



## Repricing Underwater Stock Options

When the value of a company's equity has declined since the issuance of stock options, causing the options to be considered underwater and the options no longer provide the intended incentive, companies often consider repricing the options.

This may be accomplished by amending the option agreements to reset the exercise price (but not below current fair market value), or by cancelling the existing options and issuing new options. The repricing may be applied to all outstanding underwater options, or may be limited to specific individuals or groups of employees.

Unless required by the term of the company's stock option plan, reducing the strike price of the options would not require the consent of the optionee, nor would it be necessary for a privately-held company to obtain shareholder approval of the repricing. Different shareholder approval rules apply to public companies.

Additional terms and conditions might be included in the amended or replacement options with the agreement of the affected employees. For example, a company may use the repricing of a stock option as an opportunity to add or modify the vesting schedule reflected in the original option. Changes requiring the consent of the optionee may raise securities law considerations that are beyond the scope of this article. The new or amended options may retain the expiration date of the original option, or set a new expiration date (e.g., 10 years from the date of the repricing; five years in the case of greater than 10% shareholders).

While the repricing of a nonqualified option may be treated as an amendment of the original option, the rules are different for Incentive Stock Options (ISOs). The modification of an ISO that benefits the optionee is treated as the grant of a new option. A repricing is considered to be such a modification. The date of grant of the

option affects a number of provision applicable to ISO's. For example, one prerequisite for the beneficial tax treatment applicable to ISO's is that the option shares be held for at least two years from the date of grant. If an ISO is repriced, this two-year holding period starts anew.

An optionee may wish to decline an offered change, for various reasons. No modification is deemed to have occurred solely because a company offers to change the terms of the option if the optionee does not accept the change, unless the offer remains outstanding for 30 days or more. An inadvertent modification may be reversed before exercise of the option or, if earlier, before the last day of the calendar year.

The repricing of an ISO also may have other unintended consequences. For instance, in order to qualify for ISO tax treatment, the maximum fair market value (determined as of the date of grant) of options that first become exercisable in any calendar year is limited to \$100,000. Repricing an ISO may cause this limit to be exceeded. In recalculating this limit, both the old and new options are counted in the year of repricing.

Although repricing options can trigger many complicated technical considerations, repricing may be an effective means of reinvigorating the incentive provided by options that are now underwater.

This blog was drafted by [Stephen Rickles](#), an attorney in the Spencer Fane Denver, Colorado office. For more information, visit [www.spencerfane.com](http://www.spencerfane.com).