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FARALLON LAW GROUP NEWSLETTER

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Stock Option Vesting

Start-up company clients often ask about vesting periods for stock option grants to founders, employees, directors and consultants. Stock options are almost always subject to vesting by which optionees "earn" options based on their length of service or achievement of specified milestones. Certain industry standards for stock option vesting exist:

➢ **Standard Vesting Periods**. Employees will usually vest commencing on the start of their service and continuing over 4 years (1 year cliff vesting, with monthly vesting over the ensuing 3 years).[1] In essence, optionees vest in ¼ of the grant amount on their 1 year anniversary and the remaining ¾ vests ratably thereafter (i.e., 1/36th each month). Directors and advisors will often receive annual grants that cliff vest after one year of service.

➢ **Milestones Vesting**. Vesting can be subject to achieving milestones such as beta product launch, meeting sales targets, revenue growth, etc. Milestones can be based on individual or company performance but should be clearly delineated in every case.

➢ **Acceleration on Termination**. Senior executives may be able to negotiate provisions providing for accelerated vesting on either (i) an involuntary termination "without cause" or (ii) voluntary termination with "good reason." The scope of these reasons should be very clearly defined. The amount of acceleration varies (e.g., 50% or 100% of the unvested amount vests automatically, the optionee receives one additional year of vesting, etc.).

➢ **Acceleration on Change in Control**. Senior executives may also seek accelerated vesting on a change in control, such as a sale of the company- often called "single trigger" acceleration. Companies are hesitant to agree since it reduces a key employee's incentives to continue with the company after an acquisition (unless additional equity is offered), which may be critical to the acquiror. The more common "double trigger" acceleration requires a change in control AND termination within a specified period thereafter. Note that double trigger acceleration, by itself, doesn't protect against termination immediately prior to an acquisition. Again, the amount of acceleration varies.

➢ **Fully-Vested on Grant**. There are circumstances where the optionee should receive a fully-vested grant. Most often this occurs with a consultant who has already fully performed the required services.

Please feel free to contact Boris Lieberman or Mario Kashou if you have questions or concerns about stock option vesting or the specific terms of a stock option grant.

[1] Founders will usually own restricted shares which are subject to repurchase which lapses over time- the same effect as vesting. Founders will typically get credit for prior service and "vest" from the actual commencement of service which will predate the formation of the company.