
Share plan issues on IPO

Simon Evans / Alice Greenwell, 15 December 2014

What is an IPO?

- Initial public offering of shares
 - Institutional offering
 - Intermediaries / retail offering
 - Employee offering
- Offer for sale (by current shareholders) or subscription or a combination
 - Primary vs secondary offer
- Shares being admitted to listing by UKLA (or equivalent) and admitted to trading by London Stock Exchange (or equivalent)
- Offer of securities so a prospectus is required
 - “Pathfinder” initial document if marketing to institutions only
 - “Price-range” – a stamped prospectus (needed if retail / employee element)

Who is your client?

- Company (issuer)
- Sponsor (bank advising on IPO)
- Selling shareholders (including management)

Rough IPO timetable

Key dates for share plan lawyers are in bold

- Preparation / prospectus drafting
- **Intention to float (“ITF”)**
- **Board meeting to approve pathfinder / price-range prospectus**
- Publish pathfinder / price-range prospectus
- Roadshows and bookbuilding
- Pricing and allocation
- **Publish final prospectus and pricing supplement**
- **Conditional trading (grey market)**
- **Admission**
- Lock-up period

What is your role – acting for issuer / company?

- Director and management issues – wider role
 - Board / committee structure
 - “Independence” issues on NEDs
 - Committee terms of reference
 - Executive director service contracts
 - NED letters
 - D&O and indemnities
- Remuneration and share plan issues
 - Unwinding pre-IPO management share arrangements
 - All-employee share arrangements – on and after IPO
 - Post-IPO executive share incentives (and summaries for prospectus)
 - Post-IPO remuneration policy and interaction with new DRR regime
 - Various prospectus disclosures
 - EBT issues

Key relationships for a share plan lawyer

Acting for the issuer (company):

- Your internal prospectus and reorganisation teams
- Client contacts – legal / HR / comms
- Remuneration committee (often appointed late in process)
- Remuneration consultants
 - Who is doing what (they may be drafting all share plan documents)?
- EBT trustee (new or existing)
- Project team on all-employee arrangements

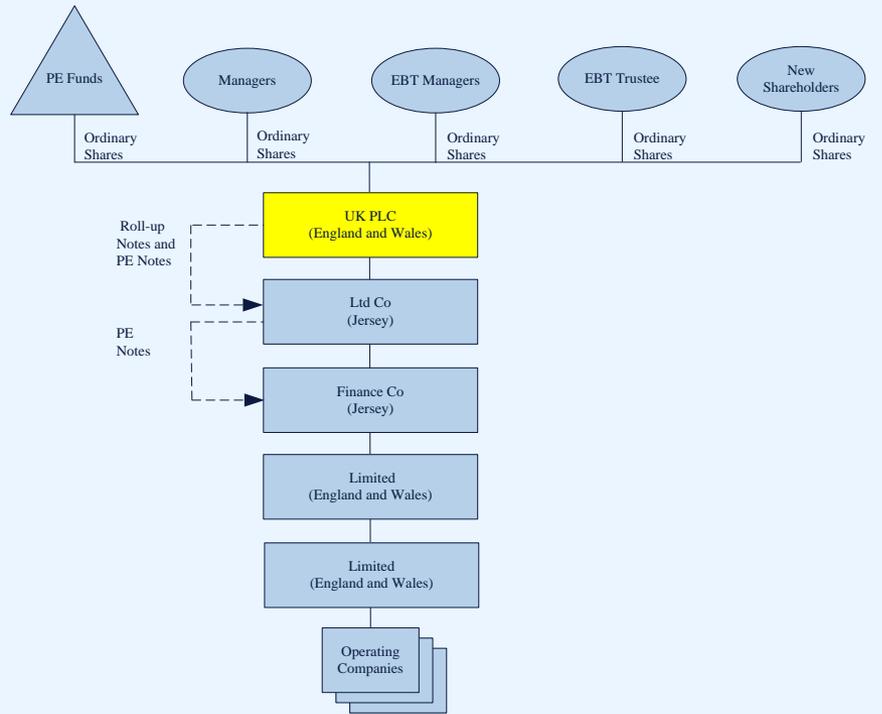
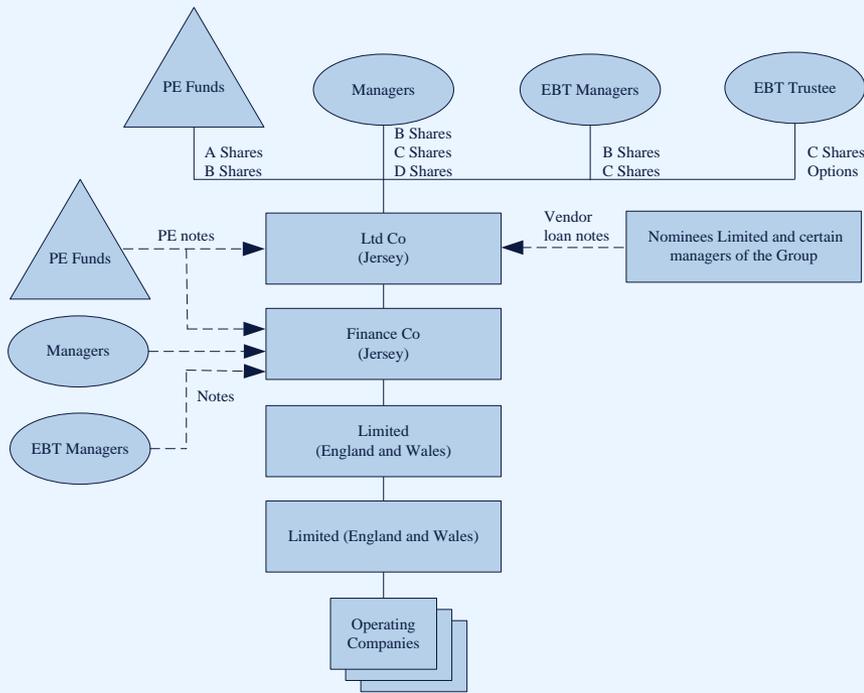
Pre-IPO re-organisations

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Section **2**

Getting from this...

to this...



Reasons for Reorganisation

- LR 2 and 6– basic conditions for premium listing:
 - Duly incorporated company
 - One class of shares
 - Issued in accordance with laws and constitution
 - Freely transferable
 - Value of at least £700,000
- Other factors:
 - FTSE inclusion
 - Dividend block
 - Ensure correct economic entitlements
 - Debt and equity “roll-up”
 - Selldown logistics
 - Share transfers pre-IPO

Existing MIPs – practical considerations

- Timing for reorganisation
- Do the arrangements work?
 - Can the economic entitlements be determined in advance of pricing?
- Are there powers of attorney in place?
 - Do they cover all the proposed steps of the reorganisation?
 - Are the right people appointed as attorneys?
- What about former management / dissident shareholders?
- Tax considerations
 - CGT rollover
 - ER
 - Spouse transfers
 - Income tax / PAYE
- Employee Benefit Trust
 - May be reluctant to appoint attorney
 - Will need to be satisfied the reorganisation is in the best interests of beneficiaries
 - Will you need a new EBT post IPO?

Existing Options – practical considerations

- Existing options over shares in the company
- Rules generally provide that options would become exercisable on an Exit Event
 - Needs to be reflected in reorganisation steps
 - May be problematic for a company if employees would cash out on IPO

Can a company prevent the options being exercised?

- Participant consent will be required, as there would be an adverse effect on subsisting rights.
- Leverage from the promise of future grants?
- How will the pre-IPO options be satisfied?
 - Carved out for dilution calculations

Major Shareholder Granting Share Awards

- To top up MIP that has not performed as expected OR to lock in management post IPO
- May vest on admission (subject to lock-up) or may vest over period following IPO
- Interaction with company's remuneration policy will be important
- Consideration needs to be given to performance conditions (if any)
- If vesting on admission, consider availability of corporation tax relief
- Appropriate input on accounting treatment of the award required
- Disclosure in prospectus

Sell-down and Lock-up

- Sell-down arrangements
 - Secondary / over-allotment
 - Percentage negotiated between sponsor, major shareholder and issuer
 - At election of each member of management but facilitated by company
 - Allows partial exit
 - Paying agent for individuals?
 - Consider any PAYE requirements
- Lock-up agreements
 - Stabilisation / marketing
 - Usually documented in underwriting agreement
 - For management?
 - Period negotiated between sponsor, major shareholder and issuer
 - Impact on free float

All-employee share offers

Simon Evans

Section **3**

All-employee share offers – an Overview

Basic issues

- What is the company looking to achieve?
- How important are tax considerations? What about non-UK employees?

Priority offer at IPO

- Is being at the front of the queue a taxable BIK?
- What about a discounted price?

Employee offers at IPO through SIPs

- The basic SIP menu – free, partnership, matching and dividend shares
- Free shares on IPO
- Partnership / matching shares with an accumulation period

Starting long-term plans following IPO

- Sharesave / CSOP
- Partnership / matching SIP offer with monthly share purchases

Employee offer structures – some recent precedents

IPO	Priority offer	Share save	SIP			Comment
			Free shares	Partnership	Matching	
Royal Mail	✓		✓ (£3,000)			Postal Services Act reserved 10% of RM for employees
Partnership Assurance		✓	✓ (£1,000)			
Just Retirement		✓	✓ (£500-£3,000)			Service-related allocation
Saga	✓ (with 1-for-20 top-up later)			✓ (£1,800)		10 month accumulation period
Zoopla			✓ (£2,500)	✓ (£1,800)	✓ (£1,800)	9 month accumulation period
Virgin Money			• (£1,000)			Not under SIP – vesting one year from IPO

Vanilla examples with sharesave, and/or SIPs that were not used on IPO: AO World, Exova, Poundland, SSP

Employee priority offer

Key features

- Employees pay same price for shares as members of the public
- If the offer is oversubscribed, applications from employees have priority over other members of the public, up to a maximum limit
- Overall cap on total number of shares available under EPO (e.g. as a percentage of retail offer)
- EPO requires a price-range prospectus (not pathfinder)

Tax treatment

- Benefit of any priority rights would ordinarily be treated as earnings
- Exemption for offer made to public and employees (s.542 ITEPA)

What is an “offer to the public”?

- Institutional offer vs intermediaries / retail
- Placings

Employee priority offer – other conditions for relief

10% cap

The shares in the priority allocation to employees and directors must not exceed 10 per cent. of the total shares on offer to members of the public and employees, including the priority shares (s.542(3) ITEPA).

“On similar terms”

All employees or directors entitled to a priority allocation of shares must be entitled to it "on similar terms" (s.542(5)).

Not just directors and high earners

The persons entitled to the priority allocation must not be "wholly or mainly" directors or those whose remuneration exceeds a particular level (s.542(6)).

Note: exemption does not apply to any benefit attributable to a discount to the public offer price which is offered to employees (ss.543 and 544).

Why use a Share Incentive Plan?

The SIP menu usually fits in well with company's objectives:

- Tax reliefs for employees
- Compulsory holding period – helps achieve employee retention
- Forfeiture of free and matching shares from bad leavers is usually applied
- Corporation tax deduction for issuer

Potential problems

- Need to comply with tax legislation over life of plan
- Difficult to explain tax treatment to employees
- Timing issues with application procedure for awards made at IPO
- Does the offer need a prospectus?

Practical SIP points on IPO (1)

Get the basics right

- Good SIP documentation (i.e. satisfying Schedule 2)
- User-friendly communication materials
- Find a co-operative SIP trustee
- How good is the company's employee data?

Sourcing the shares

- Usually from a subscription (outside the IPO offer), under a formal subscription agreement
 - Either at nominal or market value
 - Usually excluded from “10% in ten years” dilution limit
 - Are there surplus shares in a pre-IPO EBT?
- Can get complicated in view of:
 - Need to state share capital at IPO accurately in the prospectus
 - Accumulation period requiring a delayed subscription (e.g. the impact of leavers)

Practical SIP points on IPO (2)

Pricing issues

- “Initial market value” is set on date of award – must normally use closing tax market value (ESSUM 29395), not IPO price
- Where there is an accumulation period, the lower of the start / end value can be used – good news for employees, but remember to cap the share number

Obtaining employee agreement to participate

- 14 days to return application form (if used)
- 25 days if an opt-out route is used

Prospectus aspects of the SIP offer itself

- Partnership shares involve an offer of securities, so need to be covered by the prospectus unless an exemption applies (e.g. <100 persons)
- Free shares don't require consideration so exemption applies
- So may not be able to offer partnership shares pre-admission under a pathfinder structure



Save As Your Earn (Sharesave) on IPO

The basics

- All-employee plan
- Savings arrangement – up to £250 pcm for 3 or 5 years
- Share option with discounted exercise price (up to 20% discount to market price)
- Tax relief usually depends on exercise after third anniversary of grant

Usage on IPO

- Achieves different objectives to a SIP
- Usually implementation is delayed
 - Until share price is stable, or until after first results
 - Not usually possible to use IPO price to set exercise price
- But it is desirable to explain to employees at IPO that a sharesave is being introduced

Executive Plans and Prospectus Disclosure

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Section **4**

Executive Plans

- Types of plans
 - PSP / LTIP
 - Deferred bonus plan
 - CSOP
 - International equivalents
- Timing
 - Generally adopted by company pre-admission
 - Requires disclosure in prospectus
 - Interaction with directors' remuneration policy
- IPO grants
 - Different generations of management
 - 3 (or 5) year time lag
 - IPO price
 - Out of cycle grants – in addition or instead?

Disclosure Requirements

Walk through the prospectus

- Governance
- Interests in shares
- Selling shareholders
- Service contracts and letters of appointment
- Historic remuneration
- Forward looking remuneration / remuneration policy
- Share plan summaries
- Details of initial awards
- Pensions
- EBTs

Overriding requirement

All the information necessary to enable investors to make an informed assessment of the assets and liabilities, financial position, profit and losses and prospects of the issuer and of the rights attaching to the securities (Article 5(1), FSMA s87A(2))

Corporate governance

Annex 1, items 16.3 and 16.4 – board practices

16.4 – a statement as to whether or not the issuer complies with the applicable corporate governance regime

16.3 – information about the issuer’s audit committee and remuneration committee including the names of committee members

Annex 1, item 22 – material contracts

A summary of any relationship agreement will be provided in the prospectus and reference to the relationship agreement will usually also be made in the Corporate Governance section of the prospectus

The Relationship Agreement may permit the principal shareholder to appoint a non-executive director

Interests in shares

Annex 1, items 17.2 and 14.2; Annex 3, item 3.3

17.2 – disclosure of employee share ownership and any options over shares in the issuer held by directors and senior managers at the most recent practicable date

14.2 – details of conflicts of interest/private interests of directors

3.3 – interests of natural and legal persons involved in the issue/offer

Details of selling shareholders

Annex 3, items 7.1 and 7.2

7.1 – names of each selling shareholder

7.2 – number and class of securities being offered by each of the selling shareholders (where relevant this will be on a post-reorganisation basis, ie when selling shareholders have exchanged their shares for shares in the issuer)

Ensure that any shares held by an EBT and being sold into the IPO are included in the selling shareholder disclosure

Service contracts and terms of appointment

Annex 1, item 16.1 and 16.2

Details of directors' service contracts and non-executive directors' and chairman's letters of appointment need to be summarised

- Summary information will include:
- Date of service contracts
- Position
- Salary / fees from admission (including for membership of any committees)
- Benefits
- Expenses
- Termination provisions eg PILON
- Annual bonus and/or share incentive entitlements
- Holiday
- Confidentiality
- Restrictive covenants
- D&O and QTPIP

Historic remuneration

Annex 1, items 15.1 and 15.2

In relation to the last full financial year the amount of remuneration paid and benefits in kind granted to the board and senior managers and the total amounts set aside to provide pension, retirement or similar benefits

Information must be provided on an individualised basis for board in the UK (not necessarily the case in all jurisdictions)

No technical requirement to split out salary, benefits and pension from each other but this is the usual approach

Information can be quite out of date (eg a company with a calendar year end that IPOs on 25 December 2014 would show remuneration for the period 1 January – 31 December 2013)

Forward looking remuneration policy

No specific requirements as to the detail that needs to be included on future remuneration policy

What is the choice for issuers?

- developing the remuneration policy pre-IPO, ie preparing a remuneration policy at the greater level of detail that will be required to be voted on at the next annual general meeting; or
- having a high-level policy outlined in the prospectus until the work of developing the more detailed policy has been done after IPO

In practice, time constraints are likely to mean that including a high level policy is the only practical solution, taking account of the availability of the new remco NEDs in the period up to IPO

This question needs to be discussed because there will be a line of sight between incentive design before IPO and the eventual directors' remuneration policy to be put to the binding vote

Incentive plan summaries

Annex 1, item 17.3

Description of any arrangements for involving the employees in the capital of the issuer

Summary of any share plans that will be operated after IPO (and not just those that will be operated on admission)

Typical disclosures:

- Types of awards
- Individual and plan limits
- Vesting and leaver provisions
- Performance conditions
- Adjustments and corporate events
- Amendment powers

Plans should be approved by the board before the prospectus is sent out even though they may be adopted conditional on admission

Details of initial incentive awards

Annex 1, items 17.3 and 21.1.6

Details should be provided of the initial awards to be made under the share plans at or around the time of admission

Include details of grant levels and applicable performance conditions

Consider interaction of initial awards with descriptions of share plans

Pensions

Annex 1, item 15.2

The disclosure will typically include a description of pension arrangements in the group as well as, where relevant, amounts set aside or accrued by the issuer to provide pension, retirement or similar benefits

No requirement to include negative statements eg no DB scheme, but relatively standard to do this

EBTs

No technical requirement to include details of an EBT but disclosure probably better when considering Annex 1, items 7.1, 7.2 (selling shareholders) 17.3 (details of incentive arrangements)

May include some generic wording about use of a future EBT

May include information on eg a cash pool to be distributed after admission, although this may not be strictly necessary:

- The EBT will be listed as a selling shareholder; and
- Investors will expect their sale to benefit EBT beneficiaries or be used to repay outstanding loans etc so no need to say so

Thank you (LON34080376)

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