STOCK OPTION

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STOCK OPTION: ANALYSIS OF COMMERCIAL TERMS

The term stock option is, in free translation, a shareholding option. In a better definition, it is a form of gratification granted to employees, key collaborators, or people who contributed or will contribute to the company's growth; offering an option to acquire an interest in the company (shares, shares, units in the company directly advised by this employee, or in an entity of the economic group to which this company belongs), in accordance with the company's valuation.

In general, founders opt for the stock option as (i) a form of incentive, motivating their employees to employ their efforts in the company's growth – and not just comply with "their schedule and punch the clock" - allowing their team to be "owner" of the company together; and (ii) a way to reward people who bet or dedicate themselves to the company before the business manages to remunerate people financially (the classic example is developers who are motivated to develop tech-house software, for a lower remuneration than the usual, in the initial stage of the startup, when the company still does not have the cash to fully invest its resources, in exchange for the granting of a stock option).

BENEFITS

The main advantage of implementing a stock option policy in your company is to consolidate a culture of business owners in your team, as employees begin to absorb more directly the value generated by their work in the company's results. company.

In other words, the stock option allows the employee to become a partner in part of the company, with a discount on the valuation.

In this way, the stock option policy provides a greater alignment of interests for the entire organization, combining the founders' trust and willingness to bring their employees on their side, with the employees' desire for the company's success.

We can even discuss whether a rocket does not have a reverse gear, but it certainly must have gasoline – and employee motivation is the fuel of every company.

The proposition of partner status also implies some similar rights reserved to any partner (and which, in general, stock option policies guarantee to their beneficiaries), such as the right to receive dividends in cases of distribution (after the exercise of the option, according to section 5 of this Publication) and receive the gain from the sale of its participation (if exercised) in exit events, such as IPO or M&A.

And just like bitcoin, politics, and football, this is a topic that everyone thinks they understand everything about. But do they? Here we have prepared a small glossary with the main terms and concepts used in stock option plans and contracts for those who intend to apply them in its company:

CLIFF

Cliff is the barrier, the abyss (of time) that the beneficiary must cross so that part or all his option can be fully exercised.

It is established as the minimum time that the beneficiary of the option must remain providing services to the company, to ensure that the stock option is valid only when the employee has remained the minimum time to have added value to the company.

It cannot be confused with vesting, as the cliff is the time frame from which the vesting period begins to flow.

The common are 12-month cliffs, but it is something negotiated and can be adapted to the reality of each company.

VESTING

It is the period in which the option (or parts of the option) become eligible for exercise by the beneficiary.

It is only after vesting that the option becomes part of the beneficiary's equity, for tax purposes, even if the option has not been effectively exercised yet.

Such periods may be by tranches. Something common to find in stock option plans is the acquisition of partial vesting of a portion of the option monthly. For example: the beneficiary, every month, “vests” approximately 2% of his option.

Another provision – this one is a little less common in Brazil, at least – is to establish a specific exercise period for each vesting period. For example: the beneficiary will have 4 vesting periods throughout the term of their contract. Each vesting period reached triggers an independent deadline, which will run in parallel with the deadlines of the other vestings. The common experience is that even though it may generate some discomfort with certain beneficiaries, who may claim that they “missed” the exercise period due to the more complicated nature of this dynamic, many founders adopt such clause, as it guarantees greater control over the amount of participation to be paid. be issued to its employees – preventing many portions of options, accumulated over long vesting periods, from being exercised at once by several employees.

EXERCISE

This is D-Day. Exercise is the act in which the beneficiary executes its option (totally or partially, as per Item 4 above of this Publication), acquiring the portions of stock vested to which it is entitled. As stated above, the beneficiary, in general, is not obliged to acquire his share as soon as the respective vesting is reached. What happens in practice is that the vesting starts the exercise period (which can vary from 5 to 10 years).

EXERCISE AND GRANT PRICE

These are two of the disbursements that the beneficiary must make for the entry and execution of his stock option. It is a common confusion between founders and beneficiaries, since they have different rights (the right to have the option and the right to acquire the stock of the option), they result in two different values.

The grant price, or also called the reserve price, is the price to guarantee your right to the option. This amount has several practical implications, but the main ones are: (i) the removal of the characterization of the option given free of charge as a donation, which has specific fiscal consequences; and (ii) the removal of the hypothesis of recognition of the option as part of the employee's remuneration, which has specific labor and social security consequences.

Upon exercise of the option, as per Item 5 above of this Publication, the beneficiary must pay the exercise value, which is the disbursement for the payment of the equity interest. The valuation metrics and discounts defined between the company and the beneficiaries in the stock option contracts entered at the time of granting the option are applied to this value.

TERM OF THE PLAN

It is the time when the option is valid. It should not be confused with the cliff and vesting deadlines, as better detailed in the respective items of this clause above this Publication.

BUYBACK OPTION

It is the mechanism for the stock granted and exercised by the beneficiaries to return to the company. On certain occasions, although the option already exercised, it is not in the best interest of the company to keep the stock in circulation or in the possession of certain people, such as, for example: (i) death or permanent disability of the beneficiary, when meaning, for the organization's dynamics, to maintain the undetermined number of heirs, curators and administrators with participation in the company's capital stock; (ii) misconduct by the beneficiary, who practices acts of undeniable gravity that may affect the company's image and operation; and (iii) when the stock held by the beneficiary suffers any constriction, by decision of a public authority or in the context of a judicial or arbitration process.

Each of these hypotheses above, the others defined in the stock option program, may have a different price, discount and/or payment mechanism for the repurchased stock.

VESTING ACCELERATION

Sometimes, it is in the interest of the company and the beneficiary itself, to advance the exercise of the option, since waiting for the vesting periods to progress can block or delay some liquidity events, which are the famous moments of exit: IPOs (Initial Public Offers, or “IPO”, when the company “opens its shares on the Stock Exchange market” and M&A operations (when there is a substantial sale of the company's share capital or assets), a moment in which all partners and investors (including beneficiaries who were accelerated in their vesting) are able to liquidate their equity interest in the company.

Our recognitions

Análise Advocacia (2021)

Chambers & Partners Brazil (2021 & 2022)

Leaders League (2021 & 2022)

Transactional Track Record (2021 & 2022)

The Legal 500 (2022)

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