

SPECIAL DIVIDENDS FOR OPTION HOLDERS

The Special Dividend

Over the course of the last year, SOS assisted several clients with processing a special dividend on their company stock which also impacted for their stock plan participants. While the shareholders receive the dividend payout, these dividends impact equity instruments. While the impact to optionees varies between companies, the one constant is that those who hold options or awards see a change to their grants that is equivalent to the dividend payout.

This process begins when a company decides to reward their shareholders for investing in the company, often when a company has cash on hand but the share price has not delivered the desired value. The board of directors determines the payout (on a per share basis) to provide and give that amount in either cash or stock to shareholders of the company. This payment is known as a special dividend. The clients with whom we have worked most recently provided cash dividends to their shareholders and adjusted the outstanding stock grants accordingly.

How do they work?

With most of our clients the adjustment to the stock option or restricted stock unit was as follows:

Employees who hold an unexercised stock option have the exercise price reduced by the amount of the special dividend. In cases where there is a \$0.00 share price, as in the case of an unvested restricted stock unit award, or the exercise price is under a particular threshold (as determined by the dividend), then an increase to the underlying shares of the option or award is applied to provide an equivalent ratio for those holders.

In doing so, the total value (including fair value) of the grants is not changed and in the cases with which SOS has assisted, the original expiration date, vesting and all other terms under the agreement remain the same. Likewise, the expense that has been recognized is not impacted nor requires adjustment.

How do you update the database?

While on the surface it may appear to be a fairly straight-forward concept, the closer you look you find that the devil is in the details. And few, if any systems, can automatically process such a transaction. The following pointers will help you to prepare and make the necessary changes resulting from a special dividend:

1. **Understand the rules of the dividend:** The board of directors will be very specific about the treatment that the options and restricted stock units outstanding are to receive. If you were not involved before the announcement, take the time to read through everything that the company has distributed on the subject. Think about how you will update the system, and begin to compile your questions. For example, in a case where

the dividend is \$2.00, the board may announce that all outstanding options having an exercise price greater than \$2.00 will be reduced by the amount of the dividend (\$2.00), while all outstanding options with a price less than or equal to \$2.00 will receive an adjustment to the exercise price and an adjustment to the number of shares outstanding of the underlying award based on a ratio to be determined on payment date. All other terms and conditions remain the same.

2. **Analysis of the population impacted:** In most cases, before the board has made the announcement, stock plan professionals may have found themselves responding to a series of requests for information, so while the management may have taken the time to review and analyze the information, it's now stock plan's turn to perform their own analysis. Questions that arise will be many!
 - a. Which population will be impacted?
 - b. How, by whom, and when will the ratio be determined?
 - c. How many different scenarios and, therefore, kinds of adjustments are required?
 - d. Will there be a blackout?
 - e. How quickly must the data be adjusted?
 - f. How will this impact the stock plan data sent to the broker or service provider?
 - g. Since the change is to outstanding grants only, what happens to an option that has previously exercised shares but still has an outstanding balance and how should the database be updated?
 - h. What happens to the outstanding restricted stock units that have had a previous vesting and release and how should the database be updated?
 - i. What happens to grants of employees who terminate on or before the dividend payment date, but after the in-dividend date (the last day that existing shareholders will receive the dividend)?
 - j. How many groups of grants will require different share and price adjustments?
 - k. What will be the source for reconciling these changes?
 - l. How will the expense remain unchanged?
3. **Prepare the database:** Take the time to prepare a plan and step through it from beginning to end - this will help you to uncover most of the issues that will arise on the dividend payment date. Think in terms of doing as much prep work as possible and as soon as possible and whenever possible TEST, TEST and then TEST again! If you have multiple scenarios, you may find that setting up a custom field with assorted labels may help you to get to know the data. Understand how the end results should appear so that as you step through it you will be able to determine if the results are accurate. Consider creating tags and /or labels within your database to help with addressing the issues for the following groups:
 - a. Options that require a price change only, how will the price adjustment be made?
 - b. Options/Awards that have historical exercises/releases and still have outstanding shares - a split of the grant is likely necessary to retain the historical exercise details and change only the outstanding portion - so what is involved in splitting a grant and retaining all proper vesting (and expense accrual) going forward?

- c. For the grants that are under the dividend threshold, how will you change the price and the shares while retaining the same vesting and expense - and if these have had historical exercises/releases, that will add complexity to the solution.
 - d. Employees who leave or have left the company, where does their termination fall with respect to the dividend dates - will their award receive the dividend, all or only a portion, and when is the last day to exercise?
4. **Expense management:** Adjusting for the special dividend does not impact your valuations or expense, however, knowing how your database will treat the valuation and expense when you make the necessary adjustments is another key step. When making a price adjustment to an option grant is required, that change should not change the overall value per share of your option for expense purposes, however, your database may not be able to recognize the change and value customization may be necessary. Likewise if you are adjusting shares and exercise price, then the value per share will need to be recalculated to reflect any share change so as not to change your total valuation if your database is using a pre-established value per share.

Further complicating the expense management during this work is the need to retain the expense associated with any portion of an option or restricted stock unit that was previously exercised or released and the portion that remains outstanding. When splitting the option or restricted stock unit the expense must be split accordingly. One of the more complicated aspects is preventing the split grants from beginning the accrual of expense too early. Sometimes changes to the vest schedule, and even the grant date, may be necessary.

5. **Test and Reconciliation:** Testing your processes as soon as possible will help you to understand where you will have issues and what additional steps may be required to ensure your data remains in sync. Reconciliation will be required for compliance purposes and you will want to develop a process to satisfy your auditors. Remember, reconciling the shares, prices, vesting schedules, etc. is only one area of reconciliation. You will need to develop a reconciliation of your valuations and expense per option and restricted stock unit to ensure you have not changed expense.

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Julie is a Senior Equity Consultant for Stock & Option Solutions, Inc. (SOS). Julie has helped countless clients with projects ranging from special dividends to stock splits and option exchanges as well as data conversions related to software vendor changes. Julie has also provided clients with interim stock plan support during leaves. Prior to joining SOS Julie was Manager of Long Term Equity Plans at AT&T Corp.

About Stock & Option Solutions

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