

SEC Provides Greater Flexibility to Issue Equity to Employees, Seeks to Modernize Compensatory Securities Offerings

August 1, 2018

The SEC has made it easier for private companies to offer securities to employees if the total amount offered is under \$10 million. A recent SEC amendment to Rule 701 increased the dollar threshold, from \$5 million to \$10 million, at which non-reporting companies are required to make additional disclosure in connection with offerings of securities under compensatory arrangements intended to be exempt under Rule 701.

The amendment became effective on July 23, 2018, and the revised threshold for

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additional disclosure will apply to issuers that have commenced an offering within the prior 12 months (e.g., an issuer that commenced an offering January 1, 2018 and had not exceeded the \$5 million threshold before July 23 will not have to provide the additional disclosure unless the aggregate offering exceeds \$10 million). The threshold amount will be indexed every five years for inflation.

Issuers relying on the Rule 701 exemption to offer securities under a compensatory arrangement are required to deliver additional disclosures (generally risk factors and financial statement information) to investors if the amounts offered exceed a set threshold. The threshold, which had not been changed since 1999, applies to the aggregate sales price or amount of securities sold by a non-reporting issuer during any consecutive 12-month period. Congress mandated the recent change to address concerns that the prior \$5 million threshold increased the costs associated with using company stock to compensate employees and put non-reporting companies at risk of having to disclose confidential financial information.

In conjunction with the amendment, the SEC issued a Concept Release on Compensatory Securities Offerings and Sales, seeking comment on possible ways to modernize both the private company exemption available under Rule 701 and the public company registration requirements (i.e., Form S-8) for compensation-related offers of securities. The release notes that since these registration requirements were last substantively reviewed in 1999, forms of equity compensation have continued to evolve (including, specifically, an increase in the use of restricted stock units (“RSUs”)) and a “gig economy” has emerged, involving new types of contractual relationships between companies and the individuals who work for them. The release specifically solicits comments on topics including:

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- how the exemption should apply to RSUs (e.g., when should disclosure be required, how should RSUs be valued);
 - what attributes of “gig-economy” relationships may provide a basis for extending eligibility for participating in compensation-related offerings under the private company exemption or registration on Form S-8;
 - how the enhanced disclosure requirements should apply once the \$10 million threshold has been exceeded (e.g., should a grace period apply, should disclosure requirements apply retroactively once the threshold has been exceeded, should foreign private issuers be required to update financial statements quarterly); and
 - in what ways can the burdens associated with registration of securities on Form S-8 be reduced.

Comments on the concept release should be submitted on or before September 24, 2018.

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Please do not hesitate to contact us with any questions.

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