnings per share is the same as that of traditional option exercises. For example, had Duke Realty implemented requests that net-settled options, etc., on par with cashless exercise/same-day-sale options in ISS’s analysis and would have increased the number of shares ISS would approve for the plan back up to what would have been approved before net exercises. In terms of the shares available for grant under the plan, the company would be no worse off than with traditional stock options but the company would still enjoy the other benefits of net-settled options, etc., (reduced or eliminated flow of shares into the market, lower dilution, less pressure to repurchase shares, streamlined plan transactions, fewer insider trading concerns, etc.).

Proxy Disclosure. An important issue for all stock option exercises is disclosure. The Treasury Stock Method no longer applies; instead, the shares are included in the denominator for basic EPS on a share-for-share basis. Moreover, when disclosing net, swap, pyramid, and SSAR exercises in the Option Exercises and Stock Vested Table, the aggregate number of shares exercised should
March-April 2008
The Corporate Executive

112), pyramid and swap exercises of an option

In terms of the S-K Item 703 disclosure relating to company transactions in their own stock, there are
generally two mandatory disclosures: a share purchase, but 8(a) for the net settlement of options, and
Section 16 Reporting. Alan Dye’s Section 16 Forms and Filings Handbook (2005 edition) contains
model Forms 4 for net exercises (Model Form No. 109), SSARs (Model Form Nos. 111 and 112), pyramid and swap exercises of an option

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.

A further advantage here is that all of the shares tendered to the company to cover the option price (and taxes) would be valued at the same price and could be reported as a single transaction, as opposed to the numerous transactions (sometimes over 30, requiring multiple Forms 4) that are necessary for cashless/same-day-sale exercises where shares are typically sold in many different lots, at many different prices, each triggering a separate reportable transaction.

Generally, amending a plan that provides for the grant of traditional stock options to allow for
SSARs, cashless, same-day sale or tandem SSARs, could be
necessary for cashless/same-day-sale exercises, and the
necessary for cashless/same-day-sale exercises, and the
taxes, an additional transaction is necessary.

Where shares are typically sold in many different
lots, at many different prices, each triggering a
separate reportable transaction.

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.

A further advantage here is that all of the shares tendered to the company to cover the option price (and taxes) would be valued at the same price and could be reported as a single transaction, as opposed to the numerous transactions (sometimes over 30, requiring multiple Forms 4) that are necessary for cashless/same-day-sale exercises where shares are typically sold in many different lots, at many different prices, each triggering a separate reportable transaction.

Generally, amending a plan that provides for the grant of traditional stock options to allow for
SSARs, cashless, same-day sale or tandem SSARs, could be
necessary for cashless/same-day-sale exercises, and the
necessary for cashless/same-day-sale exercises, and the

Where shares are typically sold in many different
lots, at many different prices, each triggering a
separate reportable transaction.

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.

A further advantage here is that all of the shares tendered to the company to cover the option price (and taxes) would be valued at the same price and could be reported as a single transaction, as opposed to the numerous transactions (sometimes over 30, requiring multiple Forms 4) that are necessary for cashless/same-day-sale exercises where shares are typically sold in many different lots, at many different prices, each triggering a separate reportable transaction.

Generally, amending a plan that provides for the grant of traditional stock options to allow for
SSARs, cashless, same-day sale or tandem SSARs, could be
necessary for cashless/same-day-sale exercises, and the
necessary for cashless/same-day-sale exercises, and the

Where shares are typically sold in many different
lots, at many different prices, each triggering a
separate reportable transaction.

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.

A further advantage here is that all of the shares tendered to the company to cover the option price (and taxes) would be valued at the same price and could be reported as a single transaction, as opposed to the numerous transactions (sometimes over 30, requiring multiple Forms 4) that are necessary for cashless/same-day-sale exercises where shares are typically sold in many different lots, at many different prices, each triggering a separate reportable transaction.

Generally, amending a plan that provides for the grant of traditional stock options to allow for
SSARs, cashless, same-day sale or tandem SSARs, could be
necessary for cashless/same-day-sale exercises, and the
necessary for cashless/same-day-sale exercises, and the

Where shares are typically sold in many different
lots, at many different prices, each triggering a
separate reportable transaction.

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.

A further advantage here is that all of the shares tendered to the company to cover the option price (and taxes) would be valued at the same price and could be reported as a single transaction, as opposed to the numerous transactions (sometimes over 30, requiring multiple Forms 4) that are necessary for cashless/same-day-sale exercises where shares are typically sold in many different lots, at many different prices, each triggering a separate reportable transaction.

Generally, amending a plan that provides for the grant of traditional stock options to allow for
SSARs, cashless, same-day sale or tandem SSARs, could be
necessary for cashless/same-day-sale exercises, and the
necessary for cashless/same-day-sale exercises, and the

Where shares are typically sold in many different
lots, at many different prices, each triggering a
separate reportable transaction.

How to Implement Net-Settled Options, Etc.

Step 1: Shareholder Approval—Often No-Need. The first step in the process will be to review your
stock plan to see if it permits, or requires, cashless, same-day sale or tandem SSARs. Many
companies have omnibus plans that permit a
broad range of grant types and exercise methods,

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.
engage in swap, pyramid, or net exercises doesn't involve any of those actions and shouldn't require shareholder approval under NYSE listing requirements. Moreover, the NYSE has said that options and SARs are the same "type" of award, therefore adding SARs to a plan that already allows traditional options is not considered a material amendment (NYSE FAQ C-3).

The key is to get it on paper. There is no reason to wait. Under the circumstances, is material is considered to be included practically in any circumstances if it is the case. The directors of the company and OTHER ACTION AT THE<span class="redacted">CONFERENCE OF THE</span> CORPORATION, or any of its directors, have not, within the previous two years, engaged in any such sale. Furthermore, the directors of the company have not, within the previous two years, engaged in any such sale.

Amending your plan to allow net counting, however, may be a little more difficult. First, the company will need to amend the plan to allow net counting, and then the plan prospectus will need to be amended accordingly.

Step 2: Make Critical Plan Design Decisions. Inasmuch as net exercises, SSARs, etc. deliver the same economic benefit as options under a stock option program, all the same plan design criteria will be applicable. However, the company may wish to apply some restrictions to the plan. For example, the company may wish to limit the number of net exercises that can be made in a given period, or to limit the number of net exercises that can be made in a given period, or to limit the number of net exercises that can be made in a given period, or to limit the number of net exercises that can be made in a given period.

We recommend that the company add a provision to the plan to allow employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation. The plan should include a provision allowing employees to exercise both with and without a cash settlement. This will provide flexibility for employees and reduce the need for additional documentation.
need to be filed as exhibits to Forms 10-Q/K and current disclosures may be necessary under Item 5.02 of Form 8-K if the plan includes executive officers.

Step 5: Amend Existing Options? Again, Good News. Steps 1 and 2 above take care of new grants, but what about your existing options? We've already noted that under the new rules, options that are not exercisable, vesting or granted, or are in the money on the date of the change will not continue to have value; existing options will not be continued, renewed, extended, or modified. Any amendment to reduce the value of the options doesn't count as a modification and therefore wouldn't cause any TIA accounting issues.

However, the changes do require that companies verify that the new grant complies with all the requirements for ISOs, including the $100,000 requirements for ISOs, including the $100,000. This will be necessary to allow the options to be renewed or entered into a No-Risk Trial, which will also avoid any TIA issues.

Companies should verify that the amendment is consistent with Rule 16b-3(d)(1) or (2). Art also tells us that there is a 2005 IRS letter ruling addressing ISAs that are converted to SSARs. Where the plan already allows net exercises, swap or pyramid exercise or to convert to SSARs. Where the plan is not already permitted to do these types of amendments, they will need to file as exhibits to Forms 10-Q/K.

Step 6: Educate Employees and Reap Benefits. If adding net exercises, pyramid or swap or an extension/expiration to an option doesn't constitute a modification, then the economics of the arrangement for the employee will not change.

Surprisingly, however, the amendment would not be a material modification to an option under Section 422. Even if the option is underwater at the time of the amendment, it would be necessary to verify that the new grant complies with all the requirements for ISOs, including the $100,000 requirements.

Ditto for Section 162(m) and Section 16—no problem there, as ISOs lack a valuation base.

Step 7: Educate, Reap Benefits, and Bring in New Talent. The CorporateCounsel.net offer rules.

Go to TheCorporateCounsel.net to renew—or enter a No-Risk Trial—now and gain instant access to this issue in its entirety.
may be skeptical at first, through examples and illustrations you can demonstrate that they are receiving the same economic benefit as previously under the cashless exercise/same-day sale program, with the added benefit of no brokerage fees. Net exercises are probably the easiest to communicate; employees still hold the same options they held before (perhaps new grant agreements might not even be necessary) and are just exercising via a new procedure—one that isn’t all that far off from the cashless exercise/same-day sale procedure they are used to. There are no complications such as the need to already own stock to effect an exercise or the convoluted transactions involved in pyramid exercises.

This is also the time to distribute any paperwork necessary, such as updated grant agreements, prospectus, etc., if necessary. [Don’t forget to also take advantage of this opportunity to remind executives of the company’s insider trading policies and procedures—while at the same time explaining how net exercises can alleviate insider trading, Rule 144 and Section 16 complications, since open market sales are not involved (if shares are not sold to cover taxes).] Then the company, employees and executives can begin enjoying the numerous benefits of net-settled options!

**Go to It!**

Most companies should now be switching from their current cashless exercise/same-day-sale program to net exercises—which will be a “win” for companies, employees, insiders, and administrators. And, brokers who currently handle cashless exercises can reap benefits.

Savvy brokers will recognize that the miniscule commissions they currently receive from cashless exercises do not cover the brokerage firm’s administrative costs of processing such transactions. The real benefit to the broker is the professional relationship and other business that can be developed with the company and its executives. We expect that the best and most professional brokers will now see the benefit of being the first to bring to their clients’ attention the benefits of net exercises over cashless exercises. Looking out for their clients’ long-term interests (over the broker’s slight commission loss—really not a loss, just a delay until the employee sells the net shares) will strengthen the broker’s relationship and surely pay dividends over the long term. (And, don’t overlook that some brokers will still need to facilitate same-day sales to cover tax withholding).

In short, go to it!

[The NASPP has just posted (at Naspp.com) a helpful chart comparing cashless/same-day-sale exercises to net exercises and their various alternatives, as well as a one-page summary of the benefits of net exercises over cashless/same-day-sale exercises. Those few subscribers who may not yet have discovered the benefits of the NASPP can take advantage of the no-risk trial at Naspp.com to gain access to these helpful materials—and to take advantage of the significant savings, especially the more than 50% discount on registration to this year’s NASPP Annual Conference.]

—J.M.B.
The NASPP invites you to join us for our 16th Annual Conference from October 21-24 in New Orleans. Building on our 16-year history as the premier event for stock plan professionals, the NASPP Annual Conference brings together top industry luminaries to deliver fresh perspectives and cutting-edge guidance on the latest issues in executive and stock compensation. This year’s Conference includes a full week of critical and timely sessions.

**The 2008 NASPP Annual Conference**

The 2008 Conference will focus on today’s hot topics, including executive compensation disclosures, deferred compensation, stock option expensing, the latest administrative innovations, new opportunities in plan design, international developments and changing shareholder expectations. Each of the 45+ Conference workshops will deliver the real-world, practical guidance you need to respond to the latest regulatory changes.

**BONUS: “5th Annual Executive Compensation Conference” at No Extra Cost!**

This critical one-day Conference will be held on October 22, the first day of the NASPP Conference, and is included in NASPP Conference registration. This major one-day program brings together top compensation consultants, critics and business leaders to share their own inside knowledge—and practical what-to-do-now guidance—that compensation committee members (and their advisors) need now.

**“Tackling Your 2009 Compensation Disclosures: The 3rd Annual Proxy Disclosure Conference”**

This critical one-day Conference on October 21, the day before the NASPP Conference, will provide “must have” guidance on how to comply with the SEC’s latest executive compensation disclosure positions and expectations—and best practices for drafting your own disclosures addressing the thorny issues.

**The Fundamentals of Stock Plan Administration**

This intensive two-day session, scheduled on October 20-21, before the NASPP Conference, imparts the substantive knowledge and broad range of responsibilities necessary for effective stock plan administration.

**NEW THIS YEAR: Restricted Stock Essentials**

Restricted stock and units are the hottest trends in stock compensation; are you prepared to administer these plans? Find out everything you need to know, from regulatory requirements to practical considerations, in the NASPP’s newest pre-Conference program, offered on October 20.

Do Not Delay. Hold Your Place. [Register Today! Go to Naspp.com or contact us at 925-685-9271.](mailto:925-685-9271)

&

“5th Annual Executive Compensation Conference”

October 21-22, 2008 in New Orleans and via Live Nationwide Video Webcast

With two year’s worth of proxy seasons under our belt, trends are emerging—and many open issues have arisen—regarding how to comply with the SEC’s latest executive compensation positions and what to do about the new executive compensation tools and expectations. With Congress, the SEC Staff, investors and the media scrutinizing the disclosures, it is critical to have the best possible guidance. This pair of full-day conferences will provide the latest essential—and practical—implementation guidance that you need.

For 2009, all eyes will be focused on the “Analysis” section of the CD&A and the need to address the tools that compensation committees are utilizing—and the resulting findings and actions. As a result, these Conferences—with the most respected experts in the field—will be a “must” for anyone who has any role in setting/approving compensation or the preparation or review of proxy statements.

Two Conferences in One! We have combined both of our popular Conferences—one focusing on proxy disclosures and the other on practices and analytic tools that need to be addressed (and disclosed)—into one critical package.

Like last year’s blockbuster conferences, an archive of the entire video for both conferences will be right there at your desktop to refer back to—and refresh your memory when you are actually grappling with drafting the disclosures and involved with an executive’s pay package.

Who Should Attend: Every person responsible for preparing and reviewing compensation disclosures—and every person responsible for implementing executive and equity compensation plans or who counsels or advises boards—including CEOs, CFOs, directors, HR staff, lawyers, corporate secretaries, accountants and consultants.

Where: You have two choices: you can attend the Conferences at the Hilton New Orleans Riverside or via Nationwide Live, Simultaneous Video Webcast to desktops, boardrooms and conference rooms. [If you plan to attend in New Orleans, make your reservations for the Hilton as soon as possible online or call 504-561-0500. Be sure to mention the NASPP Conference to receive reduced rates.]

Do not delay. Hold your place. Register today!

Go to TheCorporateCounsel.net now—or contact us at info@thecorporatecounsel.net or 925-685-5111 with questions.
Register Today to Obtain Early Bird Rates!

To accommodate the different needs of our community, we offer the following attendance alternatives

I. Yes, I will attend in New Orleans (four categories of attendees):
   1. $1595 Early Bird Rate (until May 20 only!) per person if you are a member of TheCorporateCounsel.net and CompensationStandards.com
   2. $1895 Early Bird Rate (until May 20 only!) per person if you are a member of either TheCorporateCounsel.net or CompensationStandards.com
   3. $2995 Early Bird Rate (until May 20 only!) per person if you are not a member of TheCorporateCounsel.net or CompensationStandards.com (non-members can qualify for the member rate by entering a no-risk trial)
   4. $1990 Special Combined NASPP Conference Rate (Early Bird Rate until May 20!) per person which includes attendance at the 3-day 16th Annual NASPP Conference

II. Yes, I will attend via the video webcast (three categories of attendees):
   A. Single User
      1. $1895 Early Bird Rate (until May 20 only!) per person if you are a member of TheCorporateCounsel.net and CompensationStandards.com
      2. $1695 Early Bird Rate (until May 20 only!) per person if you are a member of either TheCorporateCounsel.net or CompensationStandards.com
      3. $2795 Early Bird Rate (until May 20 only!) per person if you are not a member of TheCorporateCounsel.net or CompensationStandards.com (non-members can qualify for the member rate by entering a no-risk trial)
   B. Single Office Location, Unlimited Users (i.e., Unlimited)
      1. $2795 Early Bird Rate (until May 20 only!) for Unlimited use by all persons in a single office location—for companies/firms with a Single Office license to both TheCorporateCounsel.net and CompensationStandards.com
      2. $3695 Early Bird Rate (until May 20 only!) for Unlimited use by all persons in a single office location—for companies/firms with a Single Office license to either TheCorporateCounsel.net or CompensationStandards.com
      3. $4595 non-member rate
   C. Unlimited Locations, Unlimited Users (i.e., Firmwide)
      1. $3095 Early Bird Rate (until May 20 only!) for Firmwide use by all persons in multiple locations—for companies/firms with a Firmwide license to both TheCorporateCounsel.net and CompensationStandards.com
      2. $3995 Early Bird Rate (until May 20 only!) for Firmwide use by all persons in multiple locations—for companies/firms with a Firmwide license to either TheCorporateCounsel.net or CompensationStandards.com
      3. $5995 non-member rate

Form of Payment:
☐ Enclosed is our check for $___________. Please make your check payable to Executive Press, Inc.
☐ Credit Card payment ☐ VISA ☐ Master Card ☐ American Express
   Credit Card Number______________________ Expiration Date______________________
   Cardholder Name________________________ Authorized Signature______________________

Name__________________________ Title________________________
Firm____________________________ E-Mail____________________
Address_________________________ Tel. No.____________________
City/State/Zip____________________ Fax No.____________________

You can order online faster for these Conferences on TheCorporateCounsel.net or CompensationStandards.com!