

Phantom Unit Award Agreement

A Practical Guidance® Annotated Form by Doreen Lilienfeld, Gillian Emmett Moldowan, and Matthew Weston, Shearman & Sterling LLP



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Summary

Use this form phantom unit award agreement to grant phantom stock units to an employee or other service provider under a phantom plan. This form includes practical guidance, drafting notes, and alternate clauses.

Phantom plan awards may either provide for full-value awards or appreciation-value awards. For full-value award plans, the amount of the cash payment for each phantom unit equals one unit of the company's applicable equity interests (e.g., one share of common stock). Phantom plan appreciation-value awards typically provide for a cash payment for each phantom unit that is equal to the value of one share of stock (or other equity interest) minus a threshold amount, typically the value of one share as of the grant date. This form contains alternate clauses so that it can be used for a full-value award plan or an appreciation-value award plan.

For an accompanying plan, see [Phantom Stock Plan \(Private Company\)](#). For additional related information and resources, see [Equity Incentive Plan Resource Kit](#).

[PLAN NAME] PHANTOM UNIT AWARD AGREEMENT

This Phantom Unit Award Agreement (this “**Agreement**”) is made by and between [company name] (the “**Company**”), and Participant identified below (the “**Participant**”) pursuant to the [plan name] (the “**Plan**”) and shall be effective upon the Participant’s acceptance of the Phantom Units by signing below. Unless otherwise defined herein, the capitalized terms used but not defined herein shall have the meanings ascribed to them in the Plan.

Drafting Note to Introductory Paragraph

The defined terms used but not defined in this form include “Phantom Unit” and “Payment Event.” See [Phantom Stock Plan \(Private Company\)](#).

In consideration of the mutual covenants and representations set forth below, the Company and Participant agree as follows:

Name of Participant: _____

Grant Date: _____

Number of Phantom Units: _____

1. Grant of Phantom Units.

- (a) **Grant of Phantom Units.** Pursuant to the terms and subject to the conditions set forth in this Agreement and the Plan, the Company hereby grants to the Participant, and the Participant hereby accepts the grant, as of the Grant Date, of the number of Phantom Units set forth above.
- (b) **Vesting.** Subject to the terms of the Plan, the Participant’s Phantom Units shall be unvested as of the Grant Date and shall vest as to [percentage]% of the total number of Phantom Units on each of the first [number, e.g., three or four] anniversaries of the Grant Date, subject to the Participant’s continued employment with the Company and/or its subsidiaries and affiliates through each vesting date.

Drafting Note to Section 1.(b)

Phantom stock awards generally vest over time based on continued employment with the company. Common vesting schedules include a three-year or four-year cliff vesting schedule (see First Alternate Section 1.(b)) or incremental annual vesting over a period of years (as provided in the default clause). Monthly vesting is generally not ideal because each vesting date triggers a Federal Insurance Contributions Act (FICA) tax for the recipient and, in the case of regular time-vesting events, the recipient does not receive payment for his or her phantom stock upon such vesting date. This results in the recipient coming out of pocket to pay the FICA tax. Further, in the private equity space, portfolio companies often grant awards that vest only when an exit event occurs, such as a change in control or initial public offering of the company. See Second Alternate Section 1.(b) for a vesting-upon-payment-event provision.

First Alternate Section 1.(b):

(b) Vesting.

Subject to the terms of the Plan, the Participant’s Phantom Units shall be unvested as of the Grant Date and shall vest in full only upon the [ordinal number, e.g., third or fourth] anniversary of the Grant Date, subject to the Participant’s continued employment with the Company and/or its subsidiaries and affiliates through each vesting date.

Drafting Note to First Alternate Section 1.(b)

Common vesting schedules include a three-year or four-year cliff vesting schedule (as provided in this First Alternate Section 1.(b)) or incremental annual vesting over a period of years (as provided in default Section 1.(b)). See Second Alternate Section 1.(b) for a vesting-upon-payment-event provision. For additional guidance, see the Drafting Note to default Section 1.(b).

Second Alternate Section 1.(b):

(b) **Vesting.**

Subject to the terms of the Plan, the Participant's Phantom Units shall be unvested as of the Grant Date and shall vest in full only upon the occurrence of a Payment Event, subject to the Participant's continued employment with the Company and/or its subsidiaries and affiliates until such event.

Drafting Note to Second Alternate Section 1.(b)

This language provides for vesting only upon occurrence of a payment event. Common alternatives are a three-year or four-year cliff vesting schedule (as provided in this First Alternate Section 1.(b)) or incremental annual vesting over a period of years (as provided in default Section 1.(b)). For additional guidance, see the Drafting Note to default Section 1.(b).

- (c) **Payment for Units.** Subject to the terms of the Plan, upon a Payment Event, the Participant shall receive a cash payment equal to: (x) the number of vested Phantom Units held by such Participant, multiplied by (y) the Per Unit Company Value (as defined below). The payment shall be made within forty-five (45) days after the Payment Event, and all of such Participant's vested and unvested Phantom Units shall terminate upon the payment, and the Participant shall have no further rights in respect of the Participant's Phantom Units. For purposes hereof, the **"Per Unit Company Value"** means, as determined by the Board in its sole discretion, an amount equal to, at any given time (i) the equity value of the Company (which, at the time of the consummation of an Exit Event, may be determined by the cash proceeds received by the Company in such Exit Event), divided by (ii) the sum of (A) the number of outstanding [shares, units, OR other equity interest denomination] of the Company's [type and class of equity interest to which phantom units relate] on a fully diluted basis, plus the number of outstanding Phantom Units. Any payment due to a Participant under this Section 1(c) shall be subject to the execution and nonrevocation of general release of claims, in a form provided by the Company, and continuous compliance with any restrictive covenant agreement or other agreement entered into between the Participant and the Company or its subsidiaries and affiliates.

Drafting Note to Section 1.(c)

This payment provision is for a plan that provides for full-value phantom awards where the amount payable for each phantom unit is based on the value of one share of company common stock (or other equity interest of the company). For a phantom plan that provides for awards based on the increase in value of the stock (or other equity interest) relating to the phantom units, use Alternate Section 1.(c).

Alternate Section 1.(c):

(c) **Payment for Units.**

Subject to the terms of the Plan, upon a Payment Event, the Participant shall receive a cash payment equal to: (x) the number of vested Phantom Units held by such Participant, multiplied by (y) the Per Unit Company Value, less the Participation Threshold of the Phantom Units (as such terms are defined below). The payment shall be made within forty-five (45) days of the Payment Event, and all of such Participant's vested and unvested Phantom Units shall terminate upon the payment, and the Participant shall have no further rights in respect to the Participant's Phantom Units. For purposes hereof, the **"Per Unit Company Value"** means, as determined by the Board in its sole discretion, an amount equal to, at any given time (i) the equity value of the Company (which, at the time of the consummation of an Exit Event, may be determined by the cash proceeds received by the Company in such Exit Event), divided by (ii) the sum of (A) the number of outstanding [shares, units, OR other equity interest denomination] of the Company's [type and class of equity interest to which phantom units relate] on a fully diluted basis, plus the number of outstanding Phantom Units. For purposes of the Phantom Units granted by this Agreement, the **"Participation Threshold"** is \$[amount]. Notwithstanding the foregoing, any payment due to a Participant under this Section 1.(c) shall be subject to the execution and nonrevocation of general release of claims, in a form provided by the Company, and continuous compliance with any restrictive covenant agreement or other agreement entered into between the Participant and the Company or its subsidiaries and affiliates.

Drafting Note to Alternate Section 1.(c)

This language is for an appreciation-value phantom award where the payment for each phantom unit is determined based only on the increase in value on the company's stock (or other equity interest) from the grant date through the payment event instead of on the full per-share value. (See the default Section 1.(c) for a full-value award payment provision.) For the amount of the Participation Threshold, use the value of one share (or other equity interest) as of the grant date of the award.

(d) Distributions.

- (i) Subject to vesting, each Phantom Unit is entitled to receive the same distributions [other than tax distributions] made on [type and class of equity interest to which phantom units relate] during the period between the Grant Date of a Phantom Unit and the date the Phantom Unit is settled.
- (ii) To the extent that a Phantom Unit is vested, any distributions described in Section 1(d)(i) with respect to such Phantom Unit shall be paid currently.
- (iii) To the extent that a Phantom Unit is unvested, any distributions described in Section 1(d)(i) with respect to such Phantom Unit shall accrue and become payable only upon the vesting of such Phantom Unit and shall be subject to the same forfeiture terms and vesting schedule as the Phantom Unit award.

Drafting Note to Section 1.(d)

This clause provides for the additional accrual and payment of amounts to a phantom unit holder that are equal to any dividends or other distributions that are made to the company's equity holders (other than tax distributions) with respect to their corresponding equity interests. This section may be omitted if such distributions are not desired.

In the private company space, it is common for such distributions that relate to any unvested portion of a phantom award to be subject to the same vesting and forfeiture provisions as the underlying phantom units (as provided here). This is especially the case when a partnership or LLC also grants profits interests, which are entitled to distributions. This effectively puts the economic terms of the phantom stock on the same level as the profits interests.

2. **Covenant Breach.** Notwithstanding anything in this Agreement to the contrary, in the event the Company determines that the Participant has breached any restrictive covenant obligation that the Participant has to the Company or any of its subsidiaries and affiliates, including without limitation under the provisions of the Participant's employment agreement or any proprietary information, non-competition, non-solicitation, or similar agreement, as applicable, all Phantom Units then held by the Participant, whether held before or after the termination of employment date, shall be forfeited in full upon the date of such breach.

Drafting Note to Section 2.

In the event the company has not, and generally does not, enter into employment or other agreements with its employees or other service providers, it may be necessary to include a full covenant section in the plan, which may include (depending on the location of the company and its employees) non-competition, non-solicitation and confidentiality covenants. For more information on this topic, see [Restrictive Covenant Basics, Including Adequate Consideration, Protectable Interests, Geographic and Time Restrictions, and Permissible Scope](#). For forms, see [Non-competes and Trade Secret Protection State Practice Notes Chart](#).

3. **Cooperation.** The Participant agrees to reasonably cooperate with the Company in taking all actions reasonably necessary to consummate the transactions contemplated by this Agreement.

4. **No Equity Interest.** Neither the Plan nor this Agreement creates or conveys any equity or ownership interest in the Company or any rights commonly associated with such interests, including, without limitation, the right to vote.

5. **Special Incentive Compensation.** By accepting the Phantom Units, the Participant agrees that such award is special incentive compensation that shall not be taken into account, in any manner, as salary, compensation or bonus in determining the amount of any payment under any pension, retirement, life insurance, disability, severance or other employee benefit plan of the Company and its subsidiaries and affiliates. In addition, each beneficiary of the Participant shall be deemed to have agreed that such award shall not affect the amount of any life insurance coverage, if any, provided by any person on the life of

the Participant which is payable to such beneficiary under any life insurance plan covering employees. Nothing contained in this Agreement or the Plan shall prevent the Company from adopting or continuing in effect other compensation arrangements.

Drafting Note to Section 5.

This clause clarifies that the value of the granted phantom stock will not be taken into account for purposes of determining other compensation or benefits that the recipient would otherwise be entitled to. For example, the value of an employee's severance benefits may be based on his or her total compensation for the year of, or the year preceding, the termination of employment date. Unless carved out, the value of any nonforfeited phantom stock would need to be included in the calculation of total compensation, which might not be the intention of the company. Notwithstanding the foregoing, if the company maintains a 401(k) plan that provides for matching contributions, it should still review the terms of the 401(k) plan and related plan documents to confirm whether the value of the phantom stock would get captured for purposes of determining a participant's total compensation for matching purposes.

6. **Binding Effect.** The provisions of this Agreement shall be binding upon and accrue to the benefit of the parties hereto and their respective heirs, legal representatives, successors and assigns; provided, however, that no transferee shall derive any rights under this Agreement unless and until such transferee has executed and delivered to the Company a valid undertaking and becomes bound by the terms of this Agreement and the Plan.

7. **Amendment; Waiver; Integration.** This Agreement may be amended only by a written instrument signed by the parties hereto. No waiver by any party hereto of any of the provisions hereof shall be effective unless set forth in a writing executed by the party so waiving. This Agreement and the Plan constitute the full and entire understanding and agreement between the parties with regard to the subject matter hereof.

8. **Waiver of Jury Trial.** THE PARTIES HEREBY WAIVE TRIAL BY JURY IN ANY JUDICIAL PROCEEDING TO WHICH THEY ARE PARTIES INVOLVING, DIRECTLY OR INDIRECTLY, ANY MATTER ARISING OUT OF, RELATED TO OR IN CONNECTION WITH THE PLAN OR THIS AGREEMENT.

9. **Withholding Obligations.** Payments made under this Agreement shall be conditional upon the satisfaction by the Participant of any federal, state or local withholding or other taxes, if any, required to be paid by the Company on account of such payments. In this regard, the Company may (i) require that the Participant pay to the Company an amount sufficient to satisfy such withholding or other taxes, (ii) withhold such amount from any remuneration, distributions or other amounts payable to the Participant or (iii) enter into any arrangements suitable to the Company for the receipt of such amount.

10. **Severability.** Should any provision of this Agreement be found to be illegal or unenforceable, the other provisions shall nevertheless remain effective and shall remain enforceable to the greatest extent permitted by law.

11. **Counterparts.** This Agreement may be executed in one or more counterparts, each of which will be deemed an original, but all of which together will constitute one and the same agreement. A facsimile, telecopy or other reproduction of this Agreement may be executed by one or more parties to this Agreement, and an executed copy of this Agreement may be delivered by one or more parties to this Agreement by facsimile or similar electronic transmission device pursuant to which the signature of or on behalf of such party can be seen, and such execution and delivery shall be considered valid, binding and effective for all purposes. At the request of any party to this Agreement, all parties to this Agreement agree to execute an original of this Agreement as well as any facsimile, telecopy or other reproduction of this Agreement.

12. **Governing Law.** This Agreement shall be governed by and construed in accordance with the internal laws of the [state] without giving effect to any choice or conflict of laws provision or rule that would cause the application of the laws of any other jurisdiction.

Drafting Note to Section 12.

The governing law of the award agreement and the plan should be the same as the state of incorporation of the company, which governs the equity terms.

13. **Participant Representation.** The Participant acknowledges that all Phantom Units are subject to the conditions of the Plan and this Agreement. The Participant acknowledges receipt of a copy of the Plan and represents that the Participant has read and is familiar with its provisions.

[COMPANY NAME]

[company representative name and title]

PARTICIPANT

[participant name]

Date: _____

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She focuses on a wide variety of compensation-related matters, including the design and implementation of retention and compensation plans, disclosure and regulatory compliance, and employment negotiations with senior executives. She has advised both U.S. and non-U.S. issuers on corporate governance and regulatory requirements relating to compensation and benefits matters.

Doreen has been a resident in the Frankfurt, London and Bay Area offices of Shearman & Sterling. She is a lecturer in Executive Compensation at the Berkeley School of Law.

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Gillian Emmett Moldowan is a partner in the Compensation, Governance & ERISA practice.

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