



Monday, October 25
9:00am-10:30am

107 - A Wellness Program for Equity Plans: Time for a Check Up?

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Prior to joining Target, Mr. Donlin was associate general counsel at ADC Telecommunications, and a shareholder of the Briggs and Morgan law firm in Minneapolis, Minnesota.

He received his undergraduate degree from the University of Minnesota, and his law degree from the University of Minnesota Law School.

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Jason Romick is vice president and deputy general counsel of Hub International Limited, a leading insurance brokerage firm headquartered in Chicago. His responsibilities include advising the company with respect to mergers and acquisitions and matters relating to labor and employment, employee benefits, real estate, and corporate governance.

Before joining Hub, Mr. Romick practiced in the corporate groups at Sidley & Austin LLP and Levenfeld Pearlstein LLP, where he regularly advised clients on a broad range of corporate transactions, including public and private company mergers, acquisitions of stock and assets, divestitures, initial public offerings, and spin-offs.

Mr. Romick graduated summa cum laude from the University of Illinois College of Law, where he was an articles editor of the University of Illinois Law Review. Following law school, he clerked for the Honorable Milton Shadur of the U.S. District Court for the Northern District of Illinois.

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Mr. Wegerson has substantial experience counseling clients on the design, implementation, and administration of ERISA employee-benefit plans, including 401(k)s, ESOPs, and welfare benefits.

Mr. Wegerson's professional memberships include the Minnesota State Bar Association (Employee Benefits Section); the American Bar Association (Real Property, Probate and Trust Law Section); and the ESOP Association. He is a frequent speaker on Code - 409A compliance for deferred compensation plans and the application of Code -409A to equity plans. Mr. Wegerson has been recognized by Woodward/White Inc. as one of The Best Lawyers in America (R) for the past three years.

Mr. Wegerson received his BA from the University of Minnesota Duluth and his JD from the University of Minnesota Law School.

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ASSOCIATION OF CORPORATE COUNSEL

2010 ANNUAL MEETING

Monday, October 25, 2010

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A WELLNESS PROGRAM FOR EQUITY PLANS:

TIME FOR A CHECKUP?

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EXHIBITS

- A. SAMPLE STOCK INCENTIVE PLAN
- B. SAMPLE STOCK OPTION TERMS AND CONDITIONS
- C. SAMPLE RESTRICTED STOCK TERMS AND CONDITIONS
- D. SAMPLE RESTRICTED STOCK UNIT TERMS AND CONDITIONS
- E. SAMPLE PHANTOM STOCK APPRECIATION RIGHTS PLAN

USER GUIDE TO THE CHECKLISTS

The general purpose of the basic and specialized checklists that follow are to aid general counsel in drafting and/or reviewing outside counsel equity and phantom equity plan documents to make sure that relevant law changes are included in the documents and that many other traps in interpreting and administering the written documents are avoided. Current issues include recent statutory, regulatory and legal developments, as well as certain shareholder and other economic trends in executive compensation that have risen to the top in the past two years. The not-so-obvious issues or “traps for the unwary” are based on various articles and seminars, as well as our collective drafting experience, where precise language or additional language will address issues that arise in the administration of both equity plans and phantom equity plans. As a general disclaimer, the checklists, while thorough, do not address every drafting issue that can arise in all situations. In this regard, the authors welcome any and all suggestions for improvements, additions and corrections that you discover or that would make these checklists more complete and useful.

Equity incentive compensation takes many forms. Like snowflakes and the authors' golf swing, no two are exactly alike. The most common type of equity plan is a stock option plan, which allows the option holder to share in the appreciation in the value of the stock between the date of grant and the date of exercise. Options generally fall into two categories, either incentive stock options (ISO), which are taxed at a generally more favorable capital gains rate on the appreciation, if certain conditions are met, and nonqualified stock options (NQSO), where the appreciation is generally taxed at ordinary income only at the time of exercise, and future gain is then taxed at capital gains tax rates.

Many current equity plans also contain a myriad of other stock rights, including stock appreciation rights (SAR) (which, like options, are based on the appreciation in the stock value from the date of grant to the date of exercise but generally without the requirement to pay the exercise price at the time of exercise) restricted stock, restricted stock units, performance stock, performance units and deferred stock. Each of these has different accounting and tax characteristics, but each provides an incentive to executives, directors, consultants, and other eligible employees, to share in the stock appreciation or to be rewarded in common stock or other rights, including profits interest in an limited liability company (LLC) or partnership, and become shareholders or unit holders of the company. The term equity plan or equity rights used in this document cover equity in both corporate (stock) and noncorporate (member unit) entities.

It is also common to incent eligible employees, directors and consultants with the economic value of the company's equity, but without actual ownership, which would carry with it the right to vote and to receive dividends, by awarding “phantom stock” or other rights which duplicate the cash value of a stock option or whole share of stock. Such phantom stock rights, while easier to administer, do not have the same tax or accounting characteristics as do actual share ownership. Many companies are now using a portfolio approach to equity incentives, providing each employee various types

of equity and phantom equity rights, and in some cases, allowing the employee to choose, in a cafeteria style, the type of awards most valuable to the employee.

These checklists are intended to address drafting issues only, and do not address some of the other issues, such as tax reporting, accounting treatment, proxy disclosures, and other security law filings. The checklists are intended to focus on the governing documents that define all of the terms and conditions for the grant, vesting, exercise and payment of equity compensation. Generally the governing documents consist of a plan that sets forth the general terms and provides discretion to the administrator to fix the specific terms and conditions of each grant; and a grant agreement, which defines both the number and exercise price, as well as the other terms, such as vesting, payment, withholding tax, etc. Some plan documents contain only minimum requirements, leaving all of the details and issues addressed in these checklists to be included in the award agreement itself. Other plan documents contain all necessary terms and conditions in greater detail, leaving the grant agreement to specify only the most basic terms, such as number of shares, exercise price and expiration date. Similarly, phantom equity plans are described in a plan document and an individual award agreement. No matter to which drafting school you ascribe, these checklists are intended to provide you with the most current thought and best practices in drafting both plan documents and award agreements.

There are two basic checklists, one for equity plans, covering stock options, restricted stock, restricted units, stock appreciation rights, etc., and a second checklist covering phantom equity plans. There are additional separate checklists for several unique tax code sections that may or may not apply to your plan or your company, and generally contain only the statutory or regulatory requirements that must be met under the tax code.

Finally, there is a sample plan document for an equity plan and a phantom equity appreciation rights plan, and separate terms and conditions for an option award, restricted stock award, and restricted stock unit award that contain specific terms and conditions consistent with the plan document.

EQUITY PLAN CHECKLIST

NEW DEVELOPMENTS

Dodd-Frank Act

Application: Publicly traded companies

Comment: Significant aspects of the Act include:

- *Independence Standards for directors.* Directors administering equity plans must meet independence standards to be established by the national securities exchanges based on guidance from the Securities Exchange Commission (SEC). Dodd-Frank Act § 952, adding new section 10C to the Securities and Exchange Act. Effective July 16, 2011.
- *Compensation Committee authority.* The Committee must have the authority to hire, compensate and oversee its own compensation consultant and legal counsel to be paid by the Company. The Committee must determine the independence of the consultants and legal counsel based on standards to be developed by the SEC. The proxy must also contain a discussion whether an independent consultant (other than legal counsel) was retained, and how any conflict of interest on the part of the consultant was resolved. Dodd-Frank Act § 952, adding new section 10C to the Securities Exchange Act. Effective July 16, 2011.
- *Mandatory clawback.* The Committee must establish a mandatory clawback of executive officer compensation to be used in the event the Company is required to prepare an accounting restatement due to the material noncompliance of the Company with any financial reporting requirements under securities laws. Dodd-Frank Act § 954, adding new section 10D to the Securities Exchange Act. Effective following SEC regulations.

Authority: Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173

Sample Language: Exhibit A, §2.17, 5.2, 13.8(b)

Employee Stock Purchase Plan (ESPP) final regulations under Code § 423

Application: Companies providing employee stock purchase plans.

Comments: Notable changes in the final regulations effective January 1, 2010 include:

- *Multiple offerings.* More than one offering may be made under a plan, and the offerings may be consecutive or overlapping.
- *Determination of grant date.* For tax purposes, the grant date is the first day of an offering period only if the maximum number of shares that may be purchased is fixed and determinable on that date.
- *Annual \$25,000 limit.* The participant's limit increases by \$25,000 for each calendar year during which the option is outstanding.
- *Coverage of non-U.S. employees.* It is possible to exclude, or provide less favorable terms, for citizens or residents of a foreign jurisdiction to comply with local laws.

However, the plan may not exclude nonresident aliens of U.S. companies participating in the ESPP.

Authority: Treas. Reg. § 1.423-2; 74 FR. 59074 (11/17/09)

☐ **ESPP & ISO reporting requirements under Code § 6039**

Application: Companies providing employee stock purchase plans or incentive stock purchase plans.

Comments: Beginning in 2010, employers must file Form 3921 (for ISOs) or Form 3922 (for ESPPs) with the IRS, and an information statement to participants, regarding the transfer of stock purchased each year.

Authority: Treas. Reg. §§ 1.6039-1(b); 1.6039-2(b); 74 FR 59087 (11/17/09)

☐ **Deduction limits for health insurance providers**

Application: Health insurance providers

Comments: Beginning in 2013, there is a \$500,000 limit on compensation deductions for compensation paid to any officer, director, or employee of, or any other individual who provides services for or on behalf of, the covered health insurance provider and all companies within the controlled group. There are no exemptions for deferred compensation or performance-based compensation, such as options and other stock rights.

Authority: The Patient Protection and Affordable Care Act section 9014, amending Code § 162(m)(6).

☐ **Troubled Asset Relief Program (TARP) restrictions on executive equity awards**

Application: Financial institutions receiving funds under the Troubled Asset Relief Program.

Comments: Some of the notable conditions are:

- A \$500,000 limit on compensation deductions for compensation paid to the CEO, CFO, and three most highly compensated employees ("Senior Executives"), and there are no exemptions for deferred compensation or performance-based compensation.
- Company may not establish incentives for the Senior Executives that may encourage them to take unnecessary and excessive risks that would threaten the entity's value.
- Only restricted stock may be granted to the Senior Executives, which cannot vest until after the TARP money has been repaid, and the value of the restricted stock awarded cannot exceed one-third of the receiving employee's total annual compensation.
- Senior Executives plus the next 20 most highly compensated employees are subject to a clawback.
- Golden parachutes (as defined under FDIC rules, not Code § 280G) are prohibited for Senior Executives plus the next 5 most highly compensated employees.

- Incentive compensation (other than long-term restricted stock described above) is prohibited for certain individuals based on the amount of TARP funds received:

Amount of TARP funds received	People prohibited from receiving incentive compensation
Less than \$25 million	The most highly compensated employee
Between \$25 million and \$250 million	5 most highly compensated employees
Between \$250 million and \$500 million	5 most senior executives and the next 10 most highly compensated employees.
More than \$500 million	5 most senior executives and the next 20 most compensated employees

Authority: American Recovery and Reinvestment Act § 7001 (2/17/09), amending the Emergency Economic Stabilization Act § 111(b)(1) and Code § 162(m).

Compensation limits when extending defined benefit amortization

Application: Companies with define benefit plans that elect to extend its amortization schedule under the Pension Relief Act of 2010.

Comments: Companies with underfunded pension plans are generally required to amortize contributions necessary to make up any annual underfunding over the next seven years. The Pension Relief Act of 2010 allows companies to extend the amortization period an additional two years and in some cases up to an additional eight years. If a company elects to extend its defined benefit plan amortization schedule, the company is required to accelerate its amortized contributions to the plan if certain executives earn more than \$1 million annually. Included in the amount of an employee's annual compensation over \$1 million are assets set aside/reserved/transferred in a trust (or other arrangement as defined by the IRS) for deferred compensation. Excluded from this are employer stock that is subject to a substantial risk of forfeiture for at least 5 years from the date of grant and compensation granted under a written contract in effect on March 1, 2010 consisting of nonqualified deferred compensation, restricted stock, stock options, or stock appreciation rights.

Authority: Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 § 201(c).

Code § 409A Document Failure Correction Program

Application: Companies whose nonqualified deferred compensation plans and arrangements, which may include equity grants, fail to comply with the written requirement of Code § 409A.

Comments: Plans may be amended to correct Code § 409A document failures such as:

- Impermissible definitions of separation from service, disability, or change in control.
- Impermissible payment event or payment schedule.
- Impermissible payment periods following a permissible payment event.
- Impermissible initial or subsequent deferral election procedures.

- A failure to include the six-month delay of payment for specified employees of publicly-traded companies.

If the company corrects the document failure by December 31, 2010, the Code § 409A penalties are eliminated, provided that any amount that was paid under the impermissible provision is corrected under the Code § 409A operational relief provided in IRS Notice 2008-113.

Authority: IRS Notice 2010-6 (12/21/07) § XIA

INVESTOR ISSUES

- Determine whether whole shares (restricted stock, performance stock, and restricted stock units) should be counted against the total number of shares authorized for grant under the Plan in greater numbers than option or SAR grants**

Comment: Because whole shares have a greater expense for accounting purposes than options (in most industries), the number of authorized shares reduced by such grants is generally greater than that for option grants, depending in part on the Black-Scholes or binomial formula used to value the expense associated with an option or SAR. RiskMetrics Group (RMG) uses a formula based on the option expense formula and industry volatility to establish a range of whole share to option ratios that are acceptable and do not provide for an equivalent "burn rate" under the Plan regardless of the type of award.

Sample Language: Exhibit A, § 3.2(f)

- Allow for unused shares to be recycled for future grants**

Comment: The Plan should contain specific rules for recycling shares for each of the following events:

- Shares subject to an award that expires without being exercised or issued.
- Shares delivered or attested to or withheld by the company in connection with the exercise of an option.
- Shares withheld to pay income tax withholding on the exercise of an option or vesting of restricted stock.
- Shares that are part of a stock appreciation right that are not issued.

Also consider how to account for shares outstanding and shares remaining under a prior plan that this plan will replace, and shares outstanding under plans that are assumed in connection with the acquisition of another company.

Sample Language: Exhibit A, § 3.2

- Determine whether the dilution resulting from the newly authorized shares is excessive**

Comment: RMG has opposed equity plans where the dilution of the authorized shares under the Plan exceed a percentage that would cause shareholders to reject the plan. Between 2007-09,

RMG voted against plans where the dilution exceeded 20% and in some cases, 15%. "Equity Plan Proposal Failure 2007-2009", Report of the Altman Group and Exequity LLP, June 2010. Similarly, in a private equity-owned company, the percentage of dilution is controlled by the investors who typically own senior securities with rights to convert to common shares.

Authority: RiskMetrics 2010 U.S. Proxy Guidelines Summary (February 2010)

Determine whether the projected number and type of annual grants is excessive

Comment: RMG will analyze the annual "burn rate" of stock authorized under prior plans and compare that rate to the rate of other companies in the industry to determine if the number of grants each year is excessive.

Authority: RiskMetrics 2010 U.S. Proxy Guidelines Summary (February 2010)

Determine whether the economic cost of the shares available under the plan, together with shares under existing plans and outstanding grants for the Company, exceed the relative total shareholder value of top companies in the industry

Comment: RMG has developed a formula to determine the cost of equity used by top-performing companies in each industrial group and determines a cap for each company based on its performance relative to total shareholder return (the formula is proprietary). If the economic cost of the plan exceeds the cap, RMG will recommend against approval of the Plan.

Authority: RiskMetrics 2010 U.S. Proxy Guidelines Summary (February 2010)

Prohibit the repricing of underwater options and stock appreciation rights

Comment: Most plans should include a provision that forbids repricing, which if permitted, may result in a recommendation by RMG to reject the Plan.

Authority: RiskMetrics 2010 U.S. Proxy Guidelines Summary (February 2010)

Sample Language: Exhibit A, § 12.1

ELIGIBILITY AND VESTING ISSUES

Define eligibility to include nonemployees

Comment: This preserves the Company's ability to make awards to employees, and non-employees such as board members, consultants, advisors, or other independent service providers to the Company or an affiliate, and to permit former employees who consult to retain awards.

Sample Language: Exhibit A, §§ 2.13, 2.14

Consider using “service” rather than “employment” for determining the vesting or exercise period

Comment: This gives an employee the ability to continue to vest and exercise even if the employee’s status changes to independent service provider or Board member only. Otherwise, there will be an accounting charge generally if an option or other grant that would expire upon termination of employment is extended to allow an employee to retain the award while continuing to provide services. An extension beyond the stated expiration date could result in a new grant that could be considered deferred compensation and subject, retroactively, to the requirements and penalties of Code § 409A.

Authority: Financial Accounting Standards (FAS) 123(R); Treas. Reg. § 1.409A-1(b)(5)(v)(C)

Sample Language: Exhibit A, § 2.29

Establish guidelines for leaves of absence and changes in status

Comment: Consider whether leave of absence with right to reemployment, whether by statute (FMLA, military service) or contract, will count as service for vesting, and is considered “service” for awards to continue to be exercisable. Code § 409A and Treas. Reg. § 1.409A-1(h) contains language regarding when a leave constitutes a “separation from service” to trigger a distribution of deferred compensation. These rules can be adapted to define the date, such as at the end of the leave period if the employee does not return, when the post termination time period for exercise of options or stock appreciation rights begins. Note that Code § 421 and Treas. Reg. § 1.421(h)(2) contains specific requirements when a leave of absence must trigger a termination of employment for purposes of the limited time period to exercise an ISO by an employee (up to three months following termination of employment).

Authority: Treas. Reg. § 1.409A-1(h); Treas. Reg. § 1.421(h)(2)

Sample Language: Exhibit B, § 4

Consider reverse vesting provisions

Comment: Reverse vesting is a concept whereby the optionholder can exercise unvested options and receive restricted stock that continues to be subject to a substantial risk of forfeiture under the same terms as the option. By doing this, the optionholder can close the compensation transaction by making a Code § 83(b) election to report income immediately (in the case of ISOs, this may not trigger immediate tax liability, other than possible alternative minimum tax (AMT)) and start the time period for capital gains treatment (and in the case of ISOs, the required holding periods to avoid a disqualifying disposition). Since the recipient paid the exercise price to receive restricted shares, the company should repay only the initial exercise price at the time the restricted stock is forfeited, to leave the optionholder in the same position as if the unvested options had remained unexercised at the time of forfeiture. Early exercise of unvested options may be important in initial stage companies where rapid increase in value is likely during the vesting period.

EXERCISE ISSUES

☐ Condition exercise upon agreement to sign shareholder agreement, or other buy-sell agreement applicable to all shareholders

Comment: Option agreement should notify option holder if shareholder agreement will govern issued shares. Consider acknowledgement in option grant that option holder has reviewed the terms of the shareholder agreement at the time of grant.

Sample Language: Exhibit A, § 8.2

☐ Provide for alternative payment methods other than cash at the discretion of the committee

Comment: Among the other methods of financing an exercise of a stock option are:

- Tender or attestation of previously owned shares.
- Cashless or net exercise, where the fair market value of shares representing the exercise price is withheld from the number of shares to be issued, resulting in a net issuance of shares, similar to a stock appreciation right.
- Pyramid exercise, where employee pays the exercise price for one or two shares, with the gain on those shares being used to purchase additional shares, similar to a net exercise. FAS 123(R) no longer treats the use of shares held for less than 6 months as creating a liability rather than an equity award.
- Broker assisted exercise, where a loan is obtained from an independent broker to pay the exercise price, with an immediate sale by the broker after receipt of the shares to repay the loan. For public companies, Sarbanes-Oxley Act § 402 prohibits too much company involvement in the selection of the broker.
- Full recourse promissory note (for public companies, Sarbanes-Oxley Act § 402 prohibits such loans to executive officers). Under tax laws, the payment with a non-recourse note will not result in a transfer for tax purposes, since the stock owner is not at risk for repayment of the note if the stock value declines.
- Prohibit exercise of fractional shares, or alternatively, provide discretion to the administrator to issue cash in lieu of fractional shares or to eliminate fractional shares by rounding down.

Authority: Sarbanes-Oxley Act of 2002 § 402 amending Section 13 of Securities Exchange Act of 1934; Treas. Reg. § 1.83-3(a)(2)

Sample Language: Exhibit A, § 7.2(f)

☐ Permit tax withholding by surrender of shares to be issued at exercise of option

Comment: Under accounting rules, to be accounted for as an equity award, the use of shares to pay the withholding tax must be limited to the minimum statutory withholding requirements, and not the full anticipated tax based on the option holder's tax bracket. A company may permit the

repurchase of additional shares when the annual tax return is filed to provide additional cash necessary to pay the additional tax, subject to compliance with Section 16-b of the Exchange Act. Otherwise, the additional tax will be the responsibility of the option holder.

Authority: FAS 123(R)

Sample Language: Exhibit A, § 9.6(a)

TERMINATION OF SERVICE ISSUES

- Clarify ability and applicable time period to exercise option on SAR or to receive an award after termination and define when termination occurs**

Comment: Be clear on all employment termination scenarios (for cause, death, disability, leave of absence, etc.)

- If rights continue after death, provide for a beneficiary designation**

Comment: If the plan provides for the designation of beneficiaries, include the procedure for completing and filing beneficiary designation forms and when such designations or changes become effective. Also consider whether vesting accelerates and any deadlines for the beneficiary to exercise or accept payment under an award.

Sample Language: Exhibit A, § 7.1(h), 7.2(c)

- Specify terms for Company's and Shareholders' repurchase right**

Comment: If the shares are subject to a repurchase agreement, determine if shares will be repurchased immediately by a put or call, or subject to a right of first refusal, and if the purchase price should vary based upon the reason for the termination (e.g., 75% of purchase price for voluntary termination). Consider providing for delay of payments upon repurchase of shares if loan or credit agreements limit or prohibit repurchases.

FORFEITURE AND CLAWBACK ISSUES

- Include forfeiture for cause for vested and unvested awards.**

Comment: Draft award agreements to provide that the recipient forfeits all awards, including vested awards, if the recipient's employment is terminated for "cause" and make sure only one definition of cause applies under the employment and option agreement. A Kentucky Court of Appeals allowed an executive to recover over \$2.5 million in deferred compensation benefits even though a jury had found the executive to have committed conversion, fraud, and breach of fiduciary duties, based in part on the absence of forfeiture language in the deferred compensation agreement. *Thornton Oil Corp v. Perconti*, 2003 WL 1340715 (KY Ct. App. 2003). This decision would apply equally to equity award agreements.

- Cause should be defined to include facts and circumstances discovered after termination of employment.**

Sample Language: Exhibit A, § 2.2

Include forfeiture for competition and violation of corporate policies, if not included in definition of cause

Comment: Draft plan or individual award agreements to provide that employee forfeits all awards, including vested awards, if he/she violates the non-compete or other restrictive covenants, which can be specified in the agreement or incorporated by reference to the terms of separate agreements or specific policies.

Sample Language: Exhibit A, § 13.8

Define the acts or omissions that result in a holdback or clawback more broadly than required by Sarbanes-Oxley and Dodd-Frank Acts

Comment: Both Sarbanes-Oxley and Dodd-Frank only provide for clawbacks for financial disclosure restatements but clawback could occur for other reasons such as fraud, violation of company policy, etc.

Sample Language: Exhibit A, § 13.8(a)

Permit clawback of other forms of compensation and incentives in addition to equity grants.

Comment: Include language in the equity grant that any clawback covers prior or future compensation earned by the executive other than the equity subject to the grant. The grant should be good consideration for the executive submitting such other compensation to the holdback and clawback provisions in the award.

Give Committee the discretion to determine the types and amounts of equity and other compensation subject to clawback

Comment: This will facilitate the company's ability to fully recover from the most appropriate sources the amount to be clawed back.

Sample Language: Exhibit A, § 13.8(c)

PLAN ADMINISTRATION ISSUES

- Specify the date of grant of options and stock appreciation rights that will provide for an exercise price that is determined no earlier than to the date of grant**

Comment: Under Code § 422, an option is considered granted on the date all necessary corporate action is taken to make the grant, if the exercise price and number of shares is fixed. The grant date should always be no earlier than the date all such actions are completed, so the exercise price is the last item to complete.

- Review power to delegate the authority to make awards**

Comment: Confirm that the plan, state corporate law, and articles and by-laws allow delegation of grant-making authority from the Board or Committee to an officer. Oftentimes, there is a need to make grants at times between Compensation Committee meetings. For a public company, if the authority is granted to the CEO, the CEO cannot make grants to other persons who are covered by Section 16(b) of the Exchange Act, which must be granted by the Committee or the Board to be exempt from the short-swing profits rules of Section 16(b). Any delegation of authority should be memorialized in the Board or Committee minutes or in some other form, including any limitations or such delegation.

Sample Language: Exhibit A, § 5.3

- Review equity committee authority**

Comment: Ensure that your committee acts in accordance with its charter and is properly constituted under state corporate laws.

- Permit the Committee to make unilateral plan amendments**

Comment: A plan may permit outstanding awards to be amended without the consent of participants, provided the Board of Directors or the plan's administrative committee determines that the amendment is in the best interest of affected participants. Under national securities association rules, certain amendments may, however, require shareholder approval, such as increasing the number of authorized shares.

Sample Language: Exhibit A, § 12.3

- Include right to terminate option holders and recipients of awards**

Comment: Include a provision that states the company has the right to terminate the employee at any time and the award that vests over a period of time is not a guarantee that the employee will be employed for the stated vesting period.

Specify whether stock rights may be transferred in the event of a divorce.

Comment: While ISOs cannot be transferred (or if transferred, become NQSOs), NQSOs and other equity rights may be divided in a divorce. The plan and grant should address whether such transfer is automatic or requires consent. Such transfers are tax-free, but raise notice and withholding issues.

Authority: IRS Notice 2002-31, Rev. Rul. 2004-24

CORPORATE TRANSACTIONS ISSUES

Include power to adjust the number of authorized shares under the plan and awards for any corporate transaction.

Comment: Expressly provide for adjustments in the number of authorized shares and outstanding awards in the event of corporate actions such as a recapitalization, stock split, merger, etc. The plan should require the Committee to make adjustments, as giving the committee only the discretion to make adjustment may result in the awards being classified as liability awards, with unfavorable accounting treatment. There are specific requirements under Code § 424 to insure that the number and exercise price adjustments to incentive stock options continue to qualify as incentive stock options after an event requiring an adjustment to outstanding awards.

Authority: Treas. Reg. § 1.424-1

Sample Language: Exhibit A, § 3.4

Carefully define change in control

Comment: Consider both a transaction in which the company survives and does not survive. Consider if the Board continues to serve or is replaced as affecting the disposition of awards. Be aware that settlement of awards upon a change in control that constitute deferred compensation under Code § 409A must meet the definition of a change in control under Code § 409A, which may be more narrow than the standard definition used in such plans.

Authority: Treas. Reg. § 1.409A-3(1)(5)

Sample Language: Exhibit A, § 11.1

Include ability to amend or terminate plan and individual awards without consent of the recipient upon a change in control

Comment: For events that constitute a change in control, the Committee should have the discretion to take any of the following actions with regard to outstanding options and other equity grants, to accommodate the terms of a transaction and the requirements of the acquirer:

- The ability and discretion to accelerate the expiration of the awards to immediately prior to the closing constituting a change in control and requiring recipients to exercise outstanding awards in order to obtain the benefits of the transaction in the same manner as other shareholders. The plan should provide that any such rights that aren't exercised or settled prior to closing will be immediately cancelled.

- The ability of the Committee to do a net exercise or cashout of outstanding awards, for either all stock, all cash or a combination of cash and stock in the acquirer. Include the right to cashout underwater options for no additional consideration and without the recipient's consent.
- The ability to allow the acquirer to assume the plan and to substitute acquiror's stock for the stock issuable upon the exercise or settlement of the awards, including the ability to substitute cash for issuance of stock at the time of the transaction, so that the acquirer can acquire all shares and terminate all rights to awards as of the date of closing.

Sample Language: Exhibit A, § 11.3

Avoid contradictory language in award agreements and plan document regarding the Committee's flexibility in disposing of equity awards in response to a corporate transaction.

Comment: Employment and change in control agreements often deal with equity grants, which should be drafted with sufficient flexibility or be subject to the terms of the Plan so as not to create conflicting provisions.

Accelerate vesting of equity awards only to the extent that such acceleration will not result in any parachute payment that violates Code § 280G (the golden parachute rules) and will not result in an excise tax under Code § 4999.

Comment: Payments contingent on a change in control in excess of certain limits are not deductible to the paying company and result in a 20% excise tax to the recipient. The events that constitute a change in control under Code § 280G are similar to, but not identical, to the events permitting payment under Code § 409A. Generally, any acquisition of 20% or more is a change in control under Code § 280G; while the threshold is 30% for purposes of Code § 409A. The nondeductibility of parachute payments affects 1% or greater shareholders, officers in the top-paid 10% of total employees (minimum 3, maximum 50) and the top 1% of employees if they make more than \$110,000 annually. Certain private companies are permitted to hold a vote of shareholders to approve additional acceleration that would cause the change in control payments to exceed the limits, which vote would permit the deductibility of the payments and avoid the excise tax.

Authority: Treas. Reg. §§ 1-280G-1, Q&A 27-29; 1.280G-1, Q&A 15-20.

Provide that a sale of assets or sale of subsidiary results in a separation from service to accelerate the exercise of options and cancellation of awards.

Comment: In some cases, the employee will continue in employment in the same entity that is part of a new controlled group, so options and other awards should not remain outstanding in those transactions even if employment does not terminate.

Sample Language: Exhibit A, § 13.3

INTERNATIONAL ISSUES

☐ Allow flexibility for grants to non US employees outside the US

Comments: Because foreign jurisdictions often require special provisions in plan documents or award agreements to comply with foreign laws, include a provision that allows the Committee to issue grants with special provisions for non-US employees, even if inconsistent with the terms of the plan for US employees. The plan should also authorize the Committee to establish sub-plans under which awards may be crafted to meet the laws of foreign jurisdictions.

Sample Language: Exhibit A, § 10

☐ Limit grant or vesting of RSUs or other grants constituting “deferred compensation” under Code § 457A to US citizens working abroad or to foreign nationals working in the US

Comments: Non-US entities that are deemed to employ US citizens in countries without a comprehensive income tax system or enforcement of tax collections may be nonqualified entities from which deferred compensation paid to a US citizen is subject to a 20% excise tax under Code § 457A. Other equity grants not constituting deferred compensation, such as options and SARs, are exempt from the penalties under Code § 457A.

Authority: Code § 457A

☐ Specify US law as governing all awards and the resolution of any disputes in non-US jurisdictions

Comment: This provision will insulate plan terms relating to an employee’s termination of employment from his or her home country’s labor and employment laws. See Oracle Corp. v. Falotti, 319 F.3d 1106 (9th Cir. 2003).

TAX COMPLIANCE

☐ For public companies, draft to meet Code § 162(m) exclusion for performance-based compensation if needed

Comment: Code § 162(m) prohibits a public company from deducting payments for certain employee compensation in excess of \$1 million, but it also contains an exclusion from this rule for performance-based compensation. See Performance-Based Compensation (Code § 162(m)) Checklist for the rules to exempt options and other performance-based compensation from the Code § 162(m) limits.

Authority: Code § 162(m)

☐ Prohibit changes to performance awards upon termination of employment

Comment: The IRS has ruled that an agreement that permits the possibility for payment of a performance goal irrespective of whether the goal was met will cause that bonus to not be exempt from the \$1 million limit under Code § 162(m). This rule against accelerating performance pay and awards only applies to certain officers whose compensation is subject to

the Code § 162(m) limits. Acceleration as a result of death, disability or a change in control does not effect bonuses that are otherwise performance-based.

Authority: Private Letter Ruling 200804004; See Treas. Reg. § 1.162-27(e)(2)(v)

Sample Language: Exhibit A, § 7.1(f)

Draft to meet a Code § 409A exemption

Comment: See Equity Rights Exemption (Code § 409A) Compliance Checklist

Include language in any equity awards that meet the definition of “deferred compensation” to comply with Code § 409A requirements

Comment: See Deferred Compensation (Code § 409A) Checklist for grants to meet the requirements of Code § 409A, if not exempt.

Sample Language: Exhibit A, §§ 9.4; 9.5

SECURITIES COMPLIANCE

Restrict transfer of exempt securities or shares issued in exempt transactions by placing an appropriate legend on certificates

Comment: A legend should be placed on certificates representing shares if the shares are restricted from transfer or re-sale, including restrictions arising from the Securities Act of 1933, as amended (the '33 Act). The '33 Act legend typically states that the shares may not be transferred without registration or an opinion from company counsel that registration is not required. Include compliance with foreign jurisdiction law if issued to residents outside the U.S. Also include legends required by any agreements among stockholders. If the company uses a third-party transfer agent, also consider instructing the transfer agent to place a “stop transfer” order on the restricted shares.

Authority: See, for example, (i) Rule 502(d)(3) applicable to offers and sales exempt under Regulation D and a best practice for other offers and sales exempt under Section 4(2); (ii) Rule 147(f)(1)(i) relating to offers and sales exempt under Section 3(a)(11); and (iii) Rule 701(g)(2) applicable to exempt offers and sales pursuant to compensatory plans.

If shares are registered under Form S-8, permit transferability of stock options only under the conditions to persons that will keep the Form S-8 registration effective as to the transferee

Comment: Form S-8 may only be used to register securities to be offered under an employee benefit plan to the issuer's employees or employees of its subsidiary or parent. The general instructions to Form S-8 also provide that the form is available for the exercise of options and subsequent resale of the underlying securities by certain family members of employees who acquire the option through gift or a domestic relations order. If an option is transferred to a person as to whom Form S-8 is not available, the shares received by the option transferee will not be registered and should be restricted from transfer.

Authority: General Instruction A(1)(a)(1) to Form S-8 and General Instruction A(1)(a)(5) to Form S-8.

Avoid equity plan issuances to entity consultants and advisors

Comment: Both Rule 701, which provides an exemption for offers and sales pursuant to compensatory plans, and Form S-8, which provides for registration of securities offered and sold pursuant to compensatory plans, permit the rule or form to be used for issuances to non-employee consultants or advisors only if they are “natural persons.” Thus, an issuer that issues equity as compensation to entity consultants (for example, an LLC) would not be eligible to use Rule 701 or Form S-8 for those issuances. While other exemptions and other registration forms exist, the exemptions have separate requirements that may be difficult to meet and other registration forms are longer and generally more expensive to see through to effectiveness.

Authority: Rule 701(c)(1)(i) and General Instruction A(1)(a)(1)9i) to Form S-8.

For private companies, limit the number of option holders to less than 500

Comment: The SEC takes the position that an option is an equity security. Companies with more than 500 shareholders become a public company if its value exceeds \$10 million dollars and must comply with the registration requirements of Section 12G of the Exchange Act. The 500 shareholder rule includes both actual shareholders and option holders, but does not include stock appreciation rights.

Authority: Section 12G of the Exchange Act

Grants to Section 16-b officers should be made only by non-employee directors so that the exercise is exempt from Section 16(b).

Comment: Purchases and sales by certain executive officers are matched to determine if the person realizes a profit from the transaction. The grant and exercise of a stock option is exempt from the short swing profits rules of Section 16-b if conditions are met, such as the award of shares pursuant to a plan by outside directors. Therefore, any delegation to an executive officer to grant stock options should exclude any grants to other Section 16-b officers.

Authority: Rule 16(b)-3(d).

Private companies that may become public should establish a committee of non-employee directors so that awards prior to becoming public are exempt from Section 16(b).

Comment: After the issuer registers a class of equity securities under Section 12 of the '33 Act, any pre-registration transactions in the issuer's securities by an officer or director becomes subject to reporting, and potential matching under Section 16(b), if, within six months after the pre-registration transaction, the insider effects a transaction that triggers an obligation to file a Form 4 under Section 16 (whether or not the transactions are “opposite way” for the purposes of short-swing profits matching). If pre-registration transactions are matchable with post-registration transactions, the director or officer will have short swing profit liability. By ensuring that equity awards are issued by a committee comprises solely of non-employee directors prior to Section 12 registration, issuers can exempt the award from potential short swing matching.

Authority: Rule 16(a)-2(a) and Compliance and Disclosure Interpretations, Exchange Act Section 16 and Related Rules and Forms, Question 110.01 (May 23, 2007); Rule 16(b)-3(d).

- If a private company, provide for ability to prevent sales of shares issued under a grant during period immediately after an initial public offering.**

Comment: Shares, including those received under an award, that are held by insiders are generally prevented by the stock sale underwriters from selling shares during the 180 day period after an initial public offering. Such restriction, if necessary, should be included in the award agreement or plan; otherwise, consents from such insiders will be necessary at the time of the initial public offering.

- Permit dispositions of shares back to the issuer only if exempt under Section 16(b)**

Comment: Certain dispositions back to the company of shares upon exercise of an option are exempt from Section 16(b) if approved by the Committee at the time of grant. This exemption would cover the tender of shares to pay required tax withholding, a net exercise where shares are retained by the company to pay the exercise price and/or attestation, and where owned shares are used to pay the purchase price. Note that a broker assisted sale, or net exercise where the shares received upon exercise are sold in the market to repay the loan necessary to exercise is not an exempt transaction, and would be subject to Section 16(b) rules.

Sample Language: Exhibit A, § 7.2(f)

- Provide for cancellation of grants (or delay the vesting of grants) until the authority to grant shares under the plan has been approved by shareholders**

Comment: Grants may be made prior to obtaining shareholder approval, but no grant should vest until the shareholders approve the plan. Alternately, provide that the option rights expire if the shareholders fail to approve the plan within the 12 month period.

Sample Language: Exhibit A, § 4

- Require acknowledgment by recipient that the purchase or receipt of shares is not made relying on any oral representations of any persons of the company**

Comment: Investors may rescind the purchase of shares if the purchase was based on a material misstatement or omission of a material fact under Rule 10b-5 of the Exchange Act. Both at the time of grant and at the exercise, when shares are actually received, or upon the payment of the shares either as a bonus or on the lapse of restrictions, employee should acknowledge that he or she is not relying on any representations, and has had the opportunity to review and examine any written financial information regarding the condition of the company.

- Ensure delivery of plan prospectus or other required plan information**

Comment: Form S-8 does not require a prospectus relating to the securities being registered to be filed with the Form S-8 registration statement. However, a plan prospectus is required and by omitting the prospectus from the registration statement, the issuer is undertaking to provide the plan prospectus to participants separately as required by Commission rules. Form S-8 specifies the information that must be provided to participants. Likewise, Rule 701 requires disclosure of certain information to participants. At a minimum, the issuer must deliver a copy of the plan to the participant. If the amount of securities sold under Rule 701 during any consecutive 12-month period exceeds \$5 million, the issuer also must deliver information to the participant that

essentially approximates the plan prospectus required by Form S-8 and also must provide financial statements.

Authority: Form S-8, Part I, Item 1. Plan Information and Rule 701(e).

If relying upon Rule 701, be sure to review the securities laws of the state or states where award recipients reside and make appropriate filings

Comment: Rule 701 is an exemption from Section 5 of the '33 Act. Issuers relying upon Rule 701 must also comply with state securities law and ensure the equity plan issuance is structured so as to be exempt under the laws of the state in which the award recipient resides. Companies should establish a process to ensure the state of residence of the award recipient is communicated to counsel as soon as possible.

Many states, but certainly not all, have adopted a version of the Model Uniform Securities Act, primarily the model acts of 1956 and 2002. It will be much easier to ensure an exemption in states with a form of the model act. For example, Section 202(21) of the 2002 model act is based upon Rule 701 so that compliance with Rule 701 will provide compliance with this state law exemption. The model act of 1956 contained a much more limited provision in its Section 402(a)(11).

Authority: Rule 701(a) and Preliminary Note 2 to Rule 701.

CORPORATE LAW COMPLIANCE

Grant of equity rights under the plan should not prevent the company from taking any action with regard to its shares otherwise permitted by law.

Comment: The grant of rights should not restrict the normal corporate law discretion and authority of the board to enter into other transactions, recapitalize or split stock and should not require the consent of the option holders or recipients prior to such actions. Unless the class of stock being issued to recipients carries preemptive rights, no one should be entitled to an increase in the number of shares covered by an award if additional shares are issued. Never draft an option or award that requires an issuance of a certain percentage of the outstanding stock of the company, which would automatically increase if additional shares are issued.

Sample Language: Exhibit A, § 13.1

Confirm state law would permit the forfeiture of granted stock upon violation of a noncompetition provision

Comment: Courts have generally upheld a forfeiture of stock rights upon violation of a non-compete or breach of confidentiality agreement, since the amount does not prohibit employee from working for another employer, but merely rescinds a portion of the compensation received during his or her previous employment. California courts, on the other hand, have held that any penalty against an employee who works for competitor is unlawful under section 1660 of the state corporate law. See *Walia v. Aetna, Inc.*, 113 Cal. Rptr. 2d 737 (Cal. Dist. Ct. App. 2001).

Beware of special requirements in California

Comment: When issuing stock options to California employees, beware of the provisions of California law that impose substantive requirements on both the plan and the option award. For example, an option must be exercisable following termination of employment for death or

disability for at least 6 months and following terminations of employment other than death or disability (other than for cause) for at least 30 days. Additionally, any plan or agreement that provides for the issuance of securities to employees, officers, directors, managers, advisors or consultants also must provide that the participants will receive financial statements at least annually. Further, the total number of securities issuable upon exercise of outstanding options may be limited in certain circumstances unless a higher number is approved by two-thirds of the outstanding securities entitled to vote.

Authority: 10 Cal. Code Regs. Title 10, § 260.140.41, § 260.140.45, and § 260.140.46.

PHANTOM STOCK AND STOCK APPRECIATION RIGHTS CHECKLIST

There are three basic types of phantom stock or phantom unit plans:

- Phantom Stock Appreciation Rights Plan, which is similar to a stock appreciation right, except that the payment is generally made in cash;
- Phantom Stock Plan, which is similar to a restricted stock unit, whereby the recipient is paid in cash based on the full value of an actual share or unit outstanding; and
- A Change in Control Bonus Plan, where the recipient is paid a bonus in cash, equal to a percentage (or a number of units), representing the value received by the shareholders as a result of the change in control.

In the first two instances, the value of the phantom stock appreciation right or phantom stock will generally be made payable at the same time as an option or a restricted stock unit would be payable, if stock, rather than cash, had been the manner of payment. A change in control bonus, while similar to restricted stock, is generally payable only if the employee or consultant is actively in the service of the company at the time of an event constituting a change in control.

It is the authors' experience that:

- some phantom stock plans are administered in a manner identical to an actual stock award, and are based on a valuation method and other conditions that would exempt the phantom award from the requirements of Code § 409A, but
- many private companies choose to use an approximation of fair market value, based on certain formulas or other valuation methods that may or may not constitute a reasonable valuation method that would exempt the award from Code § 409A. In fact, companies can be more creative in defining the value of units if not required to comply with the reasonable valuation method required for the Code § 409A exemption. Compliance with Code § 409A is generally not burdensome, since in many instances, the general timing of the payment will most often coincide with an event where such payment is permitted under Code § 409A. However, the flexible exercise dates of an option or SAR are lost under Code § 409A.

If a phantom stock plan meets the requirements to be exempt from Code § 409A (see Equity Rights Exemption (Code § 409A) Checklist), then many of the issues raised in the Equity Plan Checklist would apply (other than those applicable to the actual issuance of stock, such as securities law compliance requirements). This Checklist, and the sample phantom plan document, however, are based on a plan that is intended to comply with Code § 409A, rather than to be exempt from Code § 409A.

PHANTOM UNITS

- Define each unit as equivalent to either a whole or fractional share or unit of actual equity in the company.**

Comment. Generally, a phantom stock appreciation right or phantom stock unit represents the cash value of one share of common stock or member unit of the company. A unit can be defined as the value of a fraction of one share or unit. If there is more than one class of stock or units, the plan should identify which equity the phantom unit represents.

Sample Language: Exhibit E, § 2.14

- Determine whether the phantom units represent the full value of a share or unit or only the appreciation between date of grant and date of payment.**

Comment. It is common for the phantom plan to be similar to an option, in that each unit represents a whole share or unit of stock. If the plan is intended to provide only for the appreciation, each unit is given a value at grant and at the time of payment, the grant value is subtracted from the fair market value to determine the amount of payment. If the units are to function like restricted stock, then the grant value is irrelevant.

Sample Language: Exhibit E, § 7.1

- Determine whether the phantom units be treated as if outstanding with actual shares or units in calculating the value of each actual share.**

Comment. A phantom unit is generally not considered to be outstanding, thus it does not dilute the existing shares. However, a plan may base the value of each phantom unit as if each were an outstanding share by adding the number of phantom units to be valued to the actual number of shares outstanding.

Sample Language: Exhibit E, § 2.14

- Provide for adjustment in the number and value of units in the event of a recapitalization that does not result in payment on phantom shares**

Comment. Like in a stock option plan or other equity plan, certain corporate transactions may result in an increase or decrease in the number of outstanding shares or units. The plan should address how these changes would affect the value and number of phantom shares or units at the time of the corporate transaction. If the plan is intended to qualify under Code § 409A, it is generally not permissible to make distribution to phantom unit holders in the event of a recapitalization that results in a distribution to actual shareholders, since such an event is not permitted under Code § 409A. In that case, it would be necessary to increase the value of the phantom shares by the amount of the distribution to shareholders.

Authority: Code § 409A(2)

Sample Language: Exhibit E, § 4.3

ELIGIBILITY ISSUES

- Consider limiting eligibility so that the plan is considered a top hat plan, which is exempt from many ERISA requirements.**

Comment. If the eligibility is limited to a select group of management or other highly compensated individuals (as defined in ERISA), the plan may be exempt from many ERISA requirements, including participation, vesting, funding and fiduciary responsibility. However, see ERISA Requirements below for the top hat plan reporting and disclosure requirements under ERISA.

Authority: ERISA §§ 201, 301, 401

VESTING ISSUES

- Define circumstances under which right to payment will vest.**

Comment. Generally, and like a stock option, a phantom stock or stock appreciation right will vest based on either performance goals or the passage of time. Since this type of plan is not subject to the ERISA vesting rules, a vesting schedule longer than 3 or 5 years is permitted.

Sample Language: Exhibit E, § 5 and the Award Agreement

- Consider whether vesting should accelerate upon certain events.**

Comment. Whether vesting should accelerate upon any event is discretionary with the company. As with stock options as described in the Equity Plan Checklist, the plan should define those events that result in accelerated vesting (e.g., death, disability, change in control).

- Add forfeiture and clawback upon certain events.**

Comment. Add forfeiture and clawback of unvested and vested units in the event of termination for cause or post termination violation of noncompete or other restrictions. Also see Forfeiture and Clawback section in the Equity Plan Checklist.

PAYMENT ISSUES

- Define which events permitted by Code § 409A will give rise to payment under the plan**

Comment. If the plan is subject to Code § 409A, then any payment under the phantom stock plan must provide for payment only upon one or more of the following payments events which are defined by Code § 409A:

- Fixed date or schedule.
- Death.
- Disability.

- Separation from service.
- Change in control.
- Unforeseeable emergency.

For further details on the conditions that must be met for phantom stock and stock appreciation rights to satisfy Code § 409A payment events, see the Deferred Compensation (Code § 409A) Checklist. Code § 409A also limits the ability to accelerate or defer the selected payment date or event. Phantom stock appreciation plans that are exempt from Code § 409A may provide for payment at the election of the company or as elected by the recipient at times similar to those for a stock option or restricted stock grant. See the Equity Rights Exemption (Code § 409A) Checklist for the conditions a phantom stock appreciation plan must meet to be exempt from Code § 409A.

Authority: Code § 409A(2)

Consider using payment events that will cause the plan to be a bonus plan, which is exempt from all of ERISA requirements.

Comments: A plan may be considered a bonus plan if the payments made under the plan are not systematically deferred until termination of employment, or that provide retirement income. DOL Reg. § 2510.3-2(c). If a plan provides for payment events prior to or at termination of employment or retirement, it is possible for a plan to be a bonus plan. *Emmenegeer v. Bull Moose Tub Co.*, 197 F3d 929 (8th Cir. 1999); See DOL Opinion Letter 83-46A (1983).

Authority: DOL Reg. § 2510.3-2(c)

Define the date of payment for each event giving rise to payment to comply with Code § 409A

Comment: If Code § 409A applies, the date that payment is made or begins must be specified in the plan as well as the terms (time and amount) for each installment payment. Generally, each payment event listed above can have one or two forms of payment, which may vary only based upon age, years of service or approximate to following a change in control.

Authority: Treas. Reg. § 1.409A-3(i), See, Treas. Reg § 1.409A-3(c)

Determine what will happen when dividends or other distributions are made to shareholders.

Comment: If phantom stock or units are to be treated as equivalent to actual shares, dividends and similar distributions to shareholders may be paid or accumulate as dividend equivalents to the phantom owners. Alternatively, like an option, the plan may specify there is no right to dividends or distributions until the right to payment vests or is made. It is possible to establish a deferred distribution of dividends otherwise paid to actual shareholders, which is then paid at the same time (or may be paid at a different specified time in accordance in Code § 409A) than the value of the phantom unit.

Authority: Treas. Reg. § 1.409A-3(e)

Sample Language: Exhibit E, § 9.3

- If a subchapter S corporation or limited liability company (LLC), determine how the tax distributions to actual shareholders will be accounted for in the number and value of phantom units**

Comment: Pass through entities such as an S Corp. and LLC generally distribute a portion of their earnings each year to shareholders to pay taxes. Since the phantom units are not taxed until actually paid, no tax distribution is necessary to phantom unit holders. However, since the distribution of earnings represents a right of shareholders and reduces the value of the entity, phantom unit holders may be given the same right.

- If actual shares rather than assets of the company are sold by shareholders in a change in control, the company will be responsible for paying liability associated with phantom units**

Comment: A change in control poses several issues for a phantom unit plan. If assets are sold, the cash is received by the company, and can first be distributed to the phantom unit holders and then to the shareholders. However, if shareholders sell their stock, the portion of the stock value that is owed to the phantom unit holders must be channeled to the company for payment to the unit holders. Due to the fact that a deduction is generated from the payment of the phantom stock upon a change in control, determining who is entitled to the deduction for that payment is generally negotiated in the purchase agreement.

- Consider waiver and release of rights and other claims as a condition of payment**

VALUATION ISSUES

- Will a formal or informal appraisal be required for each payment event**

Comment: If the phantom stock is intended to be exempt from Code § 409A, generally a formal or informal appraisal, which uses a reasonable valuation method, must be documented at the time of the grant of phantom units and at the time of redemption. See Equity Plan Exemption (Code § 409A) Checklist. Plans that are not required to meet Code § 409A may still wish to engage an appraiser to determine value rather than using a formula or leaving the determination of value to the discretion of the company.

Sample Language: Exhibit E, § 2.8

- Specify the date of the financial statements to be used in determining the value of phantom shares**

Comment: If a formula or other method of valuation is used, a convenient date, such as prior year-end, should be specified as the date for valuing stock and therefore phantom units. In some cases, a date after the payment event is used, so the recipient cannot use hindsight to determine the most favorable price at which the phantom units are redeemed.

Sample Language: Exhibit E, § 2.8

Specify any adjustments to the financial statement and/or valuation in determining the value of phantom shares

Comment: Because the value of the phantom units represent the liability on the books of the company, in determining the value of a share or stock, the plan should address whether the liability associated with the phantom units is taken into account to determine the value of each actual share or unit. If the plan is not intended to be exempt from Code § 409A, other deductions for extraordinary items, asset adjustments, etc. may be made to determine the approximate value for purposes of the phantom unit plan. If payment is to be made in connection with the change in control, the valuation definition generally provides for the value to be based on the net proceeds received by the shareholders, after deducting any transaction costs.

Sample Language: Exhibit E, § 2.8

Specify how the value of any retained interest by shareholders or partial sale of stock or assets is treated in the valuation of phantom shares

Comment: In a change in control, valuation may be based on cash, but also could include other considerations paid to shareholders either prior to (i.e. a special dividend) or after (value of non compete or contingent payments) or be paid in the form of other property that would need to be valued, such as stock in the acquiring company. If less than 100% of the company or its assets are sold, the plan should address whether a partial redemption of the phantom units is made based upon a percentage of actual shares sold, or whether the retained value to the shareholders is added to the proceeds received, to pay the full redemption value of the phantom shares to recipients, regardless of the percentage of stock sold by the shareholders.

How are contingent payments, escrows or earn-outs valued for phantom shares

Comment: Upon a change in control, if the amount to be paid is based on the value received by shareholders, Code § 409A permits a payment schedule for phantom stock to be made if and when received by shareholders, provided the period of payment does not exceed five years.

Authority: Treas. Reg. § 1.409A-3(i)(5)(iv)

Determine whether the recipient is permitted to dispute valuation method and/or value

Comment: Plan can provide that any determination of value made at the discretion of the Company is final and binding on all parties. The plan could provide for a method for resolving disputes in informal valuations by the appointment of one or more qualified appraisers to conduct a formal valuation. Allocation of the costs of such a dispute resolution method should be included.

Sample Language: Exhibit D, § 2.8

TAX COMPLIANCE

Require withholding from the payment of phantom units

Comment: The major distinctions between an actual equity grant and a phantom equity grant are in the areas of taxation and accounting treatment. Actual equity grants can result, upon exercise

or the lapse of restrictions (and the payment of taxes), in further appreciation being taxed at capital gains rates. Because payment and taxation coincide in a phantom stock plan, and because the recipient has not been taxed on the gain earlier, all of the appreciation that is paid at the time of a payment event with respect to phantom stock is taxed at ordinary income, rather than capital gains, tax rates.

Plan should be unfunded and recipients should be no more than general creditors of the company, to avoid constructive receipt

Comment. Recipients of a phantom stock award will not be taxed until the amount is actually paid, as long as they remain general creditors of the company, no amounts are pledged to secure the promise to pay and the recipient derives no economic benefit (other than at the time of payment) from the promise. Even when rights to the phantom stock vest, as long as the recipient remains a general creditor, vesting will not result in constructive receipt or immediate taxation. The plan that is not operated or drafted in compliance with Code § 409A, if applicable, will result in the recipient being taxed as if the amount were constructively received on the date that the payment was no longer subject to a substantial risk of forfeiture, rather than at the time of payment. Any funding, such as an insurance policy, satisfied of assets, should specifically disclaim any right of the employee in such assets. Assets may be segregated from the working capital of the company through a rabbi trust, under which assets be held in trust unless and until the company becomes insolvent or enters bankruptcy, and such a trust is still considered unfunded under tax laws.

Sample Language: Exhibit E, §§ 9.2, 9.7

Disclaim any tax advice to recipient and, other than withholding, make recipient responsible for any and all taxes.

Comment. This general disclaimer will protect the company in the event there are any excise or other taxes, including excise taxes as the result of a violation of Code § 409A, and additional taxes due over and above the amount actually withheld.

Sample Language: Exhibit E, § 6.2

- Reserve the right to amend as necessary to comply with any tax laws, with or without the consent of the recipient.**

Comment. While such “savings clauses” will not save a plan from failing to meet the technical requirements of Code § 409A, such clauses avoid protracted negotiations and give the company more flexibility in revising plan documents.

Sample Language: Exhibit E, § 9.9

ERISA COMPLIANCE

- Design the plan to be exempt from most of ERISA.**

Comment. A plan will be exempt from all of the ERISA requirements if it is a bonus plan. If the plan is a top hat plan, it will be exempt from many of the requirements, including participation, vesting, funding and fiduciary responsibility. See Eligibility and Payment sections above for comments on these exemptions.

- Determine whether to include ERISA benefit claims determination and review procedures.**

Comment. Unless the plan is a bonus plan, it must include the benefit claims determination and review procedures found in Part 5 of ERISA. This contains the right to sue for damages and the right to a full and fair review of any claims. This would generally require a review of any denied claims and the right to examine documents used in the determination of the initial denial of benefits.

Authority: ERISA § 503

- Provide specific disclaimer of any fiduciary responsibility under ERISA or state law.**

Comment. Both a bonus plan, as well as a top-hat pension plan, are exempt from the fiduciary standards that govern ERISA-covered pension plans. Such a disclaimer should allow the state corporate law business judgment rule to govern any review by the courts of the determinations made by the company or the compensation committee, rather than the stricter fiduciary standards contained in ERISA.

Sample Language: Exhibit E, § 9.8

- Prepare and file a top-hat exemption letter with the Department of Labor to avoid the reporting requirements of ERISA.**

Comment. Top hat plans may file an exemption letter with the Department of Labor to avoid the reporting requirements of ERISA, including the annual 5500. This one-time exemption letter must be filed within 120 days following the establishment of the plan. The IRS offers a correction program with a \$750 fee to accept a late filing of the top hat exemption letter.

Authority: DOL Reg. § 2520.104-23

INCENTIVE STOCK OPTION (ISO) (CODE § 422) COMPLIANCE

Most private and public companies' equity plans provide for options that will qualify for the favorable tax treatment under Code § 422, known as incentive stock options. The following checklist contains the required elements that must appear in the plan document that also must be approved by shareholders within 12 months of adoption of the plan. If the ISO requirements are met, no compensation is reported upon exercise, and if the stock holding periods are met, all of the appreciation is taxed at capital gains rate only at the time of sale of the stock acquired upon exercise of the option. By contrast, the appreciation on the stock underlying options that don't qualify as incentive stock options is taxable as ordinary income immediately upon exercise, with capital gains rates only applying to the appreciation after exercise, if the applicable capital gains holding periods are met, which begin with the date of exercise. Note, however, that because the appreciation on the option at the time of exercise is considered income in calculating the alternative minimum tax (AMT), and since more taxpayers are now subject to AMT, many optionholders will likely pay some income tax on the exercise of incentive stock options.

TAX REQUIREMENTS

In Writing

Comment: The plan and the option agreement must be in writing or electronic form.

Authority: Treas. Reg. § 1.421-1(a)(3)

Granted by Employer

Comment: Option must be granted to and exercised by the individual in connection with employment. Employment includes service with a parent or a subsidiary of the granting company.

Authority: Treas. Reg. § 1.421-1(h)(i)

Maximum Shares in the Plan

Comment: The plan must designate the maximum aggregate number of shares that may be issued under the plan.

Authority: Treas. Reg. § 1.422-2(b)(3)

Eligibility

Comment: The plan must specify the employees or class(es) of employees eligible to receive ISOs. There are no nondiscrimination or coverage rules for the granting of ISOs. Thus, the usual practice is to provide that all employees are eligible to receive options and to give the board or

committee the authority and discretion to determine which employees will receive the grants and the specific terms of the grants. Non-employee Board members and consultants are not eligible for ISOs, but only NQSOs.

Authority: Code § 422(b)(i); Treas. Reg. § 1.422-2(b)(4)

Plan Approval

Comment: Plan must be approved by the shareholders of the employer within 12 months before or after the date the plan is adopted. Any increases in the maximum aggregate number of shares that may be issued under the plan (other than changes merely reflecting a change in the number of outstanding shares), or change in the designation of the employees eligible to receive options under the plan, is considered the adoption of a new plan requiring stockholder approval within 12 months before or after such actions.

Authority: Code § 422(b)(i); Treas. Reg. § 1.422-2(b)(2)

Sample Language: Exhibit A, § 4

Duration of Plan

Comment: The plan cannot have a duration that exceeds 10 years from the earlier of the date the plan is adopted or the date the plan was approved by the stockholders. Options that qualify as ISOs must be granted within that 10 year period; however, options need not be exercised within the initial 10 years of the plan's existence.

Authority: Code § 422(b)(2)

Exercise Terms

Comment: The option agreement must provide the exercise price, restrictions on exercise, and, generally that the option cannot be exercised more than 10 years after the date on which the option was granted, subject to earlier cancellation. If the optionee at the time of grant is a 10% or greater shareholder-employee, the option cannot be exercised more than 5 years after the date of grant of the option.

Authority: Code § 421(a)(1); Code § 422(b)(3); Code § 422(c)(5)

Sample Language: Exhibit A, § 7.2(e)

Exercise Price

Comment: The exercise price must not be less than 100% of the fair market value of the stock, as measured on the date the option is granted. In the case of 10% or greater shareholder-employee, the option exercise price must be not less than 110% of such fair market value. Fair market value for publicly traded companies is generally based on the closing price, or the average of the bid and ask price if quoted on an over-the-counter market. For private companies, the only definition of fair market value for purposes of ISOs is the good faith determination by the Board or committee, which is a more liberal standard than for non-qualified stock options, which must generally use a definition that will permit the option to be exempt from Code § 409A. See

Equity Plan Exemption (Code § 409A) Checklist for the formal requirements for fair market valuation under Code § 409A.

Authority: Code § 422(b)(4); Code § 422(c)(5)

Sample Language: Exhibit A, § 7.2(d)

Number of Shares

Comment: The option agreement must specify the number of shares subject to the option.

Authority: Treas. Reg. § 1.42-1(a)(1)

Sample Language: Exhibit A, § 7.1(h)

Non-transferability

Comment: The plan or option agreement must provide that the option cannot be transferred other than by will or by the laws of descent and distribution. The option agreement may give the optionee the ability to specifically designate the optionee's beneficiary.

Authority: Code § 422(b)(5)

Sample Language: Exhibit A, § 7.1(h)

Continuous Employment

Comment: The optionee must remain an employee of the corporation granting the ISO at all times during the term of the ISO, but the ISO, to the extent that the option agreement so provides, may be exercised during a period of up to three months immediately following the optionee's termination of employment. However, the ISO plan and the ISO agreement may allow an option to be exercised more than three months following termination of employment, but such option will be a non-qualified stock option. The option plan or option agreement may allow for additional time to exercise an option following termination of employment due to death or disability.

Authority: Code § 422(a)(2); Treas. Reg. § 1.421-1(h)(2); Treas. Reg. § 1.421-2(c); Code § 422(c)(6)

Sample Language: Exhibit A, § 7.2(b), (c)

\$100,000 limit

Comment: Options are only treated as ISO to the extent that the aggregate fair market value of the stock during any calendar year is equal to or less than \$100,000 when it first becomes exercisable. This limit is based on the exercise price at date of grant. For example, an option for 20,000 shares at \$20/share (\$400,000 exercise price) will be an ISO if it vests (first becomes eligible for exercise by the optionholder) equally over 4 years (\$100,000 per year). Be aware, ISOs granted in earlier years that vest in the same year will be counted against the annual limit.

Authority: Code § 422(d)

Reporting Requirements

Comment: For each calendar year that a company transfers an ISO share to an employee, the employer must file Form 3921 with the IRS, and provide the same information to each employee, on or before January 31 of the year following the transfer.

Authority: Code § 6039; Treas. Reg § 1.6039-1(a)

DRAFTING TIPS

Require a holding period.

Comment: In order for an employee to receive the tax benefits of the ISO he or she:

- Can't sell or transfer the share of stock within 2 years after the date of grant.
- Can't sell or transfer the share of stock within 1 year after the exercise date.

Therefore, the agreement could require the employee to retain the shares for the applicable holding period.

Authority: Code § 422(a)

Require that the optionholder must notify the company if the ISO stock is sold before the holding period expires.

Comment: If the stock is sold before the relevant holding period expires, the appreciation through the date of exercise is then taxed as ordinary income, similar to a non-qualified option, but the company will be entitled to a deduction equal to the appreciation. Since the company may not know about the sale from other sources, the plan or option can require such notice to the company to allow it to use the deduction.

Authority: Code § 422(a)

Sample Language: Exhibit A, § 9.7

Provide that any options granted that do not satisfy the ISO rules will be treated as non-qualified options.

Comment: There may exist conditions under which the ISO rules will not be satisfied, for example, an acceleration of vesting of ISO shares in excess of the \$100,000 in connection with a merger; or extending the right to exercise shares to a departing employer. So that the options can continue to be outstanding in those circumstances, the agreement should specify that the options will thereafter be treated as non-qualified stock options.

Authority: Treas. Reg. § 1.421-1(c)

Sample Language: Exhibit A, § 7.2(a)

EMPLOYEE STOCK PURCHASE PLAN (CODE §423) COMPLIANCE

TAX REQUIREMENTS

In Writing

Comment. The plan and the terms of an offering must be in writing or electronic form.

Authority. Treas. Reg. § 1.423-2(a)(1)

Employees Only

Comment. The plan must state that the options may only be granted to employees of the employer, including any subsidiary and parent company if designated by the plan.

Authority. Code § 423(b)(1)

Maximum Shares in the Plan

Comment. The plan must designate the maximum aggregate number of shares that may be issued under the plan.

Authority. Treas. Reg. § 1.423-2(c)(3)

No 5% Owners

Comment: The plan or offering must state that an employee cannot receive an option if, immediately after the option is granted, the employee owns stock possessing 5% or more of the voting power or value of all classes of stock of all the employer's stock

Authority: Code § 423(b)(3)

Eligibility

Comment. All eligible employees must be allowed to participate in the plan, although the following categories of employees may be excluded:

- employees employed less than 2 years;
- employees who customarily work less than 20 or less per week;
- employees who customarily work less than 5 months a calendar year;
- highly compensated employees
- employees who are citizens or residents of a foreign jurisdiction if the grant of the option is prohibited under the laws of such foreign jurisdiction, or if the compliance with the laws of the jurisdiction would cause the plan to violate Code § 423.

If one employee is wrongfully excluded from an offering, none of the options granted in the offering will be entitled to favorable tax treatment under Code § 421.

Authority: Code § 423(b)(4); Treas. Reg. § 1.423-2(e)(3).

Identical Rights and Privileges

Comment: All employees granted options shall have the same rights and privileges, except that the amount of stock that may be purchased may be based on compensation differences. The offering may also provide different rights and privileges to employees that are citizens or residents of a foreign jurisdiction if it is done to comply with the laws of a foreign jurisdiction, and the terms are less favorable than the terms granted to employees in the U.S.

Authority: Code § 423(b)(5); Treas. Reg. § 1.423-2(f)

Purchase Price

Comment: The option price cannot be less than the lesser of:

- 85% of the FMV of the stock at granting date
- 85% of the FMV of the stock at the exercise date

Note that, under FAS 123(R), a discount greater than 5% will result in an accounting expense for the aggregate discount.

Authority: Code § 423(b)(6)

Maximum Term

Comment: The maximum term of offering periods may not exceed 27 months from the granting dates, unless the purchase price is not less than 85% of the FMV at the time of the exercise of the option, in which case the offering period may be as long as five years.

Authority: Code § 423(b)(7)

Annual \$25,000 Limit

Comment: No employee may be permitted to accrue the right to purchase stock under all ESPPs of the employer at a rate which exceeds \$25,000 in FMV of the stock (such FMV determined on the first day of the offering period) per calendar year.

Authority: Code § 423(b)(8)

Nontransferability

Comment: An employee's options, during their lifetime, are not transferable and may only be exercised by the employee.

Authority: Code § 423(b)(9)

Plan Approval

Comment: Plan must be approved by the shareholders of the employer within 12 months before or after the date the plan is adopted. The plan must also be reapproved if the plan is amended or changed in manner that is considered to be an adoption of a new plan.

Authority: Code § 423(b)(2); Treas. Reg. § 1.423-2(c)(4)

Reporting Requirements

Comment: Beginning with the 2010 tax year, for each calendar year that an employer transfers an ESPP share to an employee (where the exercise price of the share is less than 100% of the value of the stock on the granting date, or is not fixed or determinable on the granting date), the employer must file Form 3922 with the IRS, and provide the same information to each employee, on or before January 31 of the year following the transfer.

Authority: Code § 6039; Treas. Reg. § 1.6039-2(b)

DRAFTING TIPS

Add Requirements for Special Tax Status

Comment: In order for an employee to receive the tax benefits of the ESPP he or she:

- Can't sell or transfer the share of stock within 2 years after the granting date.
- Can't sell or transfer the share of stock within 1 year after the exercise date.
- Must be an employee of the employer at all times between the option granting date and the day three months before the exercise date.

Authority: Code § 423(a)(1) and (2)

Add Maximum Shares Per Offering

Comments: If the plan designates a fixed and determinable number of shares (as of the first day of the offering) that may be purchased by each employee during the offering, then the granting day is considered the first day of the offering phase.

In order for the grant date to be considered the first day of the offering phase, the plan must designate a fixed and determinable number of shares that may be purchased by each employee during the offer. If the plan does not do this, the granting date is considered the exercise date (often the last date of the offering phase).

Determining the grant date is significant for the special tax holding period as well as for a purchase price that is based on the granting date FMV.

Authority: Treas. Reg. § 1.423-2(h)(3) and (4)

Sample Language: "...the maximum number of shares that may be purchased by any employee during the offering equals \$25,000 divided by the fair market value of the stock on the first day of the offering."

Multiple Offerings with Different Rights and Privileges

Comment: A plan may have multiple offerings, either consecutive or overlapping. The terms of each offering do not need to be identical so long as they satisfy the ESPP requirements. These separate offerings may contain different rights and privileges. Therefore, a parent corporation could have different offerings (with different percentages or different exclusions) for different subsidiaries participating in its ESPP.

Authority: Treas. Reg. § 1.423-2(a)(i)

Offering Period

Comment: Consider using a shorter offering period (3-6 months) to limit the dilution of shares. Typically the longer the offering period, the more dilutive the plan, since employees become more likely to purchase their shares at a substantial discount. If using a longer offering period consider using interim purchase periods.

EQUITY RIGHTS EXEMPTION (CODE § 409A) CHECKLIST

The purpose of this checklist is to consider whether or not an equity plan and a phantom equity plan provides awards that are exempt from the requirements of Code § 409A. Under Code § 409A, “deferred compensation” is broadly defined, with few exceptions, as: (i) a binding right to compensation that (ii) vests in one tax year and (iii) is payable in a later tax year. Treas. Reg. § 1.409A-1(b). One of the exemptions from deferred compensation is for stock rights (both actual stock and phantom stock) that meet certain conditions such that the rights function identical to an option or stock appreciation right (“Equity Rights”) under the Code. Set forth below are:

- Regulatory exceptions to Code § 409A, and
- The features that actual and phantom stock awards must meet to satisfy the exemption from Code § 409A.

A stock right that does not meet either of these categories to be exempt from the definition of deferred compensation will be subject to Code § 409A, and therefore cannot be exercisable at the discretion of the recipient, but must be exercisable only at certain times and certain events (separation from service, change in control) permitted by Code § 409A. Failure to comply with Code § 409A will result in a 20% excise tax on the amount includible in income, in addition to other penalties.

REGULATORY EXEMPTIONS FOR EQUITY RIGHTS

- The terms of the plan and the grant of stock or phantom stock must meet one of the regulatory exemptions that do not constitute “deferred compensation”**

Comments: The following are the most common regulatory exceptions to the definition of “deferred compensation” for stock based awards:

- *Short term deferral:* The terms of the grant must provide for payment to be made within 2 ½ months of the company’s or recipient’s taxable year end in which the service related event “vests” under Code § 83. This typically includes performance stock, even where the performance period extends over several years, if the payment is made immediately following the end of the performance period. Vesting requires a substantial risk of forfeiture until the vesting event, which may be based on the performance of substantial services, other than noncompete, or certain events closely associated with the services performed, for example, the occurrence of an initial public offering. Treas. Reg. §§ 1.409A-1(b)(4)(i); 1.409A-1(b)(5)(i)(A)(3)(ii); 1.409A-1(b)(5)(vi)(F)
- *Incentive stock options* under Code § 422. Treas. Reg. §§ 1.409A-1(b)(5)(i)(C); 1.409A-1(b)(5)(ii)(F)
- *Employee Stock Purchase Plan* under Code § 423. Treas. Reg. §§ 1.409A-1(b)(5)(i)(C); 1.409A-1(b)(5)(ii)(F)

- *Restricted Stock* (which meets the short term deferral exception described above). Restricted Stock Units (RSUs) on the other hand, usually do not meet this exception, since the date of payment is generally later than the date of vesting. As a result, most RSUs must meet the requirements of Code § 409A to avoid the excise tax. Treas. Reg. § 1.409A-1(b)(4)(i)(B)
- *Capital or Profits Interest* in LLC (until further IRS guidance). Because of the thorny issues involved between partnership taxation of income under Subchapter K of the Code, §§ 701-777 and the deferral rules of Code § 409A, the IRS has exempted profits interests from Code § 409A until it issues further guidance resolving these issues. Treas. Reg. § 1.409A-1(b)(5)(iii)(D) and Notice 2005-1, Q&A – 7; See also, Treas. Reg. § 1.409A-1(b)(5)(iii)(6)

FEATURES THAT MAKE AN EQUITY RIGHT EXEMPT FROM CODE § 409A

☐ Nonqualified Stock Option (NQSO) or Stock Appreciation Right (SAR) must meet all of the following conditions:

- Based upon fixed number of units or shares of common equity of the entity for which the services are performed, or the parent entity owning at least 50% of the subsidiary. Note: The parent corporation may own as little as 20% of the entity if there is a good business purpose (such as a joint venture). Treas. Reg. §§1.409A-1(b)(5)(1)(A); 1.409A-1(b)(5)(iii)(A)
- At least 100% of Fair Market Value (FMV) on date of grant based on reasonable valuation (defined below). Treas. Reg. §1.409A-1(b)(5)(i)(A)(1)
- FMV on date of payment based on reasonable valuation (defined below) Treas. Reg. §1.409A-1(b)(5)(iv)
- No dividend preference Treas. Reg. § 1.409A-1(b)(5)(iii)(A)
- No put or call rights at greater than FMV. Treas. Reg. § 1.409A-1(b)(5)(iii)(A)
- No deferral of income beyond exercise date. Treas. Reg. §§ 1.409A-1(b)(5)(i)(A)(3); 1.409A-1(b)(5)(ii)(D)

Comment. Each of these elements must be present or addressed to meet the exemption. As an exempt stock right, the right to exercise may vest in an earlier year than the date of exercise, and the recipient may retain the discretion to exercise in any year after vesting occurs. The dates of exercise, in other words, need not meet the fixed schedule or events dictated by Code § 409A.

☐ Modifications to an Equity Right that do not result in a loss of the exemption from Code § 409A

- Acceleration of vesting of Equity Rights. Treas. Reg. § 1.409A-1(b)(5)(v)(E)
- Shortening the exercise period of Equity Rights. Treas. Reg. § 1.409A-1(b)(5)(v)(B)
- Payment of ordinary dividend equivalents on Equity Rights if paid within 2 ½ months of year in which paid to actual equity holders. Treas. Reg. 1.409A-1(b)(5)(i)(E). Dividend equivalents are treated as earnings and may be paid at a different time than the value of

the stock rights. However, if payment of dividend equivalents is made only if the recipient exercises the underlying stock right, this payment is viewed as a discount to the exercise price that would not meet the exemption from Code § 409A.

- Extending the exercise period for Equity Rights that would otherwise expire only if the extension is for no longer than the earlier of the original term or ten years from grant. Treas. Reg. § 1.409A-1(b)(5)(v)(C)(1). There are 3 exceptions to this rule:
 1. NQSOs and SARs that are underwater (i.e., the exercise price is greater than the FMV of the stock right at the time of the extension) may be extended for up to an additional ten years from the date of the extension. Treas. Reg. §. 1.409A-1(b)(5)(v)(C)(1);
 2. Exercise period may be extended until 30 days after end of period in which exercise would violate securities laws relating to Section 16(b). Treas. Reg. § 1.409A-1(b)(5)(v)(C)(1)
 3. Any extension if made before April 10, 2007. Treas. Reg. § 1.409A-1(b)(5)(v)(C)(2)
- Providing a choice between cash or equity upon exercise of Equity Rights. Treas. Reg. § 1.409A-1(b)(5)(i)(D)
- Using previously acquired actual equity to pay the exercise price. Treas. Reg. § 1.409A-1(b)(5)(v)(B)
- Withholding equity to pay tax withholdings. Treas. Reg. § 1.409A-1(b)(5)(v)(B)
- Permitting the transfer of Equity Right if authorized in original grant. Treas. Reg. §§ 1.409A-1(b)(5)(vi)(F); 1.409A-1(b)(5)(v)(B)
- Substituting a SAR for an NQSO with the same terms or vice-versa. Treas. Reg. § 1.409A-1(b)(5)(6)(H)
- Adjusting the number of units and exercise price of Equity Rights in accordance with Code § 424 necessary to preserve the aggregate spread on the Equity Rights as a result of a corporate transaction. Treas. Reg. § 1.409A-1(b)(5)(v)(D)(1)-(3)

REASONABLE VALUATION METHODS

Does the valuation of Equity Rights at grant and exercise constitute the “reasonable application of a reasonable valuation method”

Comment. In the event of an IRS audit that examines whether the Equity Rights are exempt from the requirements (and penalties) of Code § 409A, the company has the burden of proving that the valuation method used is reasonable. The factors the IRS requires to be considered (and established on audit) by the company to prove that the method is reasonable include:

- Value of tangible and intangible assets.
- Present value of anticipated future cash flows.

- Readily determinable market value of similar entities in similar business.
- Recent arm's length transactions involving company equity.
- Control premiums or discounts for lack of marketability, if relevant.

Authority: Treas. Reg. 1.409A-1(b)(5)(iv)(B)(1)

If a non-publicly traded company, does the valuation method create a rebuttable presumption of a reasonable valuation method

Comment: If the method meets one of the safe harbor methods outlined in Treasury regulations, the company is presumed to have a reasonable valuation method, and the burden is shifted to the IRS, which has the burden of proving that the method was unreasonable. The Treasury regulations describe three methods that will shift the burden:

1. Independent appraisal within 12 months of valuation date. Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(2)(i)
2. Non-lapse buy-sell formula applicable to all equity holders (compensatory and noncompensatory) treated as FMV if certain non-lapse restriction under Code §83 are met Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(2)(ii)
3. A start-up company (i.e., company and predecessor have not conducted business for more than 10 years) if the following conditions are met
 - a good faith, reasonable valuation in writing by person selected by Company with at least 5 years experience in:
 - Business valuation
 - Financial accounting
 - Investment banking
 - Private equity
 - Secured lending
 - Business or industry in which Company operates
 - No put or call on stock, other than right of first refusal or Code § 83 lapse restriction (i.e., repurchase unvested equity at cost)
 - No change in control reasonably expected within 90 days of valuation
 - No public offering reasonably expected within 180 days of valuation

Authority: Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(2)(iii)

If a publicly traded company, is the valuation based on one of the following methods:

- Closing price on date of grant or trading day before
- Last sale before or first sale after date of grant
- Arithmetic mean of high or low prices on trading day before or after date of grant
- Average selling price during period within 30 days after date of grant
- Average selling price during period within 30 days before date of grant only if grantee, number of units and pricing formula fixed prior to start of period
- Other reasonable method using actual transactions reported by the market

Authority: Treas. Reg. § 1.409A-1(b)(5)(iv)(A)

DEFERRED COMPENSATION (CODE § 409A) COMPLIANCE

A Phantom Equity Right (option and SAR) that does not meet each of the conditions described in the Equity Rights Exemption Checklist will constitute “deferred compensation” under Code § 409A and will require that the exercise date on which taxation will occur be fixed at the time of grant that cannot be changed (accelerated or deferred) except as permitted under Code § 409A. A change in an Equity Right that causes it to lose its exemption from Code § 409A will generally result in the Equity Right being treated as deferred compensation retroactive to the date of grant, not just prospectively, which will result in immediate liability for the excise tax under Code § 409A.

FEATURES THAT MAKE AN EQUITY RIGHT SUBJECT TO CODE § 409A

- Does the Equity Right contain any feature that would not meet the conditions for exemption, such as the following:**
- FMV based on unreasonable valuation. Treas. Reg. § 1.409A-1(b)(5)(iv). See, Equity Right Exemption (Code § 409A) Checklist
 - Exercise price below FMV on date of grant. Treas. Reg. § 1.409A-1(b)(5)(i)(A)(1)
 - Covers other than service recipient or parent stock (i.e., management company, subsidiary or brother-sister affiliate stock). Treas. Reg. § 1.409A-1(b)(5)(iii)(E)
 - Subject to put or call at a price other than FMV. Treas. Reg. § 1.409A-1(b)(5)(iii)(A)
 - Dividend preference on service recipient stock. Treas. Reg. § 1.409A-1(b)(5)(iii)(A)
 - Payment of accumulated dividends or equivalents contingent upon exercise. Treas. Reg. § 1.409A-1(b)(5)(i)(E)
- Does a change to the Equity Right result in the loss of the exemption, such as the following:**
- Adding a deferral feature to an exempt Equity Right. Treas. Reg. § 1.409A-1(b)(5)(ii)(D)
 - Extending the exercise period beyond the end of the year in which exercise would otherwise have occurred. Treas. Reg. § 1.409A-1(b)(5)(ii)(C)
 - Modifying an “in-the-money” Equity Right to add a benefit. Treas. Reg. §§ 1.409A-1(b)(5)(v)(A); 1.409A-1(b)(5)(v)(F)

RESTRICTIONS ON EQUITY RIGHTS SUBJECT TO CODE § 409A

☐ The right to exercise and receive payment under the Equity Right must be limited to:

- *Fixed date or schedule* (e.g., exercise during 90 day period immediately before the 7th anniversary of date of grant; exercise 25% per year beginning one year after full vesting). Treas. Reg. § 1.409A-3(b)(i)(1) Payments upon a change in control also meet this condition if payments are made if, as and when received by shareholders. Treas. § Reg. 1.409A-3(i)(5)(iv)
- *Death*. Treas. Reg. § 1.409A-3(a)(3)
- *Disability* (defined in Code § 409A as either: the inability to perform any substantial gainful employment due to a condition that will last for at least 12 months or result in death, or 3 months after an illness or injury qualifying for long term disability benefits). Treas. Reg. § 1.409A-3(i)(4)
- *Unforeseeable emergency* due to illness, casualty loss or IRS approved events that cannot be satisfied from other assets or insurance without causing additional hardship. Treas. Reg. § 1.409A-3(i)(3)
- *Separation from Service* with all members of a controlled group of entities (corporate and noncorporate) for whom services were provided, or a reduction in hours of service below 20% of average hours worked in the prior 3 years, whether as an employee or independent contractor (other than service as a non-employee Board member). Treas. Reg. §§ 1.409A-3(i)(2); 1.409A-1(h)
- *Change in control* of the company for whom services were provided or its parent by merger or similar transaction if the company's shareholders control 50% or less of the resulting entity. Treas. Reg. § 1.409A-3(i)(5)(v)
- *Change in effective control* of the company for whom services provided or its parent as a result of any of the following:
 - Acquisition of at least 30% of equity by unrelated persons acting together
 - Acquisition of at least 40% of total market value of assets by unrelated persons acting together
 - Election of majority of Board members not nominated by company (i.e., proxy contest)

Authority: Treas. Reg. §§ 1.409A-3(i)(5)(vi); 1.409A-3(i)(5)(vii)

Delay exercise or payment of non-exempt Equity Rights required upon separation from service by “specified employees” of public company for six months from separation from service, or earlier in the event of death or change in control.

Comment: This delay provides a period of time after the departure of the executive during which the company can determine if any actions of the executive would justify a forfeiture of amounts owed as deferred compensation, to give the company more leverage than if payment were made and then subject to a clawback. A specified employee is defined by reference to the Code §416 definition of “key employee” used for pension plan top-heavy rules, and includes:

- The top 50 officers with annual compensation greater than \$145,000
- 1% owners with annual compensation greater than \$140,000
- 5% owners

The Company determines the 12 month determination year, then has up to 4 months after year end to identify the specified employees, who are then subject to the delay if separated from service during the 12 months following the identification.

Authority: Treas. Reg. §§ 1.409A-3(i)(2); 1.409A-1(i)

Delay in exercise or payment of non-exempt Equity Rights only if:

- Required to avoid a violation of federal securities laws, such as Section 16-b; or
- For public companies, to avoid nondeductibility of non-performance based compensation in excess of \$1 million under Code § 162(m). Treas. Reg. § 1.409A-1(b)(5)(iii)(A) See, Performance-Based Compensation (Code § 162(m)) Checklist

Authority: Treas. Reg. § 1.409A-2(b)(7)(i)(ii)

Acceleration in exercise or payment of non-exempt Equity Rights only if:

- Required to comply with a domestic relations order awarding Equity Rights to a former spouse or alternate payee
- Payment of employment taxes on income realized from Equity Rights
- To avoid a conflict of interest under securities laws

Authority: Treas. Reg. § 1.409A-3(j)(4)(ii),(iii) and (vi)

Include power to unilaterally amend grants to comply with Code § 409A

Comment: Give the employer the power to unilaterally amend for Code § 409A compliance.

Sample Language: Exhibit A, § 12.3

PERFORMANCE-BASED COMPENSATION (CODE § 162(M)) CHECKLIST

As a general rule under Code § 162(m), a publicly traded corporation is not permitted to deduct compensation in excess of \$1 million for its CEO and the next four most highly compensated employees other than the CFO (designed as “covered employees”), unless such compensation is either commission-based or performance-based. The determination of who is a covered employee is as of the date of payment, so an executive who no longer qualifies as a covered employee may be paid compensation in excess of \$1 million that would be deductible at that time, even if it was non-performance-based at the time of the award. Code § 162(m)(3). Certain options and other equity awards will be exempt from the limitation on deductibility if the plan documents satisfy the requirements of Code § 162(m) as performance-based. Code § 162(m)(4)(C). Options are by definition performance based, because their future value depends on the objective appreciation in the value of the Company’s stock. Other types of equity awards are not inherently performance based, but become performance-based if they vest or are paid only after achievement of objective performance goals.

REQUIREMENTS FOR OPTIONS TO BE PERFORMANCE-BASED

Plan granting options must be approved by shareholders

Comment: The material terms must be disclosed to shareholders and approved by a majority of the vote in a separate shareholder vote before any payment is made.

Authority: Treas. Reg. § 1.162-27(e)(4)

Sample Language: Exhibit A, § 4

Set a maximum limit on number of options that can be granted to any recipient

Comment: The period of time to which the limit applies can be annual or over a longer period of time. In approving the plan, the shareholders can make their own determination of the value of the options and therefore, the total amount of compensation the company could pay to any executive.

Authority: Treas. Reg. § 1.162-27(e)(2)(vi)

Sample Language: Exhibit A, § 3.3

Option grants to “covered employees” must be granted and administered only by directors who meet the definition of “outside director”

Comment: The definition of “outside director” for purposes of Code § 162(m) is different than the definition of an independent director for purposes of approving grants exempt from Section 16(b) of the Exchange Act (See, Securities Compliance Section of the Equity Plan Checklist) and different from the new definition of independence under the Dodd-Frank Act (See, New Developments Section of the Equity Plan Checklist). An outside director cannot be either: a current employee, a former employee receiving deferred compensation, a former officer, or a director receiving any direct or indirect payments from the company other than as a director. This

last criterion takes into account a director's share of revenues paid by the company to businesses controlled by that director.

Authority: Treas. Reg. § 1.162-27(e)(2)(vi)

Sample Language: Exhibit A, § 2.17

The exercise price of the option cannot be less than fair market value on the date of grant

Comment: As with Code § 409A, if the option is issued at less than fair market value, the discount is not performance-based, since the covered employee is entitled to that amount from the date of grant regardless of the stock performance, and in that case, the terms of vesting or other rights must be performance-based for the option to be exempt from Code § 162(m).

Authority: Treas. Reg. § 1.162-27(e)(2)(vi)

Sample Language: Exhibit A, § 7.2(d), § 7.5(a)

REQUIREMENTS FOR OTHER EQUITY RIGHTS TO BE PERFORMANCE-BASED

The procedures for approving the plan must be met

Comment: The three procedures described above for option plans must be met for other equity plans to be performance-based compensation:

- Shareholders must approve the plan before any payments are made after disclosure of the material terms of the plan
- Outside directors must administer the plan as applied to "covered employees"
- The Plan must contain an objective maximum amount any recipient can received during a specified period under the plan

Authority: Treas. Reg. § 1.162-27(e)(2), (4)

The business criteria performance goals must be objective and approved in advance by shareholders

Comment: If the specific goals are stated in the Plan, shareholder approval need not be attained for 10 years after the initial approval; if a general list of goals is approved with discretion given to the administrative committee to select the performance goals, then shareholders must reapprove the general goals every 5 years. The goals must be objective and based on business criteria.

Authority: Treas. Reg. § 1.162-27(e)(4)

The committee must approve the performance goals during the first 90 days of the performance period

Authority: Treas. Reg. § 1.162-27(e)(2)(i)

Sample Language: Exhibit A, § 9.2

- The committee must certify that the performance goals were met after the end of the performance period before payment can be made**

Authority: Code § 162(m)(4)(C)(3)

- The committee must not have the discretion to increase the performance based award, but may have the discretion to reduce the award amount**

Comment: The ability to increase an award amount later in the performance period above the parameters set initially would render meaningless the other conditions necessary to qualify as performance-based, even if the increase was based on objective financial or business criteria.

Authority: Treas. Reg. § 1.162-27(e)(2)(iii)

Sample Language: Exhibit A, § 9.1

- All agreements should prohibit the accelerated payment of part or all of a performance-based other than upon achievement of the established goals**

Comment: Similar to the previous issue, if an employment agreement or award provides for a bonus to be paid or equity issued at target upon termination without cause regardless of the level of achievement of the stated goals or the time remaining would defeat the necessary conditions that awards are only paid upon achievement of the goals, giving the committee the right to pay a bonus regardless of performance. It is acceptable to allow a covered employee to remain eligible for an award without having to be employed, as long as the amount of the payment is dependent on achievement of the approved performance goals.

Authority: Treas. Reg. § 1.162-27(e)(2)(ii), Private Letter Ruling 200804004

EXHIBIT A

**ABC CORPORATION
STOCK INCENTIVE PLAN**

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ABC CORPORATION STOCK INCENTIVE PLAN

SECTION 1 PURPOSE

The purpose of the Plan is to enable ABC Corporation (the "Company") and its Subsidiaries to attract and retain employees, directors and service providers of the Company by aligning financial interests of these individuals with the other stockholders of the Company.

The Plan provides for the grant of Incentive Stock Options, Non-Qualified Stock Options, Restricted Stock, Restricted Stock Units, Stock Appreciation Rights, Performance Stock, Performance Units, and other awards to aid the Company in obtaining these goals, subject to the approval by the shareholders.

SECTION 2 DEFINITIONS

- 2.1 BOARD means the Board of Directors of the Company.
- 2.2 CAUSE means, unless otherwise defined in the Stock Incentive Agreement or in a separate agreement with the Participant that governs Stock Incentives granted under this Plan, a felony conviction of a Participant or a material violation of any Company policy, including, without limitation, any policy contained in the Company's Code of Conduct Manual, or due to embezzlement from or theft of property belonging to the Company, regardless of when facts resulting in a finding of Cause are discovered by the Company.
- 2.3 CODE means the Internal Revenue Code of 1986, as amended and any successor, and regulations promulgated thereunder.
- 2.4 COMMITTEE means the Compensation Committee of the Board or any other committee appointed by the Board to administer the Plan.
- 2.5 COMPANY means ABC Corporation, a corporation organized under the laws of the State of _____ (or any successor corporation).
- 2.6 DEFERRED COMPENSATION means any Stock Incentive under this Plan that provides for the "deferral of compensation" as defined in Treas. Reg. §1.409A-1(b) and that would be subject to the taxes specified in Section 409A(a)(1) of the Code if and to the extent the Stock Incentive Agreement does not meet or is not administered and interpreted in compliance with the requirements of Section 409A(a)(2), (3) and (4) of the Code. Deferred Compensation shall not include any amount that is otherwise exempt from the requirements of Section 409A of the Code.

- 2.7 **DISABILITY** means a physical or mental condition resulting from a bodily injury or disease or mental disorder rendering such person incapable of continuing to perform the essential employment duties of such person at the Company as such duties existed immediately prior to the bodily injury, disease or mental disorder.
- 2.8 **EXCHANGE ACT** means the Securities Exchange Act of 1934, as amended and any successor, and regulations and rules promulgated thereunder.
- 2.9 **EXERCISE PRICE** means the price that shall be paid to purchase one (1) Share upon the exercise of an Option granted under this Plan.
- 2.10 **FAIR MARKET VALUE** of one Share of common stock on any given date shall be determined by the Committee as follows: (a) if the common stock is listed for trading on one of more national securities exchanges, or is traded on the Nasdaq Stock Market, the last reported sales price on the such principal exchange or the Nasdaq Stock Market on the date in question, or if such common stock shall not have been traded on such principal exchange or on the Nasdaq Stock Market on such date, the last reported sales price on such principal exchange or the Nasdaq Stock Market on the first day prior thereto on which such common stock was so traded; or (b) if the common stock is not listed for trading on a national securities exchange or the Nasdaq Stock Market, but is traded in the over-the-counter market, including the Nasdaq Small Cap Market, the closing bid price for such common stock on the date in question, or if there is no such bid price for such common stock on such date, the closing bid price on the first day prior thereto on which such price existed; or (c) if neither (a) or (b) is applicable, with respect to any Option intended to qualify as an ISO, by any fair and reasonable determination made in good faith by the Committee, and, with respect to any other Stock Incentive that is intended to be exempt from the requirements of Section 409A of the Code, a value determined by the reasonable application of a reasonable valuation method as defined in regulations promulgated under Section 409A of the Code, which determination shall be final and binding on all parties.
- 2.11 **INSIDER** means an individual who is, on the relevant date, an officer, member of the Board or ten percent (10%) beneficial owner of any class of the Company's equity securities that is registered pursuant to Section 12 of the Exchange Act, all as defined under Section 16 of the Exchange Act.
- 2.12 **ISO** ("Incentive Stock Option") means an Option granted under this Plan to purchase Shares that is intended by the Company to satisfy the requirements of Section 422 of the Code.
- 2.13 **KEY EMPLOYEE** means any employee of the Company or any Subsidiary holding a key management or technical position as determined by the Committee.
- 2.14 **KEY PERSON** means a person, other than a Key Employee, who is (a) a member of the Board; or (b) a service provider providing bona fide services to the

Company or any Subsidiary who is eligible to receive Shares that are registered on SEC Form S-8.

- 2.15 NQSO (“Non-Qualified Stock Option”) means an option granted under this Plan to purchase Shares that is not intended by the Company to satisfy the requirements of Section 422 of the Code, and includes any ISO that, by subsequent action of the Company or the Participant permitted by the Plan, ceases to be an ISO.
- 2.16 OPTION means an ISO or a NQSO.
- 2.17 OUTSIDE DIRECTOR means a member of the Board who is not an employee and who qualifies as: (a) a “non-employee director” under Rule 16b-3 under the Exchange Act, as amended from time to time; (b) an “outside director” under Section 162(m) of the Code; and (c) satisfies the rules of any listing association or exchange that the member of the Board is independent, based on the source of such member’s compensation, affiliations with the Company and any other requirements.
- 2.18 PARTICIPANT means a Key Person, Key Employee, or any other employee who is designated to receive an award under the Plan by the Committee.
- 2.19 PERFORMANCE-BASED EXCEPTION means the performance-based exception from the tax deductibility limitations of Section 162(m) of the Code.
- 2.20 PERFORMANCE GOAL means, unless and until the Board proposes for shareholder vote and shareholders approve a change in the general performance measures set forth in this Section, the performance measure(s) to be used by the Committee for purposes of making Bonus Awards shall be chosen from among the following: (a) earnings per share; (b) net income (before or after taxes); (c) return measures (including, but not limited to, return on assets, equity or sales); (d) cash flow return on investments (net cash flows divided by owners equity); (e) earnings before or after taxes, depreciation and/or amortization; (f) revenues and or sales (gross or net); (g) operating income (before or after taxes); (h) total shareholder return; (i) corporate performance indicators (indices based on the level of certain services provided to customers); (j) cash generation, working capital, profit and/or revenue targets; (k) growth measures, such as revenue or sales growth; (l) ratios, such as expenses or market share; and/or (m) share price (including, but not limited to, growth measures and total shareholder return). In setting performance goals using these performance measures, the Committee may establish goals on an absolute basis, rate basis, or relative to a peer group performance or other benchmark, and may exclude the effect of changes in accounting standards and non-recurring unusual events specified by the Committee, such as write-offs, capital gains and losses and acquisitions and dispositions of businesses.
- 2.21 PERFORMANCE PERIOD means the period during which a performance goal must be attained with respect to a Stock Incentive that is performance based, as determined by the Committee.

- 2.22 PERFORMANCE STOCK means an award of Shares granted to a Participant that is subject to the achievement of performance criteria, either as to the delivery of such Shares or the calculation of the amount deliverable as a result of achieving a level of performance over a specified Performance Period, or any combination thereof.
- 2.23 PERFORMANCE UNITS means a contractual right granted to a Participant to receive a Share (or cash equivalent) upon achievement of performance criteria or a level of performance over a specified Performance Period that are deliverable either at the end of the Performance Period or at a later time.
- 2.24 PLAN means the ABC Corporation Stock Incentive Plan, as it may be further amended from time to time.
- 2.25 QUALIFYING EVENT means, with respect to a Participant, such Participant's death, Disability or Retirement.
- 2.26 RESTRICTED STOCK AWARD means an award of Shares granted to a Participant under this Plan that is subject to restrictions in accordance with the terms and provisions of this Plan and the applicable Stock Incentive Agreement.
- 2.27 RESTRICTED STOCK UNIT means a contractual right granted to a Participant under this Plan to receive a Share (or cash equivalent) that is subject to restrictions of this Plan and the applicable Stock Incentive Agreement.
- 2.28 RETIREMENT means retirement from active employment with the Company and any subsidiary or parent corporation of the Company on or after age 65, or upon an earlier date with the consent of the Committee, and upon such terms and conditions as determined by the Committee.
- 2.29 SERVICE means services provided to the Company or any Subsidiary as either a Key Employee or a Key Person.
- 2.30 SHARE means one share of the common stock of the Company.
- 2.31 SPECIFIED EMPLOYEE means a Participant who is a "key employee" as described in Section 416(i)(1)(A) of the Code, disregarding paragraph (5) thereof. For purposes of determining key employees under Section 416(i)(1)(A) of the Code, the definition of compensation shall be the same as defined in the Company's Retirement Savings Plan, but excluding any compensation of a Participant whose location is not effectively connected with the conduct of a trade or business within the United States. If a Participant is a key employee at any time during the 12 months ending on each _____, the Participant is a Specified Employee for the 12 month period commencing on the next January 1. Any such identification of a Specified Employee under this Plan shall apply to all nonqualified deferred compensation plans in which the Specified Employee participates. In the case of certain corporate transactions (a merger, acquisition or spin-off), or in the case of nonresident alien employees, the Company will determine Specified Employees in accordance with Treas. Reg. §1.409A-1(i).

- 2.32 STOCK APPRECIATION RIGHT means a right granted to a Participant pursuant to the terms and provisions of this Plan whereby the individual, without payment to the Company (except for any applicable withholding or other taxes), receives Shares, or such other consideration as the Committee may determine, in an amount equal to the excess of the Fair Market Value per Share on the date on which the Stock Appreciation Right is exercised over the exercise price per Share noted in the Stock Appreciation Right, for each Share subject to the Stock Appreciation Right.
- 2.33 STOCK INCENTIVE means an ISO, NQSO, Restricted Stock, Restricted Stock Unit, Stock Appreciation Right, Performance Stock, Performance Unit, or cash.
- 2.34 STOCK INCENTIVE AGREEMENT means a document, agreement, certificate, resolution or other evidence in writing or electronic form approved by the Committee that sets forth the terms and conditions of a Stock Incentive granted by the Company or a Subsidiary to a Participant.
- 2.35 SUBSIDIARY means any corporation (other than the Company) in an unbroken chain of corporations beginning with the Company if each of the corporations (other than the last corporation in the unbroken chain) owns stock possessing 50% or more of the total combined voting power of all classes of stock in one of the other corporations in the chain.
- 2.36 TEN PERCENT SHAREHOLDER means a person who owns (after taking into account the attribution rules of Section 424(d)) of the Code more than ten percent (10%) of the total combined voting power of all classes of shares of stock of either the Company or a Subsidiary.

SECTION 3

SHARES SUBJECT TO STOCK INCENTIVES

- 3.1 AGGREGATE SHARES AUTHORIZED AND LIMITATIONS. The aggregate number of Shares that may be issued under the Plan is _____ Shares, subject to adjustment as provided in Section 10. Within the aggregate limit specified above and subject to adjustment as provided in Section 10:
- (a) No more than _____ Shares may be used for Incentive Stock Options;
- (b) No more than _____ Shares may be used for Stock Incentives for non-employee Directors; and
- (c) No more than _____ Shares may be used for Stock Incentives other than Options or Stock Appreciation Rights (which, based on the principle in Section 3.2(f)).

Such Shares shall be reserved, to the extent that the Company deems appropriate, from authorized but unissued Shares, and from Shares which have been reacquired by the Company.

- 3.2 **SHARE COUNTING.** For purposes of determining the limits described in this Plan, in particular this Section 3, Shares covered by a Stock Incentive shall not be counted as used unless and until actually delivered to a Participant. If any Shares covered by a Stock Incentive are not purchased or are forfeited or reacquired by the Company prior to vesting, or if a Stock Incentive terminates, or is cancelled without the delivery of any Shares, such Shares shall be added back to the limits described in this Plan and are again available for grants from the Plan. In addition, the following principles shall apply in determining the number of Shares under any applicable limit:
- (a) Shares tendered or attested to in payment of the Exercise Price of an Option shall not be added back to the applicable limit;
 - (b) Shares withheld by the Company to satisfy the tax withholding obligation shall not be added back to the applicable limit;
 - (c) Shares that are reacquired by the Company with the amount received upon exercise of an Option shall not be added back to the applicable limit;
 - (d) The aggregate Shares exercised pursuant to a Stock Appreciation Right that is settled in Shares shall reduce the applicable limit, rather than the number of Shares actually issued;
 - (e) Any Stock Incentive that is settled in cash shall not reduce the applicable limit; and
 - (f) Restricted Stock, Restricted Stock Units, Performance Stock, Performance Units and other Stock Incentive settled in Shares shall reduce the applicable limit by 2.5 Shares for each Share covered by the Incentive.
- 3.3 **LIMITATIONS ON STOCK INCENTIVES.** Subject to adjustment pursuant to Section 3.4, no Participant may be granted any Stock Incentive covering an aggregate number of Shares in excess of _____ in any calendar year. Notwithstanding the foregoing, in connection with his or her initial service, a Participant may be granted Stock Incentives covering not more than an additional _____ Shares, which shall not count against the limit set forth in the preceding sentence. The foregoing limits shall be determined by applying the principles of Section 3.2 (in particular Section 3.2(f)). With respect to any Performance Unit or Other Award that is not denominated in Shares, the maximum amount that a Participant may receive in any calendar year is _____.
- 3.4 **SHARE ADJUSTMENT.** Notwithstanding anything in Section 12 to the contrary: (a) the number of Shares reserved under Section 3.1, (b) the limit on the number of Shares that may be granted subject to Stock Incentives during a calendar year to any individual under Section 3.1 and 3.3, (c) the number of Shares subject to certain Stock Incentives granted subject to Section 3.1, and (d) the Exercise Price of any Options and the specified price of any Stock Appreciation Rights, shall be adjusted by the Committee in an equitable manner to reflect any change

in the capitalization of the Company, including, but not limited to, such changes as stock dividends or stock splits. Furthermore, the Committee shall have the right to adjust (in a manner that satisfies the requirements of Code Section 424(a)): (i) the number of Shares reserved under Section 3.1; (ii) the number of Shares subject to certain Stock Incentives subject to Section 3.1; and (iii) the Exercise Price of any Options and the specified exercise price of any Stock Appreciation Rights in the event of any corporate transaction described in Section 424(a) of the Code that provides for the substitution or assumption of such Stock Incentives. If any adjustment under this Section creates a fractional Share or a right to acquire a fractional Share, such fractional Share shall be disregarded, and the number of Shares reserved under this Plan and the number subject to any Stock Incentives granted under this Plan shall be the next lower number of Shares, rounding all fractions downward. An adjustment made under this Section by the Committee shall be conclusive and binding on all affected persons and, further, shall not constitute an increase in the number of Shares reserved under Section 3.1 or an increase in any limitation imposed by the Plan.

SECTION 4

EFFECTIVE DATE AND TERM OF PLAN

The effective date of this Plan shall be the date of its adoption by the Board, provided, however, that if the Plan is not approved by the shareholders of the Company within 12 months of the approval by the Board, the Plan will be terminated and all Stock Incentives granted under the Plan will be terminated and deemed null and void and further provided that no Stock Incentive shall vest and no Shares may be issued under the Plan prior to approval of the Plan by the shareholders of the Company. No Stock Incentive shall be granted under this Plan on or after the earlier of:

- (a) the fifth (5th) anniversary of the effective date of this Plan, and
- (b) the date on which all of the Shares reserved under Section 3 of this Plan have been issued or are no longer available for use under this Plan.

This Plan shall continue in effect until all outstanding Stock Incentives have been exercised in full or are no longer exercisable and all Restricted Stock Awards or Restricted Stock Units have vested or been forfeited.

SECTION 5

ADMINISTRATION

- 5.1 GENERAL ADMINISTRATION. The Committee shall administer this Plan. The Committee, acting in its absolute discretion, shall exercise such powers and take such action as expressly called for under this Plan. The Committee shall have full power to construe and interpret the Plan and any agreement or instrument entered into under the Plan; to establish, amend or waive rules and regulations for the Plan's administration, and to make all other determinations and take all other actions that may be necessary or advisable for the administration of the Plan. Notwithstanding anything herein to the contrary, the Board may, without further action of the Committee, exercise the powers and duties of the Committee

or any delegate under the Plan, unless such exercise would cause any Stock Incentive not to comply with the requirements of Section 162(m) of the Code.

- 5.2 **AUTHORITY OF THE COMMITTEE.** Except as limited by law or by the Articles of Incorporation or By-laws of the Company, and subject to the provisions herein, the Committee shall have full power to: (a) select Participants in the Plan; (b) determine the types of Stock Incentives for each Participant in a manner consistent with the Plan; (c) determine the number of Shares or the method of determining the number of Shares or other payment under such Stock Incentive; (d) determine the terms and conditions of Stock Incentives in a manner consistent with the Plan, including the time and manner of exercise, the restrictions on the rights granted under the Stock Incentive and the lapse thereof, the manner of payment, if any, the restrictions or holding period applicable to the payment or Stock received upon exercise or in satisfaction of the Stock Incentive; and (e) amend the terms and conditions of any outstanding Stock Incentives as provided in accordance with Section 12.3. The Committee shall have the independent authority and discretion over the appointment, compensation and oversight of the services of advisors to the Committee, including compensation consultants and legal counsel, provided such advisors meet the standards for independence as established by the Securities Exchange Commission. The Company shall pay the compensation and expenses of such advisors. The Committee may seek the assistance of such other persons as it may see fit in carrying out its routine administrative functions concerning the Plan.
- 5.3 **DELEGATION OF AUTHORITY.** The Committee may appoint one or more separate committees (any such committee, a "Subcommittee") composed of two or more Outside Directors of the Company (who may but need not be members of the Committee) and may delegate to any such Subcommittee or to one or more executive officers of the Company the authority to grant Stock Incentives, and/or to administer the Plan or any aspect of it; provided, however, that only the Committee may grant Stock Incentives that meet the Performance-Based Exception, and only the Committee may grant Stock Incentives to Insiders that are exempt from Section 16(b) of the Exchange Act.
- 5.4 **DECISIONS BINDING.** All determinations and decisions made by the Committee pursuant to the provisions of this Plan and all related orders and resolutions of the Committee shall be final, conclusive and binding on all persons, including the Company, its shareholders, members of the Board, Participants, and their estates and beneficiaries.

SECTION 6 **ELIGIBILITY**

Participants selected by the Committee shall be eligible for the grant of Stock Incentives under this Plan, but no Participant shall have the right to be granted a Stock Incentive under this Plan merely as a result of his or her status as a Key Person or Key Employee. Notwithstanding the foregoing, an ISO may only be granted to a Key Employee.

SECTION 7
TERMS AND CONDITIONS OF STOCK INCENTIVES

7.1 ALL STOCK INCENTIVES.

- (a) *Grants of Stock Incentives.* The Committee, in its absolute discretion, shall grant Stock Incentives under this Plan from time to time and shall have the right to grant new Stock Incentives in exchange for outstanding Stock Incentives; provided, however, the Committee shall not have the right to: (i) lower the Exercise Price of an existing Option; (ii) any action which would be treated as a “repricing” under generally accepted accounting principles; or (iii) canceling of an existing Option at a time when its Exercise Price exceeds the fair market value of the underlying stock subject to such Option in exchange for another Option, a Restricted Stock Award, or other equity in the Company (except as provided in Sections 3.4, 10 and 11). Stock Incentives shall be granted to Participants selected by the Committee, and the Committee shall be under no obligation whatsoever to grant any Stock Incentives, or to grant Stock Incentives to all Participants, or to grant all Stock Incentives subject to the same terms and conditions.
- (b) *Shares Subject to Stock Incentives.* The number of Shares as to which a Stock Incentive shall be granted shall be determined by the Committee in its sole discretion, subject to the provisions of Section 3.1 as to the total number of Shares available for grants under the Plan, and to any other restrictions contained in this Plan.
- (c) *Stock Incentive Agreements.* Each Stock Incentive shall be evidenced by a Stock Incentive Agreement. The Stock Incentive Agreement may be in an electronic medium, may be limited to notation on the books and records of the Company and, with the approval of the Committee, need not be signed by a representative of the Company or a Participant. The Committee shall have sole discretion to modify the terms and provisions of any Stock Incentive in accordance with Section 12.3.
- (d) *Date of Grant.* The date a Stock Incentive is granted shall be no earlier than the date on which the Committee: (i) has approved the terms and conditions of the Stock Incentive Agreement; (ii) has determined the recipient of the Stock Incentive and the number of Shares covered by the Stock Incentive; and (iii) has taken all such other action necessary to direct the grant of the Stock Incentive.
- (e) *Vesting of Stock Incentives.* Stock Incentives under the Plan may have restrictions on the vesting or delivery of and, in the case of Options, the right to exercise, that lapse based upon the service of a Participant, or based upon other criteria that the Committee may determine appropriate, such as the attainment of performance criteria as determined by the Committee, including but not limited to one or more Pperformance Goals. If the Award is intended to meet the Performance-Based Exception, the

attainment of such performance goals must satisfy the requirements of Sections 9.1, 9.2 and 9.3. Until the end of the period(s) of time specified in the vesting schedule and/or the satisfaction of any performance criteria, the Shares subject to such Stock Incentive Award shall remain subject to forfeiture.

- (f) *Acceleration of Vesting of Stock Incentives.* Notwithstanding anything to the contrary in this Plan, the Committee shall have the power to permit, in its sole discretion, an acceleration of the expiration of the applicable restrictions or the applicable period of such restrictions with respect to any part or all of the Shares awarded to a Participant; provided, however, the Committee may grant Stock Incentive Awards precluding such accelerated vesting in order to qualify the Stock Incentive Awards for the Performance-Based Exception.
- (g) *Dividend Equivalents.* The Committee may grant dividend equivalents with respect to any Stock Incentive. The Committee shall establish the terms and conditions to which the dividend equivalents are subject. Under a dividend equivalent, a Participant shall be entitled to receive payments equivalent to the amount of dividends paid by the Company to holders of Shares with respect to the number of dividend equivalents held by the Participant, which may be paid concurrently with the payment of dividends or deferred and paid at a later date. The dividend equivalent may provide for payment in Shares or in cash, or a fixed combination of Shares or cash, or the Committee may reserve the right to determine the manner of payment at the time the dividend equivalent is payable. Any such dividend equivalent that is intended to exempt from Section 409A of the Code with respect to a Stock Incentive that constitutes Deferred Compensation shall be stated in a separate arrangement.
- (h) *Transferability of Stock Incentives.* Except as otherwise provided in a Participant's Stock Incentive Agreement, no Stock Incentive granted under the Plan may be sold, transferred, pledged, assigned or otherwise alienated or hypothecated, except upon the death of the holder Participant by will or by the laws of descent and distribution. Except as otherwise provided in a Participant's Stock Incentive Agreement, during the Participant's lifetime, only the Participant may exercise any Option or Stock Appreciation Right unless the Participant is incapacitated, in which case the Option or Stock Appreciation Right may be exercised by and any other Stock Incentive may be payable to the Participant's legal guardian, legal representative, or other representative whom the Committee deems appropriate based on applicable facts and circumstances. The determination of incapacity of a Participant and the identity of appropriate representative of the Participant to exercise the Option or receive any other payment under a Stock Incentive if the Participant is incapacitated shall be determined by the Committee.
- (i) *Deferral Elections.* The Committee may require or may permit Participants to elect to defer the issuance of Shares or the settlement of Stock

Incentives in cash under this Plan pursuant to such rules, procedures, or programs as it may establish from time to time. However, notwithstanding the preceding sentence, the Committee shall not, in establishing the terms and provisions of any Stock Incentive, or in exercising its powers under this Plan: (i) create any arrangement which would constitute an employee pension benefit plan as defined in Section 3(3) of the Employee Retirement Income Security Act, as amended, unless the arrangement provides benefits solely to one or more individuals who constitute members of a select group of management or highly compensated employees; or (ii) create any arrangement that would constitute Deferred Compensation unless the arrangement complies with Section 9.4 and 9.5 or unless the Committee, at the time of grant, specifically provides that the Stock Incentive is not intended to comply with Section 409A of the Code.

7.2 OPTIONS.

- (a) *Grants of Options.* Each grant of an Option shall be evidenced by a Stock Incentive Agreement that shall specify whether the Option is an ISO or NQSO, and incorporate such other terms as the Committee deems consistent with the terms of this Plan and, in the case of an ISO, necessary or desirable to permit such Option to qualify as an ISO. The Committee and/or the Company may modify the terms and provisions of an Option in accordance with Section 12 even though such modification may change the Option from an ISO to a NQSO.
- (b) *Termination of Service other than upon a Qualifying Event.* Except as provided in the Option Agreement or a separate agreement with the Participant that covers Options, or as otherwise provided by the Committee: (i) if the Participant's Service with the Company and/or a Subsidiary ends before the Options vest, the Participant shall forfeit all unvested Options; and (ii) any Options held by such Participant may thereafter be exercised to the extent it was exercisable at the time of such termination, but may not be exercised after 180 days after such termination, or the expiration of the stated term of the Options, whichever period is the shorter. In the event a Participant's Service with the Company or any Subsidiary is terminated for Cause, all unexercised Options granted to such Participant shall immediately terminate.
- (c) *Termination of Service upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant that covers Options, and except as otherwise provided by the Committee: (i) if a Qualifying Event occurs before the date or dates on which Options vest, the Participant shall forfeit all unvested Options; and (ii) any Options held by such Participant may thereafter be exercised to the extent it was exercisable at the time of such Qualifying Event, but may not be exercised after 180 days after such Qualifying Event, or the expiration of the stated term of the Options, whichever period is the shorter.

- (d) *Exercise Price.* Subject to adjustment in accordance with Section 3.4 and the other provisions of this Section, the Exercise Price shall be specified in the applicable Stock Incentive Agreement and shall not be less than the Fair Market Value of a Share on the date the Option is granted. With respect to each ISO to a Participant who is not a Ten Percent Shareholder, the Exercise Price shall not be less than the Fair Market Value of a Share on the date the ISO is granted. With respect to each ISO to a Participant who is a Ten Percent Shareholder, the Exercise Price shall not be less than one hundred ten percent (110%) of the Fair Market Value of a Share on the date the ISO is granted.
- (e) *Option Term.* Each Option granted under this Plan shall be exercisable in whole or in part at such time or times as set forth in the related Stock Incentive Agreement, but no Stock Incentive Agreement shall: (i) make an Option exercisable prior to the date such Option is granted or after it has been exercised in full; or (ii) make an Option exercisable after the date that is: (A) the tenth (10th) anniversary of the date such Option is granted, if such Option is a NQSO or an ISO granted to a Participant who is not a Ten Percent Shareholder; or (B) the date that is the fifth (5th) anniversary of the date such Option is granted, if such Option is an ISO granted to a Ten Percent Shareholder. Options issued under the Plan may become exercisable based on the service of a Participant, or based upon the attainment (as determined by the Committee) of performance criteria, including but not limited to Performance Goals. Any Option that is intended to qualify for the Performance-Based Exception must satisfy the requirements of Section 9.1, 9.2 and 9.3.
- (f) *Payment.* The Exercise Price of Shares acquired pursuant to an Option shall be paid, to the extent permitted by applicable statutes and regulations by delivering to the Company or its designated agent, either: (i) in cash or by check at the time the Option is exercised; or (ii) at the discretion of the Committee at the time of the grant of the Option (or subsequently in the case of an NQSO): (A) by delivery (or by attestation) of other Shares, including Shares acquired as part of the exercise (i.e., a pyramid exercise); (B) if permitted by applicable law, the withholding of Shares delivered by that number of Shares equal to the Fair Market Value of the Exercise Price (i.e., a cashless or net exercise); (C) according to a deferred payment or other similar arrangement with the Participant, including use of a promissory note (except for executive officers and Directors of the Company to the extent such loans and similar arrangements are prohibited under Section 402 of the Sarbanes-Oxley Act of 2002); (D) pursuant to a "same day sale" program exercised through a brokerage transaction as permitted under the provisions of Regulation T applicable to cashless exercises promulgated by the Federal Reserve Board so long as the Company's equity securities are registered under Section 12 of the Exchange Act, unless prohibited by Section 402 of the Sarbanes-Oxley Act of 2002; or (E) by some combination of the foregoing. Notwithstanding the foregoing, with respect to any Participant who is an Insider, a tender of Shares or, a cashless or net exercise shall be a

subsequent transaction approved as part of the original grant of an Option for purposes of the exemption under Rule 16b-3 of the Exchange Act. Except as provided above, payment shall be made at the time that the Option or any part thereof is exercised, and no Shares shall be issued or delivered upon exercise of an Option until full payment has been made by the Participant. The holder of an Option, as such, shall have none of the rights of a shareholder.

- (g) *ISO Tax Treatment Requirements.* With respect to any Option that is intended to be an ISO, to the extent that the aggregate Fair Market Value (determined as of the date of grant of such Option) of Shares with respect to which such Option is exercisable for the first time by any individual during any calendar year exceeds one hundred thousand dollars (\$100,000), to the extent of such excess, such Option shall not be treated as an ISO in accordance with Section 422(d) of the Code and in Treas. Reg. §1.422-4. With respect to any Option that is intended to be an ISO, such Option shall cease to be treated as an ISO if the Participant disposes of Shares acquired upon exercise of the Option within two (2) years from the date of the granting of the Option or within one (1) year of the exercise of the Option, or if the Participant has not met the requirements of Section 422(a)(2) of the Code.

7.3 RESTRICTED STOCK.

- (a) *Grants of Restricted Stock Awards.* Shares awarded pursuant to Restricted Stock Awards shall be subject to such restrictions as determined by the Committee for periods determined by the Committee. The Committee may require a cash payment from the Participant in exchange for the grant of a Restricted Stock Award or may grant a Restricted Stock Award without the requirement of a cash payment.
- (b) *Termination of Service other than a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant covering the Restricted Stock, if the Participant's Service with the Company and/or a Subsidiary ends for any reason other than a Qualifying Event before any restrictions lapse, the Participant shall forfeit all unvested Restricted Stock, unless the Committee determines that some or all of the Participant's unvested Restricted Stock shall vest as of the date of such event.
- (c) *Termination of Service upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant covering the Restricted Stock: (i) if a Qualifying Event occurs before the date or dates on which restrictions lapse, the Participant shall forfeit all unvested Restricted Stock, unless the Committee determines that some or all of the Participant's unvested Restricted Stock shall vest as of the date of such event; and (ii) in the case of Restricted Stock based on performance criteria then, as of the date on which such Qualifying Event occurs, the Participant shall be entitled to receive a number of Shares that

is determined by measuring the selected performance criteria from the Company's most recent publicly available quarterly results that are available as of the date the Qualifying Event occurs or such later date as the Committee determines, but no later than the end of the Performance Period; provided, however, the Committee may grant Restricted Stock Awards precluding such partial awards when a Qualifying Event occurs in order to qualify the Restricted Stock for the Performance-Based Exception.

- (d) **Voting, Dividend & Other Rights.** Unless the applicable Stock Incentive Agreement provides otherwise, a Participant awarded Restricted Stock shall be entitled to vote and to receive dividends during the periods of restriction of the Shares to the same extent as the Participant would have been entitled if the Shares were not restricted.

7.4 RESTRICTED STOCK UNITS.

- (a) *Grants of Restricted Stock Units.* A Restricted Stock Unit shall entitle the Participant to receive one Share at such future time and upon such terms as specified by the Committee in the Stock Incentive Agreement. The Committee may require a cash payment from the Participant in exchange for the grant of Restricted Stock Units or may grant Restricted Stock Units without such requirement.
- (b) *Termination of Service other than upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant covering the Restricted Stock Unit, if the Participant's Service with the Company and/or a Subsidiary ends before the Restricted Stock Units vest, the Participant shall forfeit all unvested Restricted Stock Units, unless the Committee determines that the Participant's unvested Restricted Stock Units shall vest as of the date of such event.
- (c) *Termination of Service upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant covering the Restricted Stock Unit: (i) if a Qualifying Event occurs before the date or dates on which restrictions lapse, the Participant shall forfeit all unvested Restricted Stock Units, unless the Committee determines that the Participant's unvested Restricted Stock Units shall vest as of the date of such event; and (ii) in the case of Restricted Stock Units that are based on performance criteria, then as of the date on which such Qualifying Event occurs, the Participant shall be entitled to receive a number of Shares that is determined by measuring the selected performance criteria from the Company's most recent publicly available quarterly results that are available as of the date the Qualifying Event occurs or such later date, but not later than the end of the Performance Period; provided, however, the Committee may grant Restricted Stock Units precluding entitlement to a partial award when a Qualifying Event occurs in order to qualify the Restricted Stock Units for the Performance-Based Exception.

- (d) *Voting, Dividend & Other Rights.* A Participant awarded Restricted Stock Units shall not be entitled to vote or to receive dividends until the date the Shares are issued to the Participant pursuant to the Restricted Stock Units, and, unless the Stock Incentive Agreement provides otherwise, the Participant shall not be entitled to any dividend equivalents (as described in Section 7.1(f)).

7.5 STOCK APPRECIATION RIGHTS.

- (a) *Grants of Stock Appreciation Rights.* A Stock Appreciation Right shall entitle the Participant to receive upon exercise the excess of the Fair Market Value of number of Shares exercised, over the specified price for such Shares. The specified price for a Stock Appreciation Right granted in connection with a previously or contemporaneously granted Option, shall not be less than the Exercise Price for Shares that are subject to the Option. In the case of any other Stock Appreciation Right, the specified price shall not be less than one hundred percent (100%) of the Fair Market Value of a Share at the time the Stock Appreciation Right is granted. If related to an Option, the exercise of a Stock Appreciation Right shall result in a pro rata expiration and cancellation of the same number of Shares of the related Option for which the Stock Appreciation Right has been exercised.
- (b) *Payment.* Upon exercise of a Stock Appreciation Right, the Company shall pay to the Participant the appreciation with Shares (computed using the aggregate Fair Market Value of Shares on the date of exercise) or in cash, or in any combination thereof as specified in the Stock Incentive Agreement or, if not specified, as the Committee determines. To the extent that a Stock Appreciation Right is exercised, the specified price shall be treated as paid in Shares for purposes of Section 3.
- (c) *Termination of Service other than upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant that governs the Stock Appreciation Rights granted, or as otherwise provided by the Committee: (i) if the Participant's Service with the Company and/or a Subsidiary ends before the Stock Appreciation Rights vest, the Participant shall forfeit all unvested Stock Appreciation Rights; and (ii) any Stock Appreciation Rights held by such Participant may thereafter be exercised to the extent it was exercisable at the time of such termination, but may not be exercised after 180 days after such termination, or the expiration of the stated term of the Stock Appreciation Rights, whichever period is the shorter. In the event a Participant's employment with the Company or any Subsidiary is terminated for Cause, all unexercised Stock Appreciation Rights granted to such Participant shall immediately terminate.
- (d) *Termination of Service upon a Qualifying Event.* Except as provided in the Stock Incentive Agreement or a separate agreement with the Participant that governs the Stock Appreciation Rights granted, and except as

otherwise provided by the Committee: (i) if a Qualifying Event occurs before the date or dates on which Stock Appreciation Rights vest, the Participant shall forfeit all unvested Stock Appreciation Rights; and (ii) any Stock Appreciation Rights held by such Participant may thereafter be exercised to the extent it was exercisable at the time of such Qualifying Event, but may not be exercised after 180 days after such Qualifying Event, or the expiration of the stated term of the Stock Appreciation Rights, whichever period is the shorter.

- (e) *Special Provisions for Tandem Stock Appreciation Rights.* A Stock Appreciation Right granted in connection with an Option may only be exercised to the extent that the related Option has not been exercised. A Stock Appreciation Right granted in connection with an ISO: (i) will expire no later than the expiration of the underlying ISO; (ii) may be for no more than the difference between the exercise price of the underlying ISO and the Fair Market Value of the Shares subject to the underlying ISO at the time the Stock Appreciation Right is exercised; (iii) may be transferable only when, and under the same conditions as, the underlying ISO is transferable; and (iv) may be exercised only: (A) when the underlying ISO could be exercised; and (B) when the Fair Market Value of the Shares subject to the ISO exceeds the exercise price of the ISO.

7.6 PERFORMANCE STOCK AND PERFORMANCE UNITS.

- (a) *Awards of Performance Stock and Performance Units.* Performance Stock and Performance Units shall become payable to a Participant upon achievement of performance criteria as determined by the Committee. Each award will specify the number of Performance Stock or Performance Units to which it pertains, which number may be subject to adjustment to reflect changes in compensation or other factors; provided, however, that no such adjustment will be made in the case of a grant that is intended to qualify for the Performance-Based Exception, other than as provided in Sections 9.1, 9.2 and 9.3. Subject to the limitation set forth in Section 3.4, any grant of Performance Stock or Performance Units may specify that the amount payable with respect thereto may not exceed a maximum specified by the Committee at the date of grant.
- (b) *Payment.* Each grant will specify the time and manner of payment of Performance Stock or Performance Units that have been earned. Any Performance Stock award shall be payable in Shares. Any Performance Unit award may specify that the amount payable with respect thereto may be paid by the Company in cash, in Shares or in any combination thereof and may either grant to the Participant or retain in the Committee the right to elect among cash or Shares.

7.7 OTHER AWARDS.

- (a) Other awards may, subject to limitations under applicable law, be granted to any Participant denominated or payable in, valued in whole or in part by

reference to, or otherwise based on, or related to, Shares or factors that may influence the value of such Shares, including, without limitation, convertible or exchangeable debt securities, other rights convertible or exchangeable into Shares, purchase rights for Shares, awards with value and payment contingent upon performance of the Company or specified Subsidiaries, affiliates or other business units thereof, or any other factors designated by the Committee. The Committee shall determine the terms and conditions of such awards.

- (b) Cash awards, as an element of or supplement to any other Stock Incentives granted under this Plan, may also be granted to Participants on such terms and conditions as the Committee may determine, subject to the limitation set forth in Section 3.4.
- (c) Shares may be granted to a Participant as a bonus, or in lieu of obligations of the Company or a Subsidiary to pay cash or deliver other property under this Plan or under other plans or compensatory arrangements, subject to such terms as the Committee shall determine, subject to the limitation set forth in Section 3.4.
- (d) Participants designated by the Committee may be permitted to reduce compensation otherwise payable in cash in exchange for Shares or other Stock Incentives under the Plan.

7.8 NON-EMPLOYEE DIRECTOR RESTRICTED STOCK. Notwithstanding any other provisions of this Plan, a grant of Restricted Stock shall be made to each Director who is not an employee of the Company or any Subsidiary within the meaning of Rule 16b-3 of the Exchange Act and who at the regular annual shareholders meeting is elected (or re-elected) to the Board. Except as provided in (a) and (b) below, the number of Shares and the other terms of this Restricted Stock shall be determined by the Board in its sole discretion prior to such annual meeting of shareholders. The date of grant of the Restricted Stock is the date on which such non-employee Director is elected or re-elected to serve on the Board. The following terms shall be applied to the Restricted Stock granted under this Section to non-employee Directors:

- (a) Each grant of Restricted Stock to a non-employee Director shall vest as to one third of the Shares on the date of each of the three regular annual shareholder meetings following the date of grant, provided that the non-employee Director continues to serve as a member of the Board for the period up to such annual meeting, and if the non-employee Director ceases to serve as a member of the Board other than as provided in (b) below, shall forfeit any Restricted Stock for which the restrictions have not lapsed.
- (b) Termination of Service following Ten Years of Service. In the event a non-employee Director who has continuously served as a member of the Board for a period of ten years or more retires at the end of the non-employee Directors' elected term and does not continue to serve on the

Board for any reason (other than pursuant to the non-employee Director's removal for Cause), all restrictions on the Restricted Stock that has not previously lapsed shall, upon such retirement, immediately lapse.

The Board, in its discretion, may, in addition to the Restricted Stock grants provided above, grant any additional Stock Incentive to all non-employee Directors or to any individual non-employee Director, provided that such grant shall be solely for substantial services performed or to be performed by the non-employee Directors or non-employee Director as determined in good faith by the Board.

SECTION 8

SECURITIES REGULATION

- 8.1 **LEGALITY OF ISSUANCE.** No Share shall be issued under this Plan unless and until the Committee has determined that all required actions have been taken to register such Share under the Securities Act of 1933 or the Company has determined that an exemption therefrom is available, any applicable listing requirement of any stock exchange on which the Share is listed has been satisfied, and any other applicable provision of state, federal or foreign law, including foreign securities laws where applicable, has been satisfied.
- 8.2 **RESTRICTIONS ON TRANSFER; REPRESENTATIONS; LEGENDS.** Regardless of whether the offering and sale of Shares under the Plan have been registered under the Securities Act of 1933 or have been registered or qualified under the securities laws of any state, the Company may impose restrictions upon the sale, pledge, or other transfer of such Shares (including the placement of appropriate legends on stock certificates) if, in the judgment of the Company and its counsel, such restrictions are necessary or desirable to achieve compliance with the provisions of the Securities Act of 1933, the securities laws of any state, the United States or any other applicable foreign law. If the offering and/or sale of Shares under the Plan is not registered under the Securities Act of 1933 and the Company determines that the registration requirements of the Securities Act of 1933 apply but an exemption is available which requires an investment representation or other representation, the Participant shall be required, as a condition to acquiring such Shares, to represent that such Shares are being acquired for investment, and not with a view to the sale or distribution thereof, except in compliance with the Securities Act of 1933, and to make such other representations as are deemed necessary or appropriate by the Company and its counsel. All Stock Incentive Agreements shall contain a provision stating that any restrictions under any applicable securities laws will apply.
- 8.3 **REGISTRATION OF SHARES.** The Company may, and intends to, but is not obligated to, register or qualify the offering or sale of Shares pursuant to this Plan under the Securities Act of 1933 or any other applicable state, federal or foreign law.

SECTION 9
COMPLIANCE WITH THE CODE

- 9.1 **DISCRETION IN FORMULATION OF PERFORMANCE CRITERIA.** The Committee shall have the discretion to adjust the determinations of the degree of attainment of the pre-established performance criteria; provided, however, that any Stock Incentives that are intended to qualify for the Performance-Based Exception may not be adjusted upward (although the Committee shall retain the discretion to adjust such Stock Incentives downward).
- 9.2 **PERFORMANCE PERIODS.** The Committee shall have the discretion to determine the period during which any performance criteria, including any Performance Goal must be attained with respect to a Stock Incentive. Such period may be of any length, and must be established prior to the start of such period or within the first ninety (90) days of such period (provided that the performance criteria are not in any event set after 25% or more of such period has elapsed).
- 9.3 **MODIFICATIONS TO PERFORMANCE GOAL CRITERIA.** In the event that the applicable tax and/or securities laws and regulatory rules and regulations change to permit Committee discretion to alter the governing performance measures noted above without obtaining shareholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining shareholder approval. In addition, in the event that the Committee determines that it is advisable to grant Stock Incentives that shall not qualify for the Performance-Based Exception, the Committee may make such grants without satisfying the requirements under Section 162(m) of the Code to qualify for the Performance-Based Exception.
- 9.4 **LIMITATION ON PAYMENT OR EXERCISE.** With respect to any Stock Incentive that constitutes Deferred Compensation, such Stock Incentive shall provide for payment or exercise only upon: (a) a fixed date or schedule that complies with the requirements of Treas. Reg. §1.409A-3; (b) on a date based upon the Participant's "separation from service," or "disability," or "unforeseeable emergency" as those terms are defined under Section 409A of the Code; (c) the Participant's death; or (d) a Change in Control as defined in Section 11.1. Any election permitted under any Stock Incentive that constitutes Deferred Compensation shall comply with the requirements of Treas. Reg. §1.409A-2 and shall be irrevocable as of the date of grant of the Stock Incentive. In addition, with respect to any Stock Incentive that constitutes Deferred Compensation, except to the extent acceleration or deferral is permitted by or complies with the requirements of Section 409A of the Code, neither the Committee nor a Participant may accelerate or defer the time or schedule of any payment or exercise of, or the amount scheduled to be reported as income as a result.
- 9.5 **DELAY IN PAYMENT OR EXERCISE FOR SPECIFIED EMPLOYEES.** Notwithstanding anything in the Plan, unless the Stock Incentive Agreement specifically provides otherwise, no Stock Incentive that constitutes Deferred Compensation shall be paid to or exercised by a Specified Employee earlier than

181 days following the Participant's "separation from service" as defined for purposes of Section 409A of the Code (or if earlier, upon the Specified Employee's death), except as permitted under Section 409A of the Code and the regulations and other guidance promulgated thereunder. The Committee may specify in the Stock Incentive Agreement that the amount of the Deferred Compensation delayed pursuant to this Section 16.4 shall accumulate interest or earnings during the period of such delay.

- 9.6 WITHHOLDING. All taxes imposed on any Stock Incentive shall be the sole responsibility of the Participant. The Company shall have the right to deduct or withhold, or require a Participant to remit to the Company as a condition precedent for the grant, exercise, satisfaction of conditions or the lapse of restrictions under any Stock Incentive or the issuance of Shares, an amount sufficient to satisfy the federal, state and local taxes, domestic or foreign, required by law or regulation to be withheld with respect to any taxable event arising as a result. Unless the Stock Incentive Agreement provides otherwise, the Participant may satisfy such tax obligation by:
- (a) electing to have the Company withhold a portion of the Shares otherwise to be delivered upon such exercise, satisfaction of conditions or lapse of restriction with a Fair Market Value equal to the amount of such taxes, provided that the maximum amount shall not exceed the amount of the minimum required withholding; and
 - (b) delivering to the Company Shares other than Shares issuable upon such exercise, satisfaction of conditions or lapse of restrictions with a Fair Market Value equal to the amount of such taxes.

Notwithstanding the foregoing, with respect to any Participant who is an Insider, a withholding or tender of Shares shall be a subsequent transaction approved as part of the Stock Incentive for purposes of the exemption under Rule 16b-3 of the Exchange Act.

- 9.7 NOTIFICATION OF DISQUALIFYING DISPOSITIONS OF AN ISO. If a Participant sells or otherwise disposes of any of the Shares acquired pursuant to an ISO on or before the later of: (a) the date two (2) years after the date of grant of such ISO; or (b) the date one (1) year after the exercise of such ISO, then the Participant shall immediately notify the Company in writing of such sale or disposition and shall cooperate with the Company in providing sufficient information to the Company for the Company to properly report such sale or disposition to the Internal Revenue Service. The Participant acknowledges and agrees that he or she may be subject to federal, state and/or local tax withholding by the Company on the compensation income recognized by Participant from any such early disposition, and agrees that he or she shall include the compensation from such early disposition in his gross income for federal tax purposes. The Company may condition the exercise of any ISO on the Participant's express written agreement with these provisions of this Plan.

SECTION 10
STOCK INCENTIVES TO PARTICIPANTS OUTSIDE THE US

The Committee shall have the authority to require that any Stock Incentive Agreement relating to a Stock Incentive in a jurisdiction outside of the United States contain such terms as are required by local law in order to constitute a valid grant under the laws of such jurisdiction. Such authority shall be notwithstanding the fact that the requirements of the local jurisdiction may be different from or more or less restrictive than the terms set forth in this Plan. No purchase or delivery of Shares pursuant to a Stock Incentive to a Participant outside the United States shall occur until applicable restrictions imposed pursuant to this Plan (as modified as provided in this Section 10) or the applicable Stock Incentive have terminated.

SECTION 11
CHANGE IN CONTROL OF THE COMPANY

- 11.1 CHANGE IN CONTROL. "Change in Control" of the Company means an event that would be required to be reported in response to Item 6(e) on Schedule 14A of Regulation 14A promulgated under the Exchange Act, whether or not the Company is then subject to such reporting requirement, including, without limitation, if:
- (a) Any "person" (as such term is used in Sections 13(d) and 14(d) of the Exchange Act), other than a trustee or other fiduciary holding securities under an employee benefit plan of the Company or other than a Subsidiary of the Company, becomes a "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 30% or more of the combined voting power of the Company's then outstanding securities; or
 - (b) During any period of two consecutive years (not including any period ending prior to the effective date of this Plan), the Incumbent Directors cease for any reason to constitute at least a majority of the Board. The term "Incumbent Directors" shall mean those individuals who are members of the Board of Directors on the effective date of this Plan and any individual who subsequently becomes a member of the Board (other than a director designated by a person who has entered into agreement with the Company to effect a transaction contemplated by Section 11.1(c)) whose election or nomination for election by the Company's shareholders was approved by a vote of at least a majority of the then Incumbent Directors; or
 - (c) In the event:
 - (i) the Company consummates a merger, consolidation, share exchange, division or other reorganization of the Company with any corporation or entity, other than an entity owned at least 80% by the Company, unless immediately after such transaction, the shareholders of the Company immediately prior to such transaction

beneficially own, directly or indirectly 51% or more of the combined voting power of resulting entity's outstanding voting securities as well as 51% or more of the Total Market Value of the resulting entity, or in the case of a division, 51% or more of the combined voting power of the outstanding voting securities of each entity resulting from the division as well as 51% or more of the Total Market Value of each such entity, in each case in substantially the same proportion as such shareholders owned shares of the Company prior to such transaction;

- (ii) the Company consummates an agreement for the sale or disposition (in one transaction or a series of transactions) of assets of the Company, the total consideration of which is greater than 51% of the Total Market Value of the Company; or
 - (iii) the Company adopts a plan of complete liquidation or winding up of the Company.
- (d) "Total Market Value" shall mean the aggregate market value of the Company's or the resulting entity's outstanding common stock (on a fully diluted basis) plus the aggregate market value of the Company's or the resulting entity's other outstanding equity securities as measured by the exchange rate of the transaction or by such other method as the Committee determines where there is not a readily ascertainable exchange rate.

11.2 VESTING UPON A CHANGE IN CONTROL. Except as otherwise provided in a Stock Incentive Agreement or as provided in the next sentence, if a Change in Control occurs, and if the agreements effectuating the Change in Control do not provide for the assumption or substitution of all Stock Incentives granted under this Plan, with respect to any Stock Incentive granted under this Plan that is not so assumed or substituted (a "Non-Assumed Stock Incentive"), such Stock Incentive shall immediately vest and be exercisable and any restrictions thereon shall lapse. Notwithstanding the foregoing, unless the Committee determines at or prior to the Change in Control, no Stock Incentive that is subject to any performance criteria for which the performance period has not expired, shall accelerate at the time of a Change in Control.

11.3 DISPOSITION OF STOCK INCENTIVES. Except as otherwise provided in a Stock Incentive Agreement, the Committee, in its sole and absolute discretion, may, with respect to any or all of such Non-Assumed Stock Incentives, take any or all of the following actions to be effective as of the date of the Change in Control (or as of any other date fixed by the Committee occurring within the thirty (30) day period immediately preceding the date of the Change in Control, but only if such action remains contingent upon the effectuation of the Change in Control) (such date referred to as the "Action Effective Date"):

- (a) Unilaterally cancel such Non-Assumed Stock Incentive in exchange for:

- (i) whole and/or fractional Shares (or whole Shares and cash in lieu of any fractional Share) or whole and/or fractional shares of a successor (or for whole shares of a successor and cash in lieu of any fractional share) that, in the aggregate, are equal in value to the excess of:
 - (A) in the case of Options, the Shares that could be purchased subject to such Non-Assumed Stock Incentive less the aggregate Exercise Price for the Options with respect to such Shares; and
 - (B) in the case of Restricted Stock, Restricted Stock Units, Stock Appreciation Rights, Performance Stock, Performance Units and Other Awards, Shares subject to such Stock Incentive determined as of the Action Effective Date (taking into account vesting), less the value of any consideration payable on exercise.
- (ii) cash or other property equal in value to the excess of:
 - (A) in the case of Options, the Shares that could be purchased subject to such Non-Assumed Stock Incentive less the aggregate Exercise Price for the Options with respect to such Shares; and
 - (B) in the case of Restricted Stock, Restricted Stock Units, Stock Appreciation Rights, Performance Stock, Performance Units and Other Awards, Shares subject to such Stock Incentive determined as of the Action Effective Date (taking into account vesting) less the value of any consideration payable on exercise.

In the event the Exercise Price or consideration payable on exercise is equal to or greater than the Shares, cash or other property payable as provided in paragraphs (i) and (ii) above, then such Options and other Stock Incentives shall be automatically cancelled without payment of any consideration therefor.

- (b) In the case of Options, unilaterally cancel such Non-Assumed Option after providing the holder of such Option with: (i) an opportunity to exercise such Non-Assumed Option to the extent vested within a specified period prior to the date of the Change in Control; and (ii) notice of such opportunity to exercise prior to the commencement of such specified period. However, notwithstanding the foregoing, to the extent that the recipient of a Non-Assumed Stock Incentive is an Insider, payment of cash in lieu of whole or fractional Shares or shares of a successor may only be made to the extent that such payment: (A) has met the requirements of an exemption under Rule 16b-3 promulgated under the Exchange Act; or (B) is a subsequent transaction the terms of which were provided for in a

transaction initially meeting the requirements of an exemption under Rule 16b-3 promulgated under the Exchange Act. Unless a Stock Incentive Agreement provides otherwise, the payment of cash in lieu of whole or fractional Shares or in lieu of whole or fractional shares of a successor shall be considered a subsequent transaction approved by the original grant of the Option.

- 11.4 GENERAL RULE FOR OTHER STOCK INCENTIVES. If a Change in Control occurs, then, except to the extent otherwise provided in the Stock Incentive Agreement pertaining to a particular Stock Incentive or as otherwise provided in this Plan, each Stock Incentive shall be governed by applicable law and the documents effectuating the Change in Control.

SECTION 12

AMENDMENT OR TERMINATION

- 12.1 AMENDMENT OF PLAN. This Plan may be amended by the Committee from time to time to the extent that the Committee deems necessary or appropriate; provided, however, no such amendment shall be made without the approval of the shareholders of the Company if such amendment:
- (a) increases the number of Shares reserved under Section 3, except as set forth in Section 3.4;
 - (b) extends the maximum life of the Plan under Section 4 or the maximum exercise period under Section 7;
 - (c) decreases the minimum Exercise Price under Section 7;
 - (d) changes the designation of Participant eligible for Stock Incentives under Section 6; or
 - (e) would cause the Plan to no longer comply with Rule 16b-3 of the Exchange Act, Section 422 of the Code.

Shareholder approval of other material amendments (such as an expansion of the types of awards available under the Plan, an extension of the term of the Plan, or a change to the method of determining the Exercise Price of Options issued under the Plan) may also be required pursuant to rules promulgated by an established stock exchange or a national market system.

- 12.2 TERMINATION OF PLAN. The Board also may suspend the granting of Stock Incentives under this Plan at any time and may terminate this Plan at any time.
- 12.3 AMENDMENT OF STOCK INCENTIVES. The Committee shall have the right to modify, amend or cancel any Stock Incentive after it has been granted if:
- (a) the modification, amendment or cancellation does not diminish the rights or benefits of the Participant under the Stock Incentive (provided, however, that a modification, amendment or cancellation that results

solely in a change in the tax consequences with respect to a Stock Incentive shall not be deemed as a diminishment of rights or benefits of such Stock Incentive);

- (b) the Participant consents in writing to such modification, amendment or cancellation;
- (c) there is a dissolution or liquidation of the Company;
- (d) this Plan and/or the Stock Incentive Agreement expressly provides for such modification, amendment or cancellation; or
- (e) the Company would otherwise have the right to make such modification, amendment or cancellation by applicable law.

Notwithstanding the forgoing, the Committee may reform any provision in a Stock Incentive extended to be exempt from Section 409A of the Code to maintain to maximum extent practicable the original intent of the applicable provision without violating the provisions of Section 409A of the Code; provided, however, that if no reasonably practicable reformation would avoid the imposition of any penalty tax or interest under Section 409A of the Code, no payment or benefit will be provided under the Stock Incentive and the Stock Incentive will be deemed null, void and of no force and effect, and the Company shall have no further obligation in connection with such Stock Incentive.

SECTION 13 **MISCELLANEOUS**

- 13.1 **SHAREHOLDER RIGHTS.** Except as provided in Section 7.3 with respect to Restricted Stock, or in a Stock Incentive Agreement, no Participant shall have any rights as a shareholder of the Company as a result of the grant of a Stock Incentive pending the actual delivery of Shares subject to such Stock Incentive to such Participant. Nothing in this Plan shall limit or restrict the authority and power of the Board to make changes in the number of kind of equity securities or to consider, approve or reject any proposal for recapitalization, merger, exchange or a change in control, or to take or refrain from the exercise of any rights under federal or state law.
- 13.2 **NO GUARANTEE OF CONTINUED RELATIONSHIP.** The grant of a Stock Incentive to a Participant under this Plan shall not constitute a contract of employment or other relationship with the Company and shall not confer on a Participant any rights upon his or her termination of employment or relationship with the Company in addition to those rights, if any, expressly set forth in the Stock Incentive Agreement that evidences his or her Stock Incentive.
- 13.3 **TRANSFERS & RESTRUCTURINGS.** The transfer of a Participant's employment between or among the Company or a Subsidiary (including the merger of a Subsidiary into the Company) shall not be treated as a termination of his or her Service under this Plan. Likewise, the continuation of Service by a Participant

with a corporation that is a Subsidiary shall be deemed to be a termination of Service when such corporation ceases to be a Subsidiary.

- 13.4 LEAVES OF ABSENCE. Unless the Committee provides otherwise, vesting of Stock Incentives granted hereunder will be suspended during any unpaid leave of absence. A Participant will not cease to be in the Service of the Company in the case of any leave of absence approved by the Company. With respect to any ISOs, no such leave may exceed 90 days unless reemployment upon expiration of such leave is guaranteed by statute or contract and if reemployment upon expiration of a leave of absence is not so guaranteed, then three (3) months following the 91st day of such leave any ISO held by the Participant will cease to be treated as an ISO and if exercised thereafter will be treated for tax purposes as a NQSO.
- 13.5 GOVERNING LAW/CONSENT TO JURISDICTION. This Plan shall be construed under the laws of the State of _____ without regard to principles of conflicts of law. Each Participant consents to the exclusive jurisdiction in the United States District Court for the District of _____ for the determination of all disputes arising from this Plan and waives any rights to remove or transfer the case to another court.
- 13.6 ESCROW OF SHARES. To facilitate the Company's rights and obligations under this Plan, the Company reserves the right to appoint an escrow agent, who shall hold the Shares owned by a Participant pursuant to this Plan.
- 13.7 NO FRACTIONAL SHARES. No fractional Shares shall be issued or delivered pursuant to the Plan or any Stock Incentive, and the Committee shall determine whether cash shall be paid in lieu of any fractional Share or whether such Shares shall be cancelled or otherwise eliminated.
- 13.8 FORFEITURE AND RECOUPMENT. Without limiting in any way the generality of the Committee's power to specify any terms and conditions of an Award consistent with law, and for greater clarity, the Committee may specify in a Stock Incentive Agreement that the Participant's rights, payments, and benefits with respect to a Stock Incentive, including any payment or Shares received upon exercise or in satisfaction of the Stock Incentive under this Plan shall be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions, without limit as to time. Such events shall include, but shall not be limited to, failure to accept the terms of the Stock Incentive Agreement, termination of Service under certain or all circumstances, violation of material Company policies, misstatement of financial or other material information about the Company, fraud, misconduct, breach of noncompetition, confidentiality, nonsolicitation, noninterference, corporate property protection, or other agreement that may apply to the Participant, or other conduct by the Participant that the Committee determines is detrimental to the business or reputation of the Company and its Subsidiaries, including facts and circumstances discovered after termination of Service.

- (a) The Company shall require the chief executive officer and chief financial officer of the Company to disgorge bonuses, other incentive- or equity-based compensation, and profits on the sale of Shares received within the 12-month period following the public release of financial information if there is a restatement of such financial information because of material noncompliance, due to misconduct, with financial reporting requirements under the federal securities laws. In no event shall the amount to be recovered by the Company be less than the amount required to be repaid or recovered as a matter of law. The operation of this subsection (a) shall be in accordance with the provisions of Section 302 of Sarbanes-Oxley Act and any applicable guidance.
 - (b) The Company shall require each current and former executive officer to disgorge bonuses, other incentive- or equity-based compensation received within 36-month period prior to the public release of the restatement of financial information due to material noncompliance with the financial reporting requirements under the federal securities laws. The amount to be recovered shall be the percentage of incentive compensation, including equity awards, in excess of what would have been paid without the restated results. The operation of this subsection (b) shall be in accordance with the provisions of Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act and any applicable guidance.
 - (c) The Committee shall determine, as late as the time of the recoupment, regardless of whether such method is stated in the Stock Incentive Agreement, whether the Company shall effect any such recoupment: (i) by seeking repayment from the Participant; (ii) by reducing (subject to applicable law and the terms and conditions of the applicable plan, program or arrangement) the amount that would otherwise be payable to the Participant under any compensatory plan, program or arrangement maintained by the Company or any of its affiliates; (iii) by withholding payment of future increases in compensation (including the payment of any discretionary bonus amount) or grants of compensatory awards that would otherwise have been made in accordance with the Company's otherwise applicable compensation practices; (iv) by a holdback or escrow (before or after taxation) of part or all of the Shares, payment or property received upon exercise or satisfaction of the Stock Incentive; or (v) by any combination of the foregoing.
- 13.9 SEVERABILITY. If any provision of the Plan or any Stock Incentive is or becomes or is deemed to be invalid, illegal or unenforceable in any jurisdiction or would disqualify the Plan or any Stock Incentive under any law deemed applicable by the Committee, such provision shall be construed or deemed amended to conform to applicable laws, or if it cannot be so construed or deemed amended without, in the determination of the Committee, materially altering the purpose or intent of the Plan or the Stock Incentive, such provision shall be stricken as to such jurisdiction or as to such Stock Incentive, and the

remainder of the Plan or any such Stock Incentive shall remain in full force and effect.

- 13.10 NO TRUST OR FUND CREATED. Neither the Plan nor any Stock Incentive shall create or be construed to create a trust or separate fund of any kind or a fiduciary relationship between the Company or any Subsidiary and a Participant. To the extent that any Participant acquires a right to receive payments from the Company or any Subsidiary pursuant to a Stock Incentive, such right shall be no greater than the right of any unsecured general creditor of the Company or any Subsidiary.

Plan Term: _____ through _____

Adopted by the Board of Directors on _____

Approved by the Shareholders of the Company on _____

EXHIBIT B**UNIFORM TERMS AND CONDITIONS APPLICABLE TO OPTION GRANTS UNDER
ABC CORPORATION STOCK INCENTIVE PLAN**

Pursuant to the authority set forth in Section 5.2 of the ABC Corporation Stock Incentive Plan (the "Plan"), the Compensation Committee of the Board of Directors of ABC Corporation (the "Company") hereby establishes the following uniform terms and conditions that apply to any and all Options granted under the Plan, in addition to the terms set forth in the Plan:

Terms Applicable to Options

1. All unexercised Options shall expire immediately following the seventh anniversary of the date of grant of the Option, subject to earlier expiration as set forth in the Plan, including for Cause, a Qualifying Event, a Change in Control, or the dissolution or liquidation of the Company. (Section 7.2). If the Qualifying Event is termination of employment, the Option shall expire immediately following the 90th day after the date of termination (180th day after the date of termination as a result of death or disability).
2. The Option shall be exercisable as to one-third of the total number of Shares from and after the first anniversary of the date of grant; an additional one-third of the total number of Shares from and after the second anniversary of the date of grant, and the remainder of Shares from and after the third anniversary of the date of grant of the Option, subject to the earlier exercise of the Option under the terms the Plan or at the discretion of the Committee. (Section 7.1(e)).
3. The Option may not be sold, transferred, pledged, assigned or otherwise alienated, except upon the death of the Participant by will or the laws of descent and distribution. (Section 7.1(h)).
4. Any Option of a Participant who is on: (a) a qualified military leave; (b) a Company-approved leave of absence of less than 90 days; or (c) a Company approved leave of greater than 90 days and the Company is obligated by statute or written contract to re-employ the Participant at the end of the approved leave, shall not expire and if an Incentive Stock Option (ISO), shall continue to constitute an ISO during the leave period. If the Participant does not return to employment with the Company within 30 days of the end of the military or Company-approved leave, the Participant will incur a termination of employment as of the last day of the approved leave, and the Option will expire on the 90th day after the date of termination of employment. If a Participant is on a Company-approved leave of absence of more than 90 days but whose re-employment with the Company is not provided by statute or contract, the Option will not expire during the period of leave but if an ISO, shall constitute a Non-qualified Stock Option (NQSO) from and after 180 days following the commencement of the leave of absence. In that case, if the Participant does not return to employment with the Company prior to the end of the approved period

of leave, the Option will expire on the last day of the approved period of leave. (Section 13.4) The Vice President of Human Resources of the Company has been delegated the authority to approve all leaves of absence and to enter into such contracts to provide for re-employment for purposes of the Plan. (Section 5.3).

5. In the event the financial statements of the Company are required to be restated, the Company may modify any Option granted with respect to such fiscal year, may recover all or any portion of Shares issued under such Option (or the proceeds thereof), or may take such other action, provided that the amount recovered is no less than the amount required by law. (Section 13.8) The Chief Executive Officer has been delegated the authority and discretion to exercise the rights under Section 13.8 with respect to Options held by Participant who are not executive officers of the Company. (Section 5.3).
6. The Company may reduce, cancel, forfeit or recoup any rights, payments or benefits of the Participant under the Plan (including any Shares issued under any Option) for Cause (including termination of employment as a result), breach of any noncompetition, confidentiality, nonsolicitation, noninterference, corporate property protection or any other agreement between the Company and Participant or any other action of the Participant that the Committee deems detrimental to the business or reputation of the Company. If the Company intends for the Option to be accounted for as equity, the Company shall delay the exercise of the rights under Sections 5 and 6 for the period as may be required to preserve such accounting treatment.
7. Nothing in this Agreement shall modify or reduce the rights or discretions of the Committee set forth in the Plan, including but not limited to:
 - Adjusting Options upon a corporate transaction (Section 3.4);
 - Cashing out or requiring the exercise of Options upon a Change in Control (Section 11.3);
 - Modifying Options to comply with tax laws or upon dissolution or liquidation of the Company (Section 12.3);
 - Requiring Shares to be held in escrow (Section 13.6); or
 - Amending the terms and conditions of any Option consistent with Section 12.3.

Conditions of Exercise of Option

8. In payment of the exercise price of an Option in a form other than cash, the Participant may: (a) deliver or attest to the ownership of unrestricted Shares (including Shares issuable under this Option) having a Fair Market Value equal to the exercise price; provided that the Company may limit such right to Shares held for a minimum period of not more than six months and one day but only if such limit is otherwise necessary to allow the Option to be accounted for as equity; (b) deliver with the exercise notice, irrevocable instructions to a broker to promptly deliver to the Company the amount of sale or loan proceeds to pay the exercise price, except in the event, in the opinion of counsel to the Company, such right

constitutes a direct or indirect loan in violation of federal securities laws. (Section 7.2(g)).

9. A Participant may elect by written notice to the Company to satisfy part or all of the withholding tax requirements associated with the award by: (a) authorizing the Company to retain from the number of Shares that would otherwise be deliverable to the Participant, except to the extent such retention would violate applicable securities laws; or (b) delivering to the Company from Shares already owned by the Participant that number of Shares having an aggregate Fair Market Value equal to part or all of the tax payable by the Participant under this Section, and in the event Shares are withheld or delivered, the amount withheld shall not exceed the statutory minimum required federal, state FICA and other payroll taxes. (Section 9.6).
10. Shares shall be issued only if and to the extent such issuance is in compliance with all applicable securities laws or is otherwise exempt from such laws. The Participant may be required to sign a document satisfactory to the Company that, among other things, the Participant is purchasing the Shares for investment purposes and not with a view to sell or distribute the Shares except in compliance with applicable securities laws. (Section 8.2)

Terms Applicable to Shares

11. The Participant shall immediately notify the Human Resources department of the Company in the event the Participant sells or otherwise disposes of any Shares issued pursuant to an ISO on or before the later of (a) the date two years after the date of grant of the Option or (b) the date one year after the exercise of such Option. The Participant shall cooperate with the Company to enable the Company to properly report such disposition for tax purposes, and agrees to include any compensation income as a result of the disposition in the Participant's income for federal tax purposes. (Section 9.7)
12. Any "affiliate" (as defined in Rule 144 under the Securities Exchange Act) shall exercise and shall resell any Shares acquired upon exercise of the Option only in accordance with the applicable requirements of the Company's Insider Trading Policy, as amended from time to time, Rule 144 and any other requirements under applicable securities laws. (Section 8.2).

EXHIBIT C

**UNIFORM TERMS AND CONDITIONS APPLICABLE TO
RESTRICTED STOCK GRANTS UNDER
ABC CORPORATION STOCK INCENTIVE PLAN**

Pursuant to the authority set forth in Section 5 of the ABC Corporation Stock Incentive Plan (the "Plan"), the Compensation Committee of the Board of Directors adopts the following terms and conditions, in accordance with the terms of the Plan, to apply to any and all awards of Restricted Stock granted under the Plan to employees and directors (the "Recipient"):

1. The terms and conditions set forth below govern the issuance to the respective Recipient of the number of shares of the Company's Common Stock, \$_____ par value per share (the "Shares") set forth in a separate Notice of Grant of Restricted Stock (the "Notice"). This document and the Notice constitute the Restricted Stock Agreement. Until lapse of the restriction period described herein and in the Notice (the "Restriction Period"), Recipient shall not sell, transfer, pledge or otherwise encumber any of the Shares, whether voluntarily, involuntarily or by operation of law. Any purported transfer, pledge or encumbrance shall be void and unenforceable against the Company, and no purported transferee shall acquire any right or interest with respect to the Shares as a result.
2. The restrictions described in Section 1 above and in this Agreement shall commence on the date hereof and shall lapse and be of no further force and effect on the dates set forth in the Notice, or upon earlier lapse as set forth herein and as otherwise determined by the Committee; provided that the Recipient is employed by ABC or its subsidiaries (if an employee) or is serving as a director of ABC (if a non-employee director) on the date on which the restrictions lapse. Except as provided in the Notice, all Shares for which the Restriction Period has not lapsed shall be forfeited to the Company, without payment therefor, if during the Restriction Period the Recipient ceases to be employed (if an employee) or ceases to be a director (if a non-employee director) for any reason.
3. Notwithstanding Section 2, all restrictions on Shares for which the Restriction Period has not earlier lapsed in accordance with Section 2 and the Notice shall immediately lapse upon the occurrence of a Change in Control (as defined in the Plan) provided that the terms of the agreements effectuating the Change in Control do not provide for the assumption or substitution of the Shares.
4. The certificate or certificates representing the Shares, together with stock powers or other instruments of transfer appropriately endorsed in blank by the Recipient, will be held on deposit with the Company until the Restriction Period shall have lapsed with respect to such Shares pursuant to Section 2 above. If the Shares are maintained in uncertificated form, the Company shall denote such Shares as being subject to restrictions as set forth above as part of the book entry of the Shares on the Company's stock records. After the Restriction Period lapses, the

Company shall promptly cause the certificate or certificates for the Shares and the stock powers relating thereto, to be delivered to the Recipient, or shall mark its records that the Recipient is the owner of Shares.

5. While any Shares are subject to the restrictions during the Restriction Period, the certificate representing such Shares shall contain a legend substantially in the following form:

“The transferability of this certificate and the Shares of stock represented hereby are subject to the terms and conditions (including forfeiture) of the ABC Corporation Stock Incentive Plan (“Plan”) and an Agreement (consisting of the Notice and Uniform Terms and Conditions Applicable to Restricted Stock Grants) governing the grant of Restricted Stock. Copies of such Plan and Agreement are on file in the offices of ABC Corporation [Address].”

6. During the Restriction Period, the Recipient shall have all the rights of a stockholder of the Company with respect to the Shares, including the right to vote the Shares and to receive all cash dividends or other distributions (other than in the form of Shares of the Company) paid or made with respect to the Shares.
7. The Company may make an equitable adjustment in the number of Shares for which the Restriction Period has not lapsed in the event of any change in the capital structure of the Company, including but not limited to such changes as stock dividends or stock splits. Any additional Shares issued to the Recipient as a result of any of the foregoing events shall continue to be subject to the terms set forth herein to the same extent as the Shares giving rise to the right to receive such additional Shares.
8. A Recipient who is an employee may elect by written notice to the Company to satisfy part or all of any withholding tax requirements associated with the grant by authorizing the Company to retain from the number of shares of Stock that would otherwise be deliverable to the Recipient; or (b) delivering to the Company from Stock already owned by the Recipient that number of shares having an aggregate Fair Market Value equal to part or all of the tax payable by the Recipient under this Section, and in the event shares of Stock are withheld or delivered, the amount withheld shall not exceed the statutory minimum required federal, state FICA and other payroll taxes.
9. Any “affiliate” (as defined in Rule 144 under the Securities Exchange Act) shall resell any Shares acquired under the Plan only in accordance with the applicable requirements of the Company’s Insider Trading Policy, as amended from time to time, Rule 144 and any other applicable requirements of the Securities Exchange Act.
10. If any Recipient, who is an employee, is on a Company approved leave of absence for more than 90 days, other than a leave that qualifies as a military leave, and does not return to employment with the Company within 30 days of

the end of the approved leave, the Recipient will incur a termination of employment for purposes of the Plan as of the last day of the approved leave. The Human Resources department of the Company is hereby delegated the authority to approve all such leaves of absence and to enter into such agreements for purposes of the Plan.

11. Nothing in this Agreement shall be construed as constituting a commitment, guaranty, agreement or understanding of any kind or nature that the Company or its subsidiaries to retain the services of the Recipient, and this Agreement shall not affect in any way the right of the Company, its subsidiaries or the Recipient to terminate the relationship as employee or director, as the case may be, at any time or for any reason in accordance with the procedures governing such termination, without any liability or claim under the Plan or this Agreement. The grant of Restricted Stock hereunder shall not be considered to be part of the Recipient's wages or salary as an employee for purposes of any severance or similar pay or be part of any claim for damages arising out of any action for wrongful termination or otherwise.
12. With respect to Shares held by a Recipient who is an employee, the Company may, in its sole discretion, repurchase for cash or other immediately available funds all or any portion of any Shares issued under the Plan, provided, however, that this right to repurchase shall not be exercised with respect to any Shares until such Shares have been held by the Recipient for a period of six months and one day after the date of exercise. The repurchase price shall be the then Fair Market Value of the shares if the Recipient's termination of employment with the Company or any of its subsidiaries was other than for Cause (as defined in the Plan); if the Recipient's termination of employment with the Company or any of its subsidiaries was for Cause, or if the Recipient directly or indirectly competes with or is employed by a competitor of the Company within six months after the Recipient's termination of employment, the repurchase price shall be the lesser of the then Fair Market Value or the Fair Market Value of the Shares on the date of grant. The Committee hereby delegates to the Chief Executive Officer the authority and discretion to exercise this right of repurchase with respect to Shares held by persons other than the executive officers of the Company.
13. You may elect, under Section 83(b) of the Internal Revenue Code, to accelerate the taxation of the restricted shares and to be taxed on the value of all the shares in the year of the grant. If you make this election, the fair market value of the shares at the time the shares are granted is subject to tax as ordinary compensation income (subject to applicable tax withholding) in the year of the grant. In addition, any dividends you receive in respect of restricted shares will be subject to tax as dividend income. For example, if you are granted a total of 400 restricted shares that have a fair market value of \$1.50 per share on the date of grant, you may elect to pay tax on \$600 of income in the year of grant. If the value of the stock increases in subsequent years, this could mean you will have saved on taxes. This is because the appreciation in the value of the shares after the date of grant would be taxed at capital gains rates when the shares are sold. Conversely, if the stock price per share declines, or if you leave the Company before all of the shares have vested and thus the unvested shares are forfeited, it

could mean that you will have paid taxes that you would otherwise not have had to pay. This is because you cannot obtain a refund for the taxes you paid when you made the Section 83(b) election. Instead, if you make a Section 83(b) election and you later forfeit some or all of the shares, you would generally be entitled to a capital loss for those shares you forfeited. Capital losses are deductible only to the extent of capital gains income plus up to \$3,000 per year of ordinary income.

14. If you do not make the Section 83(b) election, any dividends you receive in respect of restricted shares will be subject to tax as ordinary compensation income (subject to applicable tax withholding).

Except to the extent specifically provided in this Agreement, this grant shall be subject to and governed by the terms and conditions of the Plan, which shall be incorporated as though fully set forth herein. The foregoing terms and conditions shall remain in effect until further modified by action of this Committee or by the Board of Directors, either in the form of a modification of these terms and conditions or by a written term or condition set forth in any individual grant approved by the Committee subsequent to the date of adoption of these terms and conditions, provided that no change shall adversely affect any accrued right of the Recipient without the Recipient's written consent.

EXHIBIT D

**UNIFORM TERMS AND CONDITIONS APPLICABLE TO
RESTRICTED STOCK UNIT GRANT (EMPLOYEE) UNDER
ABC CORPORATION STOCK INCENTIVE PLAN**

Pursuant to the authority set forth in Section 5 of the ABC Corporation Stock Incentive Plan (the "Plan") the Compensation Committee of the Board of Directors adopts the following terms and conditions, in accordance with the terms of the Plan, to apply to any and all awards of Restricted Stock Units granted under the Plan to employees (the "Recipient"):

1. The terms and conditions set forth below govern the issuance to the respective Recipient of the number of units ("Units"), which represent the right to receive shares of the Company's Common Stock, \$_____ par value per share (the "Shares") set forth in a separate Notice of Grant of Restricted Stock Units (the "Notice"), and the issuance of Shares upon the vesting of the Units. This document and the Notice constitute the Restricted Stock Unit Agreement.
2. The Units will vest in accordance with the date or dates set forth in the Notice, or upon an earlier date as set forth herein and as otherwise determined by the Committee; provided that the Recipient is employed by the Company or its subsidiaries on the date on which occurs the event giving rise to the vesting. Except as provided in the Notice or as set forth herein, all Units that are not vested shall be forfeited to the Company, without payment therefor, if the Recipient ceases to be employed for any reason. Notwithstanding the schedule set forth in the Notice, all Units that have not vested in accordance with the Notice shall immediately fully (100%) vest upon the occurrence of a Change in Control (as defined in the Plan) provided that the terms of the agreements effectuating the Change in Control do not provide for the assumption or substitution of the Units.
3. The Company shall, no later than 30 days from the date of vesting as to any Units issue to the Recipient the certificate or certificates for the number of unrestricted and fully paid Shares equal to the number of Units that vested, subject to the right to withhold Share in accordance with Section 6. If the Shares are maintained in uncertificated form, the Company shall issue such Shares as part of the book entry of the Shares on the Company's stock records. Thereafter, the Company shall promptly cause the certificate or certificates for the Shares to be delivered to the Recipient, or shall mark its records that the Recipient is the owner of Shares.
4. Until Shares are issued in settlement of the Units in accordance with Section 3, the Recipient will not be deemed for any purpose to be, or have rights as, a shareholder of the Company, or to exercise, directly or by proxy, voting rights or receive dividends with respect to the Shares issuable upon the vesting of the Units. In addition, the Recipient will not be entitled to any dividend equivalents, in the form of cash, or additional Units or Shares, with respect to the Units for the

period prior to the settlement of the Units. From and after the date of settlement, the Recipient shall have all rights and privileges of any other shareholder with respect to the Shares issued in settlement of the vested Units.

5. The Company may make an equitable adjustment in the number of Units that have not vested in the event of any change in the capital structure of the Company, including but not limited to reorganization or stock splits, but excluding any change resulting from a dividend payment. Any additional Units issued to the Recipient as a result of any of the foregoing events shall continue to be subject to the terms set forth herein to the same extent as the Units giving rise to the right to receive such additional Units.
6. As a condition to the Company's obligation to issue Shares in settlement of the Units, the Recipient shall pay or make arrangements for the payment of any required tax withholding applicable to the vesting of the Units and issuance of the Shares in settlement therefore. The Recipient may elect by written notice to the Company to satisfy part or all of any withholding tax requirements associated with the vesting of the Units and issuance of the Shares by authorizing the Company to retain from the number of Shares that would otherwise be issued to the Recipient that number of Shares having an aggregate Fair Market Value equal to part or all of the tax payable by the Recipient under this Section 6, and in the event Shares are withheld or delivered, the amount withheld shall not exceed the statutory minimum required federal, state FICA and other payroll taxes.
7. Any "affiliate" (as defined in Rule 144 under the Securities Exchange Act) shall resell any Shares issued in settlement of the Units (including as set forth in Sections 12 and 13 below) only in accordance with the applicable requirements of the Company's Insider Trading Policy, as amended from time to time, Rule 144 and any other applicable requirements of the Securities Exchange Act.
8. If any Recipient is on a Company-approved leave of absence for any reason, other than a leave that qualifies as a military leave, and does not return to employment with the Company within 30 days of the 6-month anniversary of the start of the leave of absence, the Recipient will incur a termination of employment for purposes of the Plan as of the 6-month anniversary of the start of the leave of absence, or with respect to a military leave, the last date that the Recipient is entitled to reinstatement to employment. The Human Resources department of the Company is hereby delegated the authority to approve all such leaves of absence and to enter into such agreements for purposes of the Plan.
9. Nothing in this Agreement shall be construed as constituting a commitment, guaranty, agreement or understanding of any kind or nature that the Company or its subsidiaries to retain the services of the Recipient, and this Agreement shall not affect in any way the right of the Company, its subsidiaries or the Recipient to terminate the employee at any time or for any reason in accordance with the procedures governing such termination, without any liability or claim under the Plan or this Agreement. The grant of Units hereunder shall not be considered to be part of the Recipient's wages or salary for purposes of any severance or

similar pay or be part of any claim for damages arising out of any action for wrongful termination or otherwise.

10. The Units shall represent an unfunded promise to issue Shares in the future and Recipient shall have no rights other than as a general creditor of the Company with respect to the issuance of Shares. Except as otherwise provided in Section 11, Recipient not sell, transfer, pledge, assign or otherwise encumber any of the Units, whether voluntarily, involuntarily or by operation of law. Any purported transfer, pledge or encumbrance of such Units shall be void and unenforceable against the Company, and no purported transferee shall acquire any right or interest with respect to the Shares as a result.
11. This Agreement shall be binding upon, and inure to the benefit of, the Company and its successors and assigns, and upon any person acquiring, whether by merger, consolidation, purchase of assets or otherwise, all or substantially all of the Company's assets and business. Any Shares issuable under this Agreement as a result of the vesting of Units on or after the Recipient's death shall be issued to the beneficiary or beneficiaries ("Designated Beneficiary") designated by the Recipient in a writing filed with the Company in such form and at such time as the Company shall require. If the Recipient fails to designate a beneficiary, or if the Designated Beneficiary does not survive the Recipient, any Shares issuable shall be issued to the legal representative of the Recipient's estate. If the Designated Beneficiary survives, but dies before all Shares are issued to the Designated Beneficiary under this Agreement, then any Shares issuable to the Designated Beneficiary shall be issued to the legal representative of the estate of the Designated Beneficiary.
12. If Recipient is terminated by the Company for Cause (as defined in any written employment agreement between the Company and the Recipient or in the absence of such agreement, as defined in the Plan), or in the event of any breach of any noncompetition, confidentiality, nonsolicitation, noninterference, corporate property protection or any other agreement between the Company and Recipient or any other action of the Participant that the Committee deems detrimental to the business or reputation of the Company, the Company may reduce, cancel or forfeit any Units that have not vested, and upon demand and without any payment or other consideration from the Company, the Recipient shall disgorge and return to the Company any Shares issued in settlement of the number of Units, less the net effect of any taxes paid by the Recipient (taking into account the initial taxes paid and the tax effect of the disgorgement), or if the Recipient does not then own that number of Shares, the amount of the cash proceeds received by the Recipient from the Recipient's most recent sale of a like number of the shares of common stock of the Company, less the net tax effect as stated above. Recipient understands and agrees that the return of Shares and the disgorgement of any proceeds received by the Recipient is in addition to and separate from any other relief available to the Company, including but not limited to, injunctive relief. Recipient agrees that the Company may recover any disgorgement required under this Section 12 by right of offset against any amounts due and owing by the Company to the Recipient, to the maximum extent permitted by law.

13. The Company may, in its sole discretion, repurchase for cash or other immediately available funds all or any portion of any Shares issued under the Plan, provided, however, that this right to repurchase shall not be exercised with respect to any Shares until such Shares have been held by the Recipient for a period of six months and one day after the date of exercise and such repurchase otherwise complies with Section 7 above. The repurchase price shall be the then Fair Market Value of the Shares, provided, however, that no payment shall be required with respect to any Shares to which Section 12 above applies. The Committee hereby delegates to the Chief Executive Officer the authority and discretion to exercise this right of repurchase with respect to Shares held by persons other than the executive officers of the Company.
14. The Compensation Committee of the Board (the "Committee") shall exercise any authority and discretion in the administration of this Agreement in accordance with the terms of the Plan. This Agreement is intended to be exempt from the requirements of Section 409A of the Code and shall be construed and interpreted in accordance with such intent. Except as provided herein or as provided in the Plan, no payment shall be subject to further deferral except as otherwise permitted or required pursuant to regulations and other guidance issued pursuant to Section 409A of the Code. Any provision of this Agreement that would fail to satisfy the exemption for a short-term deferral for purposes of Section 409A of the Code shall be amended to so comply on a timely basis.

Except to the extent specifically provided in this Agreement, this grant shall be subject to and governed by the terms and conditions of the Plan, which shall be incorporated as though fully set forth herein. The foregoing terms and conditions shall remain in effect until further modified by action of the Board of Directors or the Compensation Committee thereof, either in the form of a modification of these terms and conditions or by a written term or condition set forth in any individual grant approved by the Board or the Compensation Committee subsequent to the date of adoption of these terms and conditions, provided that no change shall adversely affect any accrued right of the Recipient without the Recipient's written consent.

EXHIBIT E**ABC CORPORATION****PHANTOM STOCK APPRECIATION RIGHTS PLAN****1. Purpose.**

1.1 Purpose. The purpose of the ABC Corporation Phantom Stock Appreciation Rights Plan ("Plan") is to provide deferred compensation to certain key employees of ABC Corporation, a _____ corporation ("Corporation"). Such deferred compensation will be based upon the award of Stock Appreciation Rights ("Rights"), the value of which shall be determined based on the appreciation in the economic value of the Common Stock of the Corporation after the date of the award of such Rights.

2. Definitions. For purposes of the Plan, the following terms are defined below:

2.1 "Award Agreement" means a written agreement setting forth the award of Stock Appreciation Rights and the terms and conditions applicable thereto.

2.2 "Board" means the Board of Directors of the Corporation.

2.3 "Cause" means the following, regardless of when it is discovered by the Company:

(A) Participant's conviction, including the entry of a plea of guilty or no contest, of a felony, or any other criminal violation involving dishonesty, fraud, or breach of trust;

(B) Participant's willful engagement in any misconduct in the performance of his or her duty that materially injures the Corporation, or its affiliates;

(C) Participant's performance of any act which, if known to the customers, clients, employees or stockholders of the Corporation, would materially and adversely impact the business of the Corporation, or its affiliates; or

(D) Participant's willful and substantial nonperformance of assigned duties; provided that such nonperformance continues more than ten (10) days after the Participant has been given written notice of such nonperformance and of its intention to terminate Participant's employment because of such nonperformance.

If there is an employment agreement in effect between the Participant and the Corporation that provides for termination for cause, then the definition of "cause" contained in that agreement, and not this definition, shall govern any Stock Appreciation Rights under this Plan.

2.4 “Change in Control” means either of the following events:

(A) During any 12-month period, any person or group (as defined in Treas. Reg. §1.409A-3(i)(5)(v)(B)) that is not affiliated with the Corporation, acquires 80 percent or more of the total gross fair market value of the Corporation’s assets; or

(B) Any person or group (as defined in Treas. Reg. §1.409A-3(i)(5)(v)(B)) that is not affiliated with the Corporation, acquires ownership of stock of the Corporation that, together with stock held by such person or group, constitutes more than 50 percent of the total voting power of the stock of the Corporation.

This definition of “Change in Control” shall be determined and administered in accordance with Code § 409A and regulations promulgated thereunder.

2.5 “Common Stock” means the common stock of the Corporation as such stock may be classified, reclassified, converted or exchanged by reorganization, merger or otherwise.

2.6 “Corporation” means ABC Corporation, a Corporation organized under the laws of the State of _____.

2.7 “Disability” means the inability of the Participant to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months and is certified in writing to the Corporation by the disabled Participant’s attending physician. This definition of “Disability” shall be determined and administered in accordance with Code § 409A and the corresponding regulations.

2.8 “Fair Market Value” means the value of a share of Common Stock of the Corporation as determined by the Board in accordance with this Section 2.8. The Board shall base its determination of such Fair Market Value upon the then most recent prior financial statements of the Corporation. Fair Market Value shall be determined without regard to any expense or liability associated with the outstanding Stock Appreciation Rights under this Plan. In determining the value of a share of Common Stock, Fair Market Value of the Corporation shall be divided by the sum of: (a) the total number of shares of Common Stock outstanding; plus (b) the total number of vested Stock Appreciation Rights as of the date of such determination. The Board’s determination of Fair Market Value of the Common Stock shall be binding on all parties, and no party shall have the right to appeal this determination.

In the case of a Change in Control of the Corporation, Fair Market Value shall mean the value received by or paid to the Corporation (in the case of a sale of assets) or to the stockholders (in the case of a sale of stock) in connection with such transaction, less any liabilities retained or assumed, and less any transaction costs. If the consideration received or paid in connection with a Change in Control consists of property, including any interest retained proportionally by the selling stockholders, the Administrative

Committee shall determine the value of such property, which determination shall be final and binding on all parties.

2.9 “Grant Date” means the effective date of an award of Stock Appreciation Rights under this Plan, which shall be set forth in the Award Agreement.

2.10 “Grant Date Value” means the Fair Market Value of a share of Common Stock on the Grant Date, as determined by the Board.

2.11 “Participant” means any employee of the Corporation, as designated by the Board, to participate in this Plan and who holds Stock Appreciations Rights that are outstanding under this Plan.

2.12 “Payment Event” means:

- (A) Separation of Service without Cause;
- (B) Change in Control; or
- (C) continuous employment with the Corporation until [Date] .

2.13 “Separation of Service” means the Participant’s termination of employment with the Corporation, whether on account of death, Disability or otherwise, whether voluntary or involuntary, for any reason or no reason. The Corporation will determine whether a Participant has incurred a Separation of Service based on the facts and circumstances and in accordance with Treas. Reg. §1.409A-1(h)(1)(ii).

(A) A Participant incurs a Separation of Service if the parties reasonably anticipate, based on the facts and circumstances, the Participant will not perform any additional services after a certain date or that the level of bona fide services (whether performed as an employee or as an independent contractor) will permanently decrease to no more than 20% of the average level of bona fide services performed over the immediately preceding 36-month period (or, if less, the period the employee has rendered service to the Corporation).

(B) A Participant does not incur a Separation of Service if the Participant is on military leave, sick leave, or other bona fide leave of absence if such leave does not exceed a period of 6 months, or if longer, the period for which a statute or contract provides the Participant with the right to reemployment with the Corporation. If a Participant’s leave exceeds 6 months but the Participant is not entitled to reemployment under a statute or contract, the Participant incurs a Separation of Service on the next day following the expiration of 6 months, (29 months where a leave of absence is due to a condition that constitutes a Disability unless the Corporation or the Participant terminate the leave sooner).

2.14 “Stock Appreciation Right” means an award under this Plan, the future value of which is determined based upon the appreciation in the value of the Common

Stock of the Corporation from the Grant Date to the first Payment Event. Each Stock Appreciation Right shall equal one share of Common Stock of the Corporation.

3. Administration, Claim and Review Procedure. The Board of the Corporation will administer the Plan. In its sole discretion, the Board may delegate its duties and rights under the Plan to a committee or individual and, in such event, references to the Board herein will also be deemed to include such committee or individual.

3.1 Authority and Discretion of the Board. Subject to the provisions of the Plan, the Board will have exclusive power to select those employees to be granted Stock Appreciation Rights, to determine the number of Stock Appreciation Rights to be granted to each Participant, and to set all other terms and conditions of such rights consistent with the terms of this Plan. The Board will have authority to interpret the Plan, to adopt and revise rules and regulations relating to the Plan, to determine the conditions subject to which any grants of Stock Appreciation Rights may be made, and to make any other determinations that it believes necessary or advisable for the administration of the Plan. The Board shall, to the extent reasonably possible, administer and interpret the Plan to comply with the requirements of Internal Revenue Code of 1986 ("Code") § 409A and regulations promulgated thereunder. Determinations by the Board with respect to all matters relating to the Plan will be final and binding on all parties.

3.2 Reliance on Advice. The Board may employ attorneys, consultants, accountants, appraisers, brokers, or other persons. The Board, the Corporation, and the officers and managers of the Corporation shall be entitled to rely upon the advice, opinions, or valuations of any such person.

3.3 Indemnification. No member of the Board shall be personally liable for any action, determination, or interpretation made in good faith with respect to the Plan, the Award Agreements, or the Stock Appreciation Rights, and all members of the Board shall be fully protected and indemnified by the Corporation with respect to any such action, determination, or interpretation.

3.4 Claims. Any decision by the Corporation denying a claim by a Participant for benefits under this Plan shall be stated in writing and delivered or mailed to the Participant within 60 days of receipt of such claim. Such decision shall set forth the specific reasons for the denial, the provisions of this Plan on which the denial is based, and shall inform the Participant of the right to appeal the denial, to review information and documents relevant to the claim and the denial, and to submit additional information and documents in connection with the claim.

3.5 Review. The Participant may request, in writing to the Board, a full and fair review of any decision denying such claim within 60 days of receipt of a denial. The Board may hold a hearing on the denied claim. The Board shall make its decision promptly, which shall ordinarily be not later than 60 days after receipt of the request for review. The decision on review shall be in writing and shall include specific reasons for the decision and specific references to the pertinent Plan provisions on which the decision is based. In the event the initial denial or the decision on review is not

furnished to the Participant within the time required, the claim (or the denial upon review) shall be deemed denied.

4. Awards of Stock Appreciation Rights.

4.1 Awards. Stock Appreciation Rights may be granted to Participants as the Board may determine from time to time. Each Stock Appreciation Right will be given a Grant Date Value, as determined by the Board. Each award of Stock Appreciation Rights under the Plan to a Participant, the number and Grant Date Value of such Stock Appreciation Rights, and any other terms and conditions on such Stock Appreciation Rights will be set forth in the Award Agreement, which shall be communicated to the Participant within thirty (30) days after the Grant Date.

4.2 Stock Appreciation Rights Available. The maximum number of Stock Appreciation Rights that may be awarded under the Plan will not exceed _____ percent (___%) of the Corporation's total Common Stock (subject to adjustment as determined by the Board in accordance with Section 4.3). If any Stock Appreciation Rights awarded under the Plan are forfeited or canceled, such Stock Appreciation Rights may again be awarded under the Plan.

4.3 Adjustments. The Board shall make or provide for such adjustments to Stock Appreciation Rights, Grant Date Value or other criteria as it deems appropriate in its sole discretion in the event of changes to the number of the Corporation's Common Stock, by a division or consolidation of such Common Stock, or by reason of a recapitalization, merger, purchase of assets (to the extent the purchase price is funded with additional capital), consolidation, exchange, reorganization and the like. Notwithstanding anything in this Plan to the contrary, no Stock Appreciation Rights will be adjusted due to the issuance of additional Common Stock for substantial value to any person or entity.

5. Vesting of Stock Appreciation Rights; Forfeiture.

5.1 Vesting. The Stock Appreciation Rights awarded to a Participant will vest at such times or under such conditions and in such numbers as set forth in the Award Agreement.

5.2 Forfeiture of Unvested Stock Appreciation Rights. Except as otherwise provided in the Award Agreement, upon a Participant's Payment Event, the Participant's rights to any unvested Stock Appreciation Rights will terminate and be cancelled without any payment therefor. Neither the Participant nor his or her heirs, personal representatives, successors or assigns will have any future rights with respect to any such unvested Stock Appreciation Rights.

5.3 Forfeiture of All Stock Appreciation Rights for Cause. All unvested and vested Stock Appreciation Rights will terminate and be forfeited if the Participant incurs a Separation for Service for Cause.

5.4 Forfeiture and Clawback of Stock Appreciation Rights and Payments. If the Participant breaches any noncompetition, confidentiality, nonsolicitation,

noninterference, or nondisclosure agreement, or other agreement that may apply to the Participant, then, unless the Award Agreement or such other agreement otherwise provides:

(A) all unvested and vested Stock Appreciation Rights will terminate and be forfeited; and

(B) the Participant will be required to immediately repay all Stock Appreciation Right payments previously made to such Participant.

Such forfeiture and clawback shall be in addition to any other right the Corporation may have with respect to any such violation or breach. The Corporation may undertake any legal action to collect and recover the amount of any such required repayment.

6. Payment of Stock Appreciation Rights upon a Payment Event.

6.1 Payment of Stock Appreciation Rights upon a Payment Event. Upon the occurrence of a Payment Event, and subject to the limitations in Section 5.3 and 5.4, the Corporation shall pay to the Participant (or in the event of his or her death, to his or her designated beneficiary in accordance with Section 6.3) the value of the Participant's vested Stock Appreciation Rights, as determined in Section 7, as follows:

(A) If the Payment Event is Separation of Service other than due to death or Disability, the Participant will receive _____ equal annual installments. The first installment shall be made no later than 90 days following the Participant's Separation from Service and each subsequent installment on the anniversary of the Payment Event; or

(B) If the Payment Event is Separation of Service due to death or Disability, the Participant (or designated beneficiary upon your death) will receive a lump sum payment no later than 90 days following the Participant's Separation of Service;

(C) If the Payment Event is a Change in Control, the Participant will receive a lump sum payment immediately following the consummation of the Change in Control.

(D) Upon any other Payment Event, the Participant shall receive a lump sum payment within 90 days of such Payment Event.

In the event that, at the time of the Payment Event, the value of the Stock Appreciation Rights as determined under Section 7 is not a positive number, then all such vested Stock Appreciation Rights held by the Participant shall be cancelled without any payment therefor, and thereafter, the Participant shall have no further rights in or to such Stock Appreciation Rights.

6.2 Withholding. The Corporation has the right to deduct from all amounts paid pursuant to the Plan any taxes required by law to be withheld and any other deductions applicable to such payment. Except for the amount so withheld, the

Participant or beneficiary shall be liable for any and all other taxes due with respect to amounts paid pursuant to the Plan.

6.3 Designation of Beneficiary. The Participant shall designate a beneficiary by completing and signing the Beneficiary Designation form and delivering it to the Corporation. The Participant shall have the right to change a beneficiary by completing, signing and otherwise complying with the terms of the beneficiary designation form. A Beneficiary designation shall be valid only if actually received by the Corporation. In the event the Participant fails to designate a Beneficiary or the named Beneficiary does not survive the Participant, then the payments shall be made to the personal representative of the Participant's estate.

6.4 No Acceleration or Rodeferral. No payment under this Plan or any payment in substitution for a payment under this Plan shall be accelerated or deferred, except as provided in this Plan, or as may be permitted in accordance with Code § 409A and final regulations promulgated thereunder.

7. Determination of Value of Stock Appreciation Rights.

7.1 Value of Stock Appreciation Rights. The total amount to be paid to the Participant for the vested Stock Appreciation Rights shall be equal to the number of vested Stock Appreciation Rights multiplied by the following amount:

(A) The Fair Market Value of a share of Common Stock as of the date of a Payment Event, less

(B) The Grant Date Value of each vested Stock Appreciation Right as set forth in the Award Agreement.

8. Amendment and Termination of the Plan.

8.1 Amendment. The Board may alter or amend the Plan from time to time without obtaining the approval of any Participant; provided, however, that except as provided in Section 4.3 and Section 9.9, no amendment to the Plan may alter, impair or reduce the number of Stock Appreciation Rights granted or the Grant Date Value of the Participant's Stock Appreciation Rights under the Plan prior to the effective date of such amendment without the written consent of the affected Participant.

8.2 Termination. The Board may at any time terminate the Plan, provided that:

(A) such termination complies with the requirements of Code § 409A;
and

(B) such termination does not alter, impair or reduce the number of Stock Appreciation Rights granted or the Grant Date Value of the Participant's Stock Appreciation Rights under the Plan prior to the effective date of such termination without the written consent of the affected Participant.

9. Miscellaneous.

9.1 Related Agreements. As a condition to the receipt of benefits hereunder, each Participant may be required to execute related agreements, which may include but are not limited to, a noncompetition, confidentiality, nonsolicitation, noninterference, or nondisclosure agreement with the Corporation. The specific provisions of such related agreements shall be determined by the Board. In the event of any breach of such agreement, the Participant shall be subject to the forfeiture and clawback provisions in accordance with Section 5.4.

9.2 Non-transferability. Stock Appreciation Rights granted under the Plan, and any rights and privileges pertaining thereto, may not be transferred, assigned, pledged or hypothecated in any manner, by operation of law or otherwise, other than by will or by the laws of descent and distribution, and will not be subject to execution, attachment or similar process.

9.3 Voting and Dividend Rights. No Participant is entitled to any voting rights, to receive any distribution with respect to Stock Appreciation Rights or, except as provided in Section 4.3, to have the value of his or her Stock Appreciation Rights credited or increased as a result of any other distribution contribution with respect to the Common Stock of the Corporation.

9.4 Changes in Corporation Capital and Structure. Nothing in this Plan or any Award Agreement shall limit or restrict the authority and power of the Board, the Corporation and its members to make changes to the number or kind of equity securities including by reason of a recapitalization, merger, exchange of shares, reorganization and the like, or to consider or reject any proposal or transaction that might result in a Change in Control, or to take or refrain from any act or exercise of its or their respective rights under federal or _____ law.

9.5 No Employment Rights. No employee has any claim or right to be granted Stock Appreciation Rights under the Plan. Neither the Plan nor any action taken hereunder may be construed as giving any employee any right to be retained as the employee of the Corporation.

9.6 Effect of Plan on Other Compensation Programs. The establishment of this Plan shall not affect any other compensation or incentive plan or program in effect for the Corporation nor shall this Plan be construed to limit the right of the Corporation to establish any other forms of incentives or compensation for any employees of the Corporation.

9.7 Unfunded Status; Subordination. The Plan will at all times be entirely unfunded and no provision will at any time be made with respect to segregating assets of the Corporation for payment of any benefits hereunder. No Participant or other person will have any interest in any particular assets of the Corporation by reason of the right to Stock Appreciation Rights under the Plan and any such Participant or other person will have only the rights of a general unsecured creditor of the Corporation with respect to any rights under the Plan.

9.8 No Trust or Fiduciary Status. Nothing in this Plan shall establish any trust or similar arrangement with regard to the rights of the Participant, nor shall the Corporation or any officer, employee or service provider become a fiduciary with respect to this Plan for purposes of the Employee Retirement Income Security Act of 1974, if applicable, or any state trust laws.

9.9 Compliance with Code § 409A. The Plan is intended to satisfy the requirements of Code § 409A and final regulations promulgated thereunder. The Corporation will administer and interpret the Plan and Stock Appreciation Rights granted to the Participants in good faith and accordance with the requirements of Code § 409A and final regulations promulgated thereunder. Notwithstanding Section 8.1, the Board reserves the right, without the consent of the Participant, to amend this Plan and/or Stock Appreciation Rights granted under this Plan at any time to comply with Code §409A and regulations promulgated thereunder, preserving to the greatest extent possible, the economic benefits provided under this Plan.

9.10 Successors. This Plan shall be binding upon, and shall inure to the benefit of the Corporation and its successors and assigns, and upon any person acquiring, whether by merger, consolidation, purchase of assets or otherwise, all or substantially all of the Corporation's assets and business.

9.11 Arbitration of Claims. Except as otherwise provided in Section 2.8, any disputes arising under or relating to the Plan, Award Agreement or Stock Appreciation Rights shall be determined by a single arbitrator selected by the Participant from a list of three qualified American Arbitration Association (AAA) arbitrators with at least five years experience in employment law selected by the Corporation. Such arbitration shall be conducted in accordance with the Rules of Commercial Arbitration of the AAA in the city of the registered office of the Corporation.

9.12 Governing Law. To the extent not preempted by federal law, the Plan shall be construed in accordance with and governed by the laws of the state of _____.

Dated: October __, 2010

ABC Corporation

By:
Its:

ABC CORPORATION PHANTOM STOCK APPRECIATION RIGHTS PLAN

PHANTOM STOCK APPRECIATION RIGHTS AWARD AGREEMENT

In accordance with the ABC Corporation Phantom Stock Appreciation Rights Plan (the "Plan"), notice is hereby given that ABC Corporation ("Corporation") hereby grants to the Participant, as of the Grant Date, the number of Stock Appreciation Rights identified below at the Grant Date Value of each such Stock Appreciation Right as set forth below and subject to vesting as set forth below.

Participant: _____

Social Security No: _____

Grant Date: _____

No. of Stock Appreciation Rights: _____

Grant Date Value: _____

Vesting Schedule:	Anniversary of Grant Date	% of Unit Appreciation Rights Vested as of Such Date
	_____	_____
	[First	20%]
	[Second	40%]
	[Third	60%]
	[Fourth	80%]
	[Fifth	100%]

Notwithstanding the foregoing, Vested Stock Appreciation Rights are subject to forfeiture and/or clawback in the event of a termination for Cause, a breach of [*name of related agreement*], or as otherwise stated in Section 5 of the Plan.

The Stock Appreciation Rights granted hereby are subject to certain additional terms and conditions set forth in the Plan. A copy of the Plan is on file with the Secretary of the Corporation and by acceptance of this Award Agreement the Participant agrees to and accepts this award subject to the terms of the Plan.

Dated: _____

ABC CORPORATION

By: _____

Title: _____

Dated: _____

PARTICIPANT:



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