

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



Welcome to the first Orrick Global Equity Report which will be published every quarter. As this is our first edition, we were excited to get it to you, so are publishing it even before the end of Q1 2011!

The purpose of this quarterly report is to assist U.S. multinational companies that make grants of equity incentives overseas to be timely alerted to new tax and legal developments which may significantly affect grants. Our Compensation & Benefits group is comprised of equity compensation specialists on both the U.S. and non U.S. fronts. We have blended both of these areas of expertise to bring you this report. We know that you may not have a lot of time, so we're not going to bog you down with every detail, just the information you really need to know to figure out your "next steps." We welcome any input or feedback regarding the format or content of our Global Equity Report that you may have and look forward to sending you our alerts on a quarterly basis.

Significant Tax and Legal Developments outside the U.S.

Denmark **Danish Supreme Court Rejects Reduction of Option Exercise Period in Change in Control**

In a recent ruling, the Danish Supreme Court held that an employer did not have authority to reduce the exercise period of outstanding stock options following a change in corporate structure. In this case, a U.S. parent company granted stock options to employees of its Danish subsidiary. There was a change of control triggering event and pursuant to the terms of the option agreement, the company argued that the post-termination exercise period was triggered and that the employee only had a certain period of time to exercise the option. However, the Court determined that the provisions in the stock option agreement were not clear as to the consequences of a change of control (as many are not) and therefore, they held that the exercise period should remain unaffected as a result of the change in control.

Although the Court did not decide whether such change of control clauses are invalid as a matter of law, the judgment confirms a generally employee-friendly stance in Denmark when it comes to forfeiture and continued vesting provisions. Therefore, change of control clauses that reduce an applicable exercise period or otherwise could have a potentially negative effect on option holders should be reviewed carefully, narrowly drafted, and presumed to be read in favor of the employee.

France **Possible New Withholding Requirements**

We will skip updating you on the increases in rates for tax-qualified stock options and restricted stock units ("RSUs") as these changes were made at the end of 2010 to be effective January 1, 2011. If you are not already aware of these changes, please feel free to contact us and we will provide you with the current rates of employee and employer social charges for French qualified awards.

As to a more recent development, the French tax authorities will start imposing employer withholding requirements for non French tax residents on qualified awards effective April 1, 2011. As no tax is generally due until the shares are sold for qualified awards, this requirement will impact how shares are tracked and held by the company's stock broker and how sales proceeds are distributed. We strongly

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



recommend that companies discuss this change with their broker to ensure that appropriate procedures can be set up to comply with this new requirement.

Ireland

Social Insurance Contribution Changes: Some Grandfathering Now Possible

As you may be aware, under new tax legislation effective as of January 1, 2011, equity awards offered to employees in Ireland are now subject to social contributions ("PRSI") for both the employer and employee. Generally, the PRSI rate for employers is 10.75% and the employee rate is 4% (both uncapped). The employer portion may not be passed through to the employee (as is allowable in the UK).

Neither the 2011 Budget nor the Finance Bill (which enacts the budget) provided for any grandfathering provisions for any awards granted prior to January 1, 2011. However, on March 18th, the Minister for Finance issued welcomed guidance that grandfathering would be available for awards for which there is a written agreement in place between the employer and employee prior to January 1, 2011. It is unclear about whether if a grant was made but was not yet papered or was papered but not signed will qualify under this grandfathering provision. Our contact in Ireland is on an advisory committee to the tax authorities discussing these new provisions with the Irish tax authorities and from his discussions, he thinks that provided there was a binding agreement/ entitlement to the grants as of January 1, 2011, the grandfathering likely applies as the employee would likely be able to argue that he or she is entitled to the grant. Therefore, provided the grants were communicated to employees as of January 1, 2011, the grandfathering likely applies. If the grants were made prior to January 1, 2011, but had not been communicated/ promised to employees by this date, the rules are less than clear, but the spirit of the guidance was certainly to provide grandfathering for grants made prior to January 1, 2011.

If you withheld/ paid PRSI on awards that were granted prior to January 1, 2011, it is possible to seek a refund for the amounts paid.

Also, another change made in the 2011 Budget was to impose a new employee paid tax ("Universal Social Charge") on taxable income, including income from equity awards, generally at a 7% rate. There is no grandfathering for this tax.

As was previously announced, new withholding requirements also apply after January 1, 2011. There continues to be some uncertainty regarding what equity types are subject to withholding for income tax and/or social contributions, but for now it appears that income tax, PRSI (if applicable), and the new employee Universal Social Charge ("USC") should be withheld by the employer in relation to RSU and ESPP income. For stock options, however, no withholding of income tax or USC applies, although the employer should still withhold PRSI (if applicable). The employee should pay income tax and USC on stock option income directly to the tax authorities within 30 days of the taxable event (i.e., exercise).

Please keep in mind reporting for equity awards is due by March 31st of each year for the prior calendar year.

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



Japan Proposed Amendment to Liberalize Securities Filing Requirements

As you many know, under Japanese securities law, offers to purchase shares such as stock options and ESPP rights offered to 50 or more individuals in Japan within a 6-month period are considered public offerings. Such public offerings are generally subject to stringent filing and reporting requirements (depending on the offering value), including a Securities Registration Statement, as well as regular and fairly burdensome financial reports.

Under the current rules, there is an exemption from the above filing requirements for offers of securities to the Japanese employees and directors of an issuing company or a wholly-owned subsidiary. Unfortunately this exemption is available only when there is no intervening company between the issuer and the Japanese subsidiary.

However, the Japanese securities regulator has recently proposed to extend the scope of this exemption. It is considering amending the exemption such that it would extend also to offers made to employees of a wholly-owned subsidiary of a subsidiary of the issuer (i.e., a “grandchild” or 2nd tier sub). It is also possible that directors who receive offers granted under this exemption would then be excluded from the headcount for purposes of calculating whether a public offering has been made.

Although still only under consideration, it is perhaps a sign that the Japanese securities authorities may be loosening some of its restrictions. There is not yet any timeline for deliberation, but if your company is currently subject to securities filing requirements in relation to offering stock option grants or an ESPP (or if you would like to consider making such offers) to the Japanese employees of a wholly-owned indirect subsidiary, there may be hope on the horizon.

Russia Russia Changes to Taxation of Stock Options Unclear

Effective January 1, 2011, the Russian Tax Code was amended with respect to the taxation of financial instruments including stock options and ESPPs. Although the intent of the changes does not seem to be to start taxing these incentives at grant, under a strict reading of the new provisions, this may be the outcome. Specifically, in December 2010, the Federal Service for Financial Markets adopted a decree setting forth methods for determining the value of unlisted financial instruments, including stock options and ESPP rights that cannot be publicly traded. Previously, unlisted financial instruments were taxed as material income when exercised and converted into shares under Article 212 of the Tax Code. As a result of this decree, it looks like stock options and ESPP rights are caught under the provision that includes all unlisted financial instruments and therefore, taxed at grant. However, as the legislative history of this decree does not evidence any discussion or intend to start taxing employee stock options and ESPP rights at grant, we are hopeful that the Russian tax authorities will issue guidance (or respond favorably to tax ruling requests) providing a “carve out” for these types of employee benefits. Nonetheless, even if the Russian tax authorities do not provide such a “carve out,” Russian law recognizes a principle prohibiting taxation of the same income twice so employees should not be subject to tax on the amounts already

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



taxable at grant at the time of exercise (options) or purchase (ESPP rights).

Until this uncertainty is resolved, companies that are offering stock options and ESPPs to employees in Russia should (at a minimum) inform employees of the uncertainty as there is generally no employer tax withholding or reporting obligation for stock options or an ESPP offered by a U.S. parent company to employees of its subsidiary in Russia. It is the employee's responsibility to report and pay applicable taxes for stock options and ESPP rights.

United Kingdom

New Budget and Changes to PAYE Codes

The UK Budget for 2011 proposes some changes that will affect stock awards offered to employees in the UK including the rates of income tax (i.e., the highest rate of 50% will be revisited and the lower tax bracket limit will be increased). In addition, there is a proposal to combine income tax and national insurance contributions into one tax; although, this convergence probably would not occur for a few years to come. In addition, changes are proposed to be made to the taxation of mobile employees including increased charges for remittance based taxpayers and also the introduction of a "statutory residence" test with the intent of making taxation of mobile employees in the UK more straightforward.

Another budget proposal is the adoption of additional "anti avoidance" legislation aimed at employers using third party arrangements to avoid defer or reduce tax payable on benefits provided to employees. Not clear if these rules could apply to employee stock plans, but we imagine that they do as anti-avoidance provisions are usually broadly drafted. However, the fact that the plan administrator/broker is a third party involved in the payment of the benefits to employees does not mean that this arrangement was created to defer or reduce taxes paid and the only types of programs in the UK that avoid or defer taxes are generally the ones that are specifically approved by the UK Revenue. The Finance Bill that will set out more detailed information about these rules is expected to be published this week. These new rules are effective April 6, 2011.

We will keep you posted on developments for the 2011 Budget as the budget progresses to implementation. (The UK tax year runs from April 6th through April 5th of each year.)

Also, recently, there have been changes in applying PAYE codes in certain circumstances where the basic rate of 20% was previously allowed. Such changes are effective as of April 6, 2011. The situation in which using the basic rate comes up most frequently for our clients is for terminated employees for which a Form P45 has been issued. We recommend checking in with local payroll in the UK to ensure that they are aware of the changes in PAYE code rules as these changes not only impact withholding rates for equity incentives, but also all types of income and ensuring that your plan administrator/ broker is informed of the correct rates to use.

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



Venezuela Exchange Controls Get More Stringent, But There Are Workarounds

As most of you are aware, the exchange controls in Venezuela significantly changed in May 2010 and such exchange controls generally prohibit employees in Venezuela from purchasing shares of stock in a foreign company with local currency (Bolivars). If awards offered do not require the employee to pay for the shares (which is generally the case for RSUs and stock options limited to cashless sell all exercises), these exchange controls should not impact offering such awards. A traditional 423 style ESPP will run afoul of these exchange controls. However, prior to shutting down your ESPP in Venezuela, we advise that you consider other alternatives and ways that the ESPP may be offered which do not run afoul of these exchange controls as there are potential labor law implications with shutting down an ESPP in Venezuela. Recently, we have been successful in helping a U.S. multinational company to work out the details of keeping their ESPP up and running in Venezuela by making a few changes to the normal operation of their ESPP.

From the Desks of Our U.S. Compensation and Benefits Experts

Our U.S. compensation and benefits experts have been closing monitoring proxy season this year and working with companies to help them through the many choices/ strategies for proxy disclosures. As you may have heard, Hewlett-Packard recently became the fourth company to fail to receive majority support for its say-on-pay, with 48% voting in favor. As a result, it is becoming very clear that companies really need to manage institutional investors and obtain their support and approval of the company's executive compensation program. Items to be mindful of in obtaining a "yes" vote include:

- How to deal with sometimes erroneous ISS reports
- How to craft the CD&A to ensure that the proper points and overall message is conveyed to company shareholder in an effective "Executive Summary"
- How to identify poor pay practices and how the company can avoid them or get rid of them
- What the company should recommend on say on pay vote frequency (annual, bi-annual, tri-annual or no recommendation)
- How to get a "yes" vote on the refresh of the company's employee equity plan and avoid a withhold vote on board members and, in particular, compensation committee members up for reelection

Our U.S. Compensation and Benefits experts are happy to help with these issues and have been offering complimentary workshops focusing in on these issues for some local clients. If your company may be interested in receiving training/ assistance in this regard, please contact Jonathan Ocker, head of Orrick's Compensation and Benefits group, (contact information below).

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



Upcoming Events/ Client Resources

Upcoming Events/Where to Find Us:

- April 26th - 29th: E*Trade Directions Conference: Jennifer George speaking on Top Trends and New Developments in Global Stock Plans
- May 12th: Northern CA GEO ½ Day Event: Christine McCarthy and Jennifer George speaking on Hot Topics in Equity Compensation: U.S. and Beyond!
- June 15th – 17th: GEO Annual Meeting (Amsterdam): Laura Becking speaking on "EU/EFTA Based Issuers: Managing Culture, Compliance And Communication Between EU/EFTA And The U.S." and Jennifer George speaking on "Comparing Common Equity Instruments From A Global Perspective"
- July (date to be determined): NASPP Denver Chapter Meeting: Jennifer George to be speaking on a global equity topic to be determined
- September 14th – 16th: National Equity Compensation Forum in Scottsdale, AZ: We will have a booth, a hospitality suite and a timeslot at the technology showcase (to show you our innovative online compliance platforms for international corporate and global equity compliance); also may be speaking
- November 1-4th: We will be attending the annual NASPP conference in San Francisco: We will be announcing where to find us there after details have been finalized

Helpful Resources:

Although you may be tired of hearing about China SAFE filings, there still appears to be quite a bit of interest in this topic. And we know some of you may not have registered with SAFE yet (not mentioning any names!). If you are one of them, we have a workbook for preparing for and completing your China SAFE registration that we are happy to share with you.

Good Deals on Conferences:

- **ShareComp 2011:** Even though the live portion of the conference is over, ShareComp is live and available until February 2012. You can log in at any time and listen to presentations, download materials and even chat with people online who may be there too. If you didn't register to attend, it is not too late. Registration is free. Just e-mail Annie Piggins at apiggins@orrick.com to obtain log in information.
- **National Equity Compensation Forum 2011** (September 14-16th in Scottsdale, AZ): We are excited to be founding sponsors of this event which was organized by the Global Equity Organization to be an annual conference entirely focused on U.S. company issuers. As part of our Topaz level sponsorship; we can extend a

The Orrick Global Equity Report: 2011 Q1

March 29, 2011



15% discount off registration to our clients and friends. Please e-mail Annie Piggins for information on taking advantage of this discount.

Contact Us:

If you would like to discuss any of the above or if you have questions regarding employee equity or other compensation and benefit matters in any country around the world, please feel free to contact us.

Primary Global Equity Contacts:

Jennifer George, Partner, San Francisco Office, jennifer.george@orrick.com 415 773 5640

Laura Becking, Of Counsel, New York Office, lbecking@orrick.com 212 506 5113

Our Other Compensation and Benefits Partners:

Jon Ocker, Partner, Head of Compensation and Benefits Group, San Francisco Office, jonocker@orrick.com 415 773 5595

Juliano Banuelos, Partner, San Francisco Office, jbanelos@orrick.com, 415 773 5961

Bill Berry, Partner, San Francisco Office, wberry@orrick.com, 415 773 5519

Nancy Chen, Partner, Silicon Valley Office, nchen@orrick.com, 650 289 7128

Sarah Downie, Of Counsel, New York Office, sdownie@orrick.com, 212 506 5234

Christine McCarthy, Partner, Silicon Valley Office, cmccarthy@orrick.com, 650 614 7634

* * * * *