Dechert LLP

Equity incentives: understanding single and double triggers

Share options and other equity incentives are often issued to directors and senior employees of private companies as performance incentives. Here, Thomas Clarke of Dechert LLP explains the differences between single and double trigger vesting structures and discusses what they mean for managers.

Equity incentives are an effective way to align the interests of a private company's managers with those of its investors. As a result, they are a common feature in UK private companies backed by venture capital or private equity, and equity participation can be an important component of a manager's compensation.

When equity incentives are awarded, the terms of the grant document generally specify certain criteria that must be met for the economic benefit of the incentives to accrue (or "vest") to the individual manager. For example, the incentives tend to vest over a defined period. A manager who voluntarily leaves the company before the end of this vesting period will be likely to lose at least the unvested portion of the incentives.

Sometimes, this vesting may be accelerated – that is, some or all of the incentives will vest before the original vesting period is over – as a result of one or two trigger events relating to the company or the individual.

Single trigger vesting

This is where the vesting is brought forward if one event occurs. Usually, that event is the sale of the company, or a transaction that realises the value of most of the company's assets.

Single trigger vesting is rare in the UK. Clearly, it is attractive for the managers (usually founders or key management), who might argue that their incentives should be focused on achieving an exit, especially ahead of schedule. However, investors generally don't like single trigger vesting. After all, a buyer may well question whether it will be too costly – or even possible – to retain and motivate these managers once the deal is done, and that will in turn make the company less attractive as a target.

Double trigger vesting

This is where vesting is brought forward only if two events both occur. Usually, these triggers will be the sale of the company and the termination of the manager's employment "without cause" – in other words, where the manager has not committed a "bad act", such as a material breach of their employment agreement. If a sale occurs part way through a vesting period and double trigger vesting applies, any vested incentives are normally paid straight away. However, any unvested incentives will continue to vest on the original schedule unless the second trigger occurs and causes accelerated vesting.

Double trigger vesting is more common in the UK market, as it strikes a compromise between rewarding the individual for a successful exit and continuing to incentivise performance after the transaction.

From the manager's perspective, double trigger vesting often represents a fair result: you still have the chance to earn further equity incentives; but, if you are dismissed without cause, the acceleration occurs and so you don't lose the opportunity for further vesting. This can be particularly important for a manager who is worried about being dismissed as the company is integrated into the buyer's group.

Whether single or double trigger vesting is used, the structure of equity incentive schemes is nuanced from both a legal and tax perspective, and not "one size fits all". Managers may wish to seek advice so that they understand the terms of the particular scheme and what that may mean for them in future.

Contact us

Robert.Darwin@dechert.com