

## **ESOPs in India: Everything You Need to Know About Employee Stock Option Plans (Companies Act, 2013)**

Employee Stock Option Plan (“ESOP”) is a popular medium for companies to attract and retain talent, and align the interests of employees with that of shareholders. In India, for private limited companies and unlisted public companies, the regulatory framework for ESOPs is governed by Section 2(37) and Section 62(1)(b) of the Companies Act, 2013 (“CA, 2013”) and Rule 12 of the Companies (Share Capital and Debentures), 2014.

According to section 2(37) of the CA, 2013, ESOP is an option granted to directors, officers, or staff members of a company, which includes its holding company, or subsidiary company or companies, if any, giving them the advantage or right to subscribe to or buy the company’s shares at a predetermined price at a later date.

### **Eligibility criteria for ESOP**

#### ***Eligible Employees***

ESOPs can be granted to permanent employees and directors (*whether whole-time or not*) except independent directors of a company, its holding company, or subsidiary companies. This includes permanent employees working in or outside India as per the ESOP policy of the company.

#### ***Restrictions on eligibility of certain employees***

Certain individuals are not eligible for ESOP, such as promoters, those belonging to the promoter group, and director(s) who hold more than 10% of the outstanding equity shares of the company either himself or through his relative or through body corporate whether directly or indirectly.

However, these restrictions do not apply to startups, defined under notification GSR 127(E) dated February 19, 2019, issued by the Department for Promotion of Industry and Internal Trade.

### **Stages of ESOPs**

***Grant of Option-*** Grant of option is issuance of options by a company in terms of pre-approved ESOP scheme to its eligible employees.

***Vesting of Option-*** It is the process by which the eligible employees to whom options had been granted, become entitled to receive the benefits from such grant. As per CA, 2013, there should be a minimum period of 1 (one) year between the grant of an option and the vesting of such option.

***Exercise of Option*** - It is the process by which employees avail the benefits of option by making application for issuance of shares. The companies shall specify the period within which the employees can exercise the vested options.

The company may specify lock-in period for the shares issued to employees pursuant to exercise of the option.

***Expiration Date-*** This specifies the due date by which options can be exercised by the employees else the option expires.

### **Process for issue and administration of ESOP**

- ***Resolutions and mandatory disclosures***

The issuance of ESOP by an Indian company requires the approval of its Board of directors as well as the approval of its shareholders. An ESOP scheme so prepared shall be approved by the Board in their meeting and the shareholders of the company in its general meeting through a special resolution.

However, in case of a private company, an ordinary resolution to approve ESOP scheme would suffice.

In addition to the approval for granting of ESOPs, separate shareholders' approval shall be required in the following scenarios:

- a) grant of option to the employees of subsidiary or holding company; and
- b) grant of option to identified employees, during any one year, equal to or exceeding 1% (one percent) of the issued capital of the company at the time of grant of option.

The necessary disclosures with respect to an ESOP scheme, such as options granted, options vested, options exercised, exercise price, money realized, shall be disclosed in the Board's report of the company issuing ESOPs.

- ***Filings for issuing ESOP***

E-form MGT-14 for filing the special or ordinary resolution, as the case may be, would need to be filed with the Registrar of Companies within 30 days from the date of approving such resolution.

- ***Conditions for issuing ESOP***

The conditions required to be complied with for issuing ESOP, *inter alia*, include the following:

- a) **Lock-in period-** The company may specify the lock-in period for the shares issued pursuant to the exercise of option.
- b) **Dividends and voting abstention-** The employees do not have any right to receive any dividend or to vote or in any manner enjoy the benefits of a shareholder in respect of option granted to them, till the time shares are issued on exercise of options.
- c) **Prohibition on transferability-** The option granted to employees shall not be transferable to any other person.
- d) **Prohibition on creation of charge etc.-** The options granted to the employees are not allowed to be pledged, hypothecated, mortgaged, or otherwise encumbered or alienated in any other manner.
- e) **Exclusive exercise rights-** Only the employees to whom the option is granted shall have the right to exercise the option. However, in case of the death of an employee while in employment, all the options granted to him till such date would vest in the legal heirs or nominees of the deceased employee.
- f) **Permanent incapacity-** In case an employee suffers a permanent incapacity while in employment, all the options granted to him as on the date of permanent incapacitation, shall vest in him on that day.
- g) **Resignation or termination-** In case of resignation or termination of employment, all options granted to the employee but not yet vested as on that day shall lapse. However, the employee can exercise the options granted to him which are vested within the period specified in this behalf, subject to the terms and conditions under the scheme granting such options.

- ***Register of ESOP***

The company issuing ESOPs shall keep details of the ESOPs granted to the company's employees in a "Register of Employee Stock Options" in **Form SH-6** which would be maintained at the registered office of such company or any other place as the Board may decide.

### **Conclusion**

In conclusion, ESOP provides a sense of ownership to employees and right to participate in the growth and profit of the company. This serves as a motivational aspect to the employees which may generate astounding returns for the company and in turn benefit the employees.

***Disclaimer: This publication is not intended to cover all the aspects of those referred to herein and is only based on the understanding with respect to Employee Stock Option Plan under the Companies Act, 2013. This publication has been prepared for information purposes only and should not be construed as legal advice.***

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