Bloomberg Law

Executive Compensation Guide

Impact of the Federal Securities Laws, The 1933 Act

Chapter 135. The 1933 Act

Contributed by:
Gillian Emmett Moldowan
Shearman & Sterling LLP
New York, NY

Gillian Emmett Moldowan, Esq., is a Partner in the Compensation, Governance & ERISA practice of Shearman & Sterling's New York City office. She advises companies, boards of directors, executives, and investors on compensation and benefit matters, including equity-based incentives, deferred compensation programs, and employment, retention, and severance arrangements. Her practice focuses in particular on issues that arise at the intersection of human capital management and corporate governance, in securities offerings, and in mergers and acquisitions transactions. She regularly counsels clients on disclosure, trading rules (including Section 16), and the negotiation of executive employment arrangements. Moldowan also advises on the applicability of federal securities law, tax law, and general employment-related legal issues. She holds a Juris Doctor from the George Washington University Law School and a Bachelor of Arts from Barnard College, Columbia University. Moldowan is admitted to practice in New York.

Contributed by:
Jai Garg
Shearman & Sterling LLP
New York, NY

Jai Garg is an Associate in the Compensation, Governance & ERISA practice of Shearman & Sterling's New York City office. He focuses on a wide variety of compensation and benefit-related matters, with a particular focus on issues that arise in connection with M&A transactions and capital markets. He regularly advises both U.S. and non-U.S. companies regarding equity-based incentives, employment arrangements, disclosure, corporate governance, and securities and tax law compliance. He holds a Juris Doctor from Washington University School of Law and a Bachelor of Arts from Grinnell College. Garg is admitted to practice in New York.

.10 Introduction —

Compensation arrangements frequently involve the offer and sale of issuer securities; these arrangements must comply with the Securities Act of 1933,[1] as amended.[2] The 1933 Act requires that any offer or sale of a security be registered with the Securities and Exchange Commission (SEC) unless the security involved is an exempt security or otherwise subject to an exemption from registration. The 1933 Act has no special exemption from this basic rule for offerings to employees of the issuer; however, certain rules and exemptions under the 1933 Act help facilitate offerings of issuer securities to employees.

[1] 15 U.S.C. ch. 2A, subch. I.

[2] 1933 Act § 5, 15 U.S.C. § 77e *et seq.*

This chapter discusses the scope of the 1933 Act as applied to securities offerings in connection with compensatory arrangements, the use of the Form S-8 registration statement, and the principal exemptions from registration that issuers typically rely on to avoid registration under the 1933 Act. This chapter also discusses certain limitations under the 1933 Act on the resale of issuer securities.

This chapter is limited to the federal securities laws of the U.S. and doesn't address state (often called “Blue Sky”), local, or foreign laws with respect to the offer and sale of securities. Rules that apply to security offerings directed at the public at large (as opposed to those limited to employees or others who perform services for the issuer), or involving a principal purpose of capital raising (as opposed to being compensatory in nature) are not discussed in this chapter.

.20 Scope of the 1933 Act —

Whether a compensation plan or arrangement is subject to the 1933 Act is determined by a three-part analysis:

(1) the issuer must determine whether a non-exempt security is involved;

(2) assuming a non-exempt security is present, the issuer must determine whether there is an offer and sale of the security; and

(3) if the compensatory arrangement involves the offer and sale of a non-exempt security, the issuer must register the offering under the 1933 Act or determine that it fits within an exemption from registration.

Each of these determinations is examined separately below. For more on registration requirements under the 1933 Act, see *The 1933 Act*, 44 CPS §II.D.; 362 T.M., *Securities Law Aspects of Employee Benefit Plans, §II.D*.

.20.10 Definition of a Security —

For the 1933 Act to apply to a compensation arrangement either the arrangement must include a non-exempt security or the employee's interest in the arrangement itself must constitute a non-exempt security. The 1933 Act broadly defines “security” to encompass stock, options, warrants, participation interests, bonds, debentures, and investment contracts.[3] A typical employer long-term incentive plan includes many award types that fall under the 1933 Act's definition of a security. Options, warrants, shares of employer common stock and contractual entitlements to receive employer common stock or its value (such as restricted stock units)—all commonly available under these plans—constitute securities under this definition.

[3] The 1933 Act states that a security is “any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call,

straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof) or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing." *See* 1933 Act § 2(a)(1), 15 U.S.C. § 77b(a)(1).

Certain securities are expressly exempt from the requirements of the 1933 Act.[4] In the context of compensatory arrangements, the most relevant exemption is for interests in tax-qualified retirement plans[5] that do not permit employees the option to allocate their own money to the purchase of issuer securities held by these plans.[6] Most interests in defined benefit pension plans would be exempted securities, re-exempted securities, whereas interests in a typical 401(k) plan that permits participants to invest in an issuer common stock fund, or has a self-directed "brokerage window" through which participants can invest in issuer common stock, are not exempt.[7]

[4] 1933 Act § 3(a)(2), 15 U.S.C. § 77c(a)(2).

[5] A tax-qualified retirement plan is a plan that satisfies the requirements of IRC § 401(a). The sponsor of, and the participants in, a tax-qualified plan receive favorable tax treatment under the tax code.

[6] 1933 Act § 3(a)(2), 15 U.S.C. § 77c(a)(2). This exemption applies to both the interests of plans in investment vehicles maintained by banks and insurance companies and to the interests of participants in the plans. *See* Employee Benefit Plans, Securities Act Release 33-6188 (Feb. 1, 1980).

[7] However, a 401(k) plan that grants an employer matching contribution in employer stock may not be required to register the shares granted in connection with the match. *See*, *e.g.*, Bank of Los Angeles, SEC No-Action Letter, SEC NAL 29937 (Sept. 25, 1987); Commonwealth Bancshares Corp., SEC No-Action Letter, SEC NAL 16275 (Feb. 9, 1987); Monsanto Co., SEC No-Action Letter, SEC NAL 12013 (Sept. 16, 1983). *But see* Securities and Exchange Commission, Division of Corporation Finance, Manual of Publicly Available Telephone Interpretations, § G.88 (July 1997) (suggesting that employer stock used for 401(k) matching contributions must be registered on Form S-8, whereas employer stock used for an automatic, profit-sharing contributions need not be registered). *See also* Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations (C&DI): Securities Act Forms § 126.19 (Jan. 26, 2009) and § 126.41 (Sep. 21, 2016) (last updated Sept. 21, 2020).

In *SEC v. W. J. Howey Inc.*,[8] the U.S. Supreme Court established a four-prong test to analyze whether an investment contract is a security. Under the so-called *Howey* test, an investment contract is a security if it is a contract, transaction, or scheme whereby "(1) a person invests his money (2) in a common enterprise and (3) is led to expect profits (4) solely from the efforts from the promoter or third party."[9] The *Howey* test requires, among other things, that the purchaser of the investment contract provide money or other tangible consideration.

[8] *SEC v. W. J. Howey Inc.*, 328 U.S. 293 (1946).

[9] *SEC v. W. J. Howey Inc.,* 328 U.S. 293, 298-99 (1946). The basic test set out by the court in *Howey* continues to apply. *See*, *e.g.*, *IN RE ENRON CORPORATION SECURITIES, DERIVATIVE & 'ERISA' LITIGATION*, 238 F. Supp. 3d 799 (S.D. Tex. 2017) ("In Howey, the Supreme Court established a test to determine whether a financial relationship constituted an 'investment contract,'").

An employment agreement under which an employee provides services to an issuer in exchange for compensation doesn't qualify as a security under the Howey test.[10] Employee interests in pooled investment vehicles sponsored by an employer do qualify as securities under this test. The interests of participants in employee benefit plans where money is invested and interests in collective investment media (*i.e.*, bank collective trust funds and insurance company separate accounts) are also considered securities unless exempt.

[10] *Teamsters v. Daniel*, 439 U.S. 551 (1979).

Courts have also applied the so-called "family resemblance test" to determine whether a compensatory investment contract is a security. Under the "family resemblance" test, as adopted by the Supreme Court in *Reves v. Ernst & Young*,[11] the interests are analyzed to determine whether they resemble notes or evidences of indebtedness under the 1933 Act. Under the family resemblance test, a note or debt obligation is presumed to be a security,[12] but the presumption may be rebutted by demonstrating that such note or debt obligation "bears a strong family resemblance" to an item on a judicially crafted list of instruments that are excepted from the presumption.[13] The family resemblance test uses four factors to determine whether a note or debt obligation bears a resemblance to instruments on the list of exceptions:

[11] *Reves v. Ernst & Young*, 494 U.S. 56 (1990).

[12] Although *Reves* was construing a case under § 3(a)(10) of the 1934 Act, the Supreme Court acknowledged that the 1934 Act definition and 1933 Act definition are virtually identical and the coverage of the two acts may be considered the same for this purpose. *Reves*, 494 U.S. 56, 61 (citing *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 847 n.12 (1975)).

[13] The list of notes and debt obligations that are exceptions and aren't securities includes the following: (i) notes delivered in consumer financing; (ii) notes secured by a mortgage on a home; (iii) short-term notes secured by a lien on a small business or some of its assets; (iv) notes evidencing a "character" loan to a bank customer; (v) short-term notes secured by an assignment of accounts receivable; (vi) notes which simply formalize an open-account debt incurred in the ordinary course of business (particularly if collateralized); and (vii) notes evidencing loans by commercial banks for current operations. *Reves*, 494 U.S. 56, 65.

(1) the motivations that would prompt a reasonable buyer and seller to enter into the transaction—if the seller's purpose is to raise money for the general use of a business or to finance substantial investments, and the buyer is interested primarily in the expected profit from the instrument, then it is likely a security;[14]

(2) the plan of distribution of the instrument to determine whether there is common trading in it for speculation or investment;[15]

(3) the reasonable expectations of the investing public;[16] and

(4) the existence of risk reducing factors, such as another regulatory scheme, with respect to the instrument that make the application of the 1933 Act unnecessary.[17]

[14] See Point of Law for the latest cases.

[15] See Point of Law for the latest cases.

[16] See Point of Law for the latest cases.

[17] It appears that the family resemblance test is a balancing test. *McNabb v. SEC,*, 298 F.3d 1126, 1131-33 (9th Cir. 2002); Bass v. Janney Montgomery Scott Inc., 210 F.3d 577, 585 (6th Cir. 2000); Resolution Trust Corp. v. Stone, 998 F.2d 1534, 1539 (10th Cir. 1993);

Lebrun v. Kuswa, 24 F. Supp. 2d 641, 646 (E.D. La. 1998). See Point of Law for the latest cases.

If an instrument is not sufficiently similar to the list of exceptions, the court will decide whether another category should be added by examining the same four factors.[18]

[18] *See Reves,* 494 U.S. 56, 67.

The Supreme Court has noted that funded pension plans are heavily regulated under ERISA. As such, pension plan interests, although they could be construed as notes or debt obligations, wouldn't be considered securities under the family resemblance test.[19]

[19] *See Reves*, 494 U.S. 56, 69.

In the early 1980s, the SEC issued two releases that continue to serve as the foundation for analyzing whether interests in a plan or other arrangement constitute securities for purposes of the 1933 Act.[20] These releases reaffirm the basic principle that interests in a plan will constitute a security for purposes of the 1933 Act when plan participation is both voluntary and contributory and, when tax-qualified retirement plans are involved, the participant has an opportunity to apply the amounts contributed to the plan to the purchase of issuer securities under the plan.[21]

[20] Employee Benefit Plans, Securities Act Release No. 33-6281, 46 Fed. Reg. 8446 (Jan. 15, 1981); Securities Act Release No. 33-6188 (Feb. 1, 1980).

[21] Securities Act Release No. 33-6281, 46 Fed. Reg. 8446 (Jan. 15, 1981), § I(A); Securities Act Release No. 33-6188 (Feb. 1, 1980), § II(A)(2)(d). A voluntary plan is one in which employees may elect to participate. A contributory plan is one in which employees make direct payments to the plan. *See* Securities Act Release No. 33-6188, nn.19, 20. In *Teamsters v. Daniel*, an opinion which addressed whether a noncontributory, compulsory tax-qualified plan was a security, the Supreme Court explained that a tax-qualified plan is exempt from the registration requirements of the 1933 Act unless such plan is voluntary and contributory and “invests in the securities of the employer company an amount greater than that paid into the plan by the employer.” 439 U.S. 551, 568, 69 (1979) (citing Interim Report of Activities of the Private Welfare and Pension Plan Study, 1971, S. Rep. No. 92-634, at 96 (1972)). *See also* Diasonics Inc., SEC No-Action Letter (Dec. 20, 1982) (stating that a provision in a 401(k) plan offering employer stock that permits employees to determine voluntarily whether to make elective deferrals creates interests in the plan that are securities, whereas a profit-sharing plan doesn't); Securities and Exchange Commission, Division of Corporation Finance, Manual of Publicly Available Telephone Interpretations, § G.78 (July 1997) (stating that interests in a 401(k) plan that doesn't include employer stock wouldn't be considered a security).

A nonelective arrangement wouldn't typically involve an offer and sale unless it could be demonstrated that the employee had given up something of value in exchange for the interest in the plan.[22] In this regard, interests in most noncontributory supplemental executive retirement plans (commonly called SERPs) wouldn't involve an offer and sale of securities.

[22] Securities Act Release No. 33-6188. In *Daniel*, the Supreme Court rejected the notion that an employee purchases the deferred compensation by providing services to the employer. 439 U.S. 551, 560.

Whether interests in nonqualified deferred compensation plans that involve voluntary deferrals constitute a security has been the subject of scrutiny by both the courts and the SEC. The security created under such voluntary and contributory deferred compensation plans is perhaps most analogous to a corporate debenture, in that it represents an unsecured promise by the issuer to pay a specified amount in the future, often at a specified rate of interest or other measure of investment return. Courts have yet to apply the *Reves* analysis to an unfunded deferred compensation plan.[23] The SEC view is that voluntary and contributory plans, such as deferred compensation plans, would satisfy the *Howey* definition of investment contracts.[24] However, in several no-action letters, the SEC stated that registration of plans offering a fixed rate of return was unnecessary because interests in these plans aren't securities under the *Howey* test and participants are sophisticated investors who don't need the protection offered by registration.[25] Despite these no-action letters, in November 2000, the SEC stated that it would not disregard in its analysis the argument that interests in nonqualified deferred compensation plans that involve voluntary deferrals are securities, given the prevalence of such plans and the lack of any meaningful difference between such plans that offer returns tied to different investment alternatives and those that offer a fixed rate of return only.[26] To date, the SEC hasn't not affirmatively taken the position that fixed-rate nonqualified deferred compensation plans involve securities;[27] rather, the determination is made on a facts and circumstances basis.[28]

[23] A lower court applied the *Reves* analysis to a wage deferral program. In *In re Tucker Freight Lines*, 789 F. Supp. 884 (W.D. Mich. 1991), a district court held that wage deferral contracts, in which the employees agreed to a percentage deduction of their wages, which the near-bankrupt employer would repay without interest as it reached certain levels of profit, weren't securities under *Reves*. The court in *Tucker* held that such wage deferral contracts, since they didn't generate any interest for the participants, didn't induce a reasonable expectation of profit as set forth in the first factor in *Reves*. *See Tucker*, 789 F. Supp. 884, 888, 889.

[24] Securities Act Release No. 33-6188 (Feb. 1, 1980), § II(A)(2). Moreover, the SEC release regarding use of Rule 701 (an exemption to registration) indicates that deferred compensation plans are able to use this rule. Rule 701—Exempt Offerings Pursuant to Compensatory Arrangements, Securities Act Release No. 33-7645 (Feb. 25, 1999).

[25] *See*, *e.g.*, Shearson Lehman Bros. Inc., SEC No-Action Letter (May 29, 1986) (describing a plan in which participants earn interest equal to the average 30-day U.S. Treasury bill rate); Dean Witter Reynolds, SEC No-Action Letter (Mar. 4, 1985) (describing a plan in which participants earn interest at a rate equal to the time-weighted average interest rate paid by the company to its lending institutions). In both no-action letters, the SEC stated that the interests didn't satisfy the *Howey* test because (1) participants in these interest-only plans didn't make investments, but rather they deferred payment of compensation for services rendered; (2) they could have no expectation of profits, as their accounts earned interest at a flat rate, notwithstanding the profits or losses of the issuer; and (3) the investment success of fund managers under the plan had no bearing on benefits paid. The SEC hasn't issued a no-action position on this topic since 1991 and won't grant requests for no-action with respect to nonqualified deferred compensation plans. *See* Securities and Exchange Commission, Division of Corporation Finance, Current Issues and Rulemaking Projects, § VIII(A)(12), at 57 (Nov. 14, 2000).

[26] Current Issues and Rulemaking Projects, § VIII(A)(12), at 57. Plans that offer returns tied to investment alternatives are more likely to satisfy the *Howey* test than plans that offer a fixed rate of return.

[27] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections, § 239.15 (Nov. 26, 2008) (last updated Sept. 22, 2016). The SEC also has not addressed plans that pay interest tied to an equity index (such as the S&P Index). The SEC refers to deferred compensation plans that pay a fixed rate of return as "interest-only" plans.

[28] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections, § 239.03 (Nov. 26, 2008) (last updated Sept. 22, 2016).

.20.20 Definition of a Sale —

Most issuances by a company of its securities under a compensation arrangement where the employee has a choice regarding participation are likely to involve an offer and sale of a security for purposes of the 1933 Act, which defines the term "sale" broadly to include every contract of sale or disposition of a security or interest in a security for value. The terms "offer to sell," "offer for sale," and "offer" mean every attempt to offer, to dispose of, or to solicit an offer to buy a security or interest in a security for value.[29] However, for purposes of the registration requirements of the 1933 Act, such offers and sales are limited to those that occur within the U.S.[30] Although the 1933 Act doesn't define the term "value," the SEC has taken the position that value includes all "ordinary forms of consideration such as cash, property, services, or the surrender of a legal right."[31]

[29] 1933 Act § 2(a)(3), 15 U.S.C. § 77a.

[30] 1933 Act Rule 901, 17 C.F.R. § 230.901. Rule 901 is part of Regulation S, a safe harbor from the registration requirements of the 1933 Act for offshore offers and sales of securities. Among other exemptions, Regulation S provides an exemption for securities issued under employee benefit plans established and administered in accordance with the law of a country other than the U.S. and in accordance with that country's practices and documentation to employees who reside outside the U.S. or who are on temporary assignment in the U.S.

[31] Securities Act Release No. 33-6188. *See also* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections, § 139.03 (Nov. 26, 2008) (stating that where awards of shares are tied to the achievement of specific goals (such as sales goals) by individual employees, the awards may "constitute compensation for services performed or to be performed by the employees" and an offer or sale requiring 1933 Act registration may be involved).

With respect to most securities offered and sold for compensatory purposes, the offer and sale is deemed to occur at the time of grant of the securities. However, options are treated differently. Long-term incentive compensation plans adopted by U.S. issuers commonly provide for the grant of employee stock options that allow recipients to purchase issuer common stock at a price established at the time of grant. Although options are "securities" for purposes of the 1933 Act, the grant of options under these plans is typically viewed as a sale of the underlying common stock of the issuer and not a sale of the option itself, except in those rare situations in which the recipients pays for the option instrument. As such, the grant of the option is treated as an offer to purchase the common stock of the issuer, and that offer is treated as having first been made when the option becomes exercisable. If an option becomes exercisable within one year of the date of grant, it is deemed immediately exercisable. Similarly, the exercise or conversion of the option is viewed as the sale of the common stock for purposes of the 1933 Act.[32] It is, therefore, permissible for the registration of the security underlying an option to be effective under a Form S-8 registration statement filed after the grant of such option, provided it is filed before the option is exercised.[33]

[32] 1933 Act Reg. S, Rule 701(d)(3)(iii), 17 C.F.R. § 230.701(d)(3)(iii); Registration of Securities on Form S-8, Securities Act Release No. 33-7646, at § I(B) (Feb. 25, 1999).

[33] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections, § 239.15 (Nov. 26, 2008) (last updated Sept. 22, 2016). *See also* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms, § 126.02 (Feb. 27, 2009) (last updated Sept. 21, 2020). For more, see the discussion under *Registration in Connection with Compensatory Arrangements—Form S-8*. Different rules

apply to timing of the disclosure in connection with offers and sales that are exempt from registration pursuant to Rule 701. If a Rule 701 sale involves an option or other derivative security, the employer must deliver disclosure within a reasonable period of time before the date of exercise or conversion. 1933 Act Reg. E, Rule 701(e)(6), 17 C.F.R. § 230.701(e)(6).

Where no value other than the obligation to perform future services is paid in connection with the grant of an award that is a security (for example, bonus or restricted stock), the grant may not be considered an offer and sale under the "no sale" theory.[34] However, before utilizing the no sale theory, the applicable facts of issuance should be analyzed to confirm they support the use of the theory. In addition, the no sale theory isn't available for all awards that may be considered bonus stock, such as awards tied to the achievement of specific goals (such as sales goals) by individual employees.[35] Where the no sale theory applies, public reporting companies still typically register the shares subject to these grants to facilitate resales by plan participants. Registration also often occurs because the shares are granted under an omnibus plan that contemplates multiple types of compensation awards and a registration statement is filed to cover all awards under the plan.

[34] Securities Act Release No. 33-6188 (Feb. 1, 1980), at § II(A)(5)(d). Bonus stock is stock awarded to an employee without any requirement for out-of-pocket contributions from the employee. McKesson Corp., SEC No-Action Letter (July 10, 1985). Restricted stock is stock that is subject to forfeiture if the employee doesn't satisfy certain conditions, such as completion of a specified term of employment. E. I. DuPont de Nemours and Co., SEC No-Action Letter, at § II (Nov. 28, 1994). Restricted stock may also be subject to transfer restrictions. Securities Act Release No. 33-10075 (May 3, 2016); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Exchange Act Release No. 34-28869, § III(c)(3) (Feb. 8, 1991).

[35] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections, § 139.03 (Nov. 26, 2008) (last updated Sept. 22, 2016).

.20.30 Registration and Exemptions from Registration —

Where a compensatory arrangement involves the offer and sale of a non-exempt security, the issuer must register the offering under the 1933 Act or determine that it fits within an exemption from registration. Although not the only available method of registering securities in connection with a compensatory arrangement, issuers typically use a registration statement on Form S-8 under the 1933 Act to register the offers and sales of their securities to employees and other individuals who perform services for them when an exemption from registration is neither available nor desirable. Registration on a Form S-8 is discussed in more detail below under Registration in Connection with Compensatory Arrangement—Form S-8. Exemptions from registration applicable to the compensatory arrangement context are discussed below in "Exemptions from Registration under the 1933 Act in Connection with Compensatory Arrangements".

.20.40 Penalties and Other Consequences for Violations —

Failure by the issuer to properly register the offer and sale of a non-exempt security without a valid exemption from registration subjects the issuer to risk of liability under the 1933 Act. Any issuer who offers or sells a security in violation of the registration requirements of the 1933 Act is liable to the purchasers of such security for an amount equal to the consideration paid for the security and interest.[36] Such an action has a one-year statute of limitations from the date of the unregistered offer and sale.[37] Issuers may conduct an offer to repurchase all securities sold in violation of the 1933 Act (a rescission offer) to mitigate these individual claims.

[36] 1933 Act § 12, 15 U.S.C. § 77l. Liability would also arise if an issuer registered securities

but did so pursuant to a registration statement containing untrue or misleading statements. In such a case, the issuer along with any person who signed the registration statement and underwriters of an offering, if any, are subject to liability. 1933 Act § 11, 15 U.S.C. § 77k.

[37] 1933 Act § 13, 15 U.S.C. § 77m.

In addition to the above, the issuer is subject to possible SEC enforcement, which can include injunctive actions, cease and desist proceedings, and other remedies available to the SEC to redress violations of the 1933 Act, including civil monetary penalties. An issuer may also face private rights of action from individuals who have been harmed by the conduct, such as award recipients. The U.S. Department of Justice can bring criminal enforcement proceedings for securities laws violations, but such proceeds generally require evidence of willful violation—transactions conducted for legitimate business purposes and in good faith are unlikely to be the subject of criminal prosecution.

.30 Registration in Connection with Compensatory Arrangements—Form S-8 —

Public reporting companies typically rely on Form S-8 to register the offers and sales of their securities to employees and other individuals who perform services for them when an exemption from registration is neither available nor desirable. For an issuer, Form S-8 offers the advantages of simplicity, a streamlined filing procedure that doesn't require filing of a prospectus, and effectiveness immediately on filing. Other forms of registration statement—Form S-1 or S-3, for example—may also be used in connection with employee offerings, although the complexity of these forms in comparison to Form S-8 generally makes their use inadvisable, except in situations where registration is required and Form S-8 is not available. This section focuses exclusively on the requirements of Form S-8.[38]

[38] On November 24, 2020, the SEC proposed amendments to Form S-8 and Rule 701 to modernize the frameworks. *See* SEC Proposes Amendments to Modernize Framework for Securities Offerings and Sales to Workers.

.30.10 Availability —

An issuer can register offers and sales on Form S-8 if the issuer is a reporting company immediately before the date on which the Form S-8 is filed and the offer and sale is made to the employees of the issuer, its subsidiaries, or its parent under an employee benefit plan.[39] Each of these requirements is explained in more detail below. Form S-8 isn't available for capital-raising purposes or to effect sales to the public at large.[40] Form S-8 is also not available to register offers and sales to employees in the following cases:

[39] Form S-8, General Instruction A.1; 17 C.F.R. § 239.16b. The form is available online.

[40] Securities Act Release No. 33-7646.

- when the issuer controls or directs a public resale of the securities;
- when the issuer or its affiliates directly or indirectly receives a portion of the proceeds from the resale; or
- when it is used to arrange a merger through which a private issuer becomes a public reporting company under the 1934 Act.[41]

[41] Securities Act Release No. 33-7646, § II(A)(2).

Reporting Company. An issuer is eligible to use Form S-8 if immediately before the filing of the Form S-8 registration statement it is subject to the reporting requirements of § 13 or § 15(d) of the Securities Exchange Act of

1934, as amended (the 1934 Act) and it has filed all reports and other required materials during the shorter of the preceding 12-month period and the period during which the issuer has been subject to the reporting requirements.[42] A foreign private issuer may use Form S-8 to offer securities under a plan.[43] An issuer who voluntarily files reports under the 1934 Act isn't eligible to register securities on Form S-8.[44] There is no waiting period to use a Form S-8 for new reporting companies; an issuer may file a Form S-8 immediately after the issuer's initial public offering.[45]

[42] General Instructions to Form S-8. Sections 13 and 15(d) of the 1934 Act generally require issuers registered under § 12 of the 1934 Act to file certain periodic reports and other supplementary information. An issuer is subject to these requirements if (1) it lists securities on a U.S. national exchange or has securities quoted on the National Association of Securities Dealers Automated Quotation System (Nasdaq), or (2) its equity securities become owned by a sufficient number of U.S. investors. Unlike Form S-3, Form S-8 doesn't require these filings to be timely, only that they are made. *See also* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.10 (Feb. 27, 2009) (last updated Sept. 21, 2020). As such, reporting companies that become ineligible to use Form S-3 because of delinquent reporting still may be eligible to use Form S-8 once the late filing has been made. Whenever required filings have not been made, issuers must suspend the use of then-effective Form S-8 registration statements until the filings are made.

[43] A foreign private issuer is any foreign issuer other than a foreign government, except that an issuer meeting the following conditions may not be a foreign private issuer (and would instead be subject to the rules applicable to domestic U.S. companies): (1) more than 50% of its outstanding voting securities are directly or indirectly *owned of record* by residents of the U.S. and (2) any of these conditions are met: (i) the majority of the executive officers or directors are U.S. citizens or residents, (ii) more than 50% of the assets of the issuer are located in the U.S., or (iii) the business of the issuer is administered principally in the U.S. A foreign issuer is “any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.” 1933 Act Reg. C, Rule 405, 17 C.F.R. § 230.405; 1934 Act Rule 3b-4, 17 C.F.R. § 240.3b-4.

[44] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms, Section 126, Form S-8 (Feb. 27, 2009) (last updated Sept. 21, 2020). *See also* Applied Materials Inc., SEC No-Action Letter (Apr. 23, 1973).

[45] Registration and Reporting Requirements for Employee Benefit Plans, Securities Act Release No. 33-6867, § II(E)(2) (June 6, 1990) (explaining that the Form S-8 registration statement was amended to eliminate the requirement that an issuer be subject to the reporting requirements of the 1934 Act for at least 90 days before the filing date of the Form S-8 registration statement).

Eligibility. Form S-8 is available for offers and sales made to employees. For purposes of Form S-8, “employee” means any employee, director, general partner, trustee (where the registrant is a business trust), officer, consultant, or advisor of the issuer, its parent, or its subsidiaries.[46] For certain limited purposes, as described below, the term also includes former employees and retirees, executors, administrators, or beneficiaries of the estates of deceased employees or other persons with legal authority to administer the estate or assets of former employees.[47]

[46] Form S-8, General Instruction A.1(a)(1); 17 C.F.R. § 239.16b.

[47] *See* 17 C.F.R. § 239.16b, A.1(a)(3); 17 C.F.R. § 239.16b. Registration and Reporting Requirements, Securities Act Release No. 33-6867, § II(E)(3). A February 1999 amendment

to the Form S-8 rules provided that, as of May 10, 1999, currently exercisable options held by nonemployees have to be registered on a form other than Form S-8, such as Form S-3, if otherwise available to the employer. Joint Committee on Employee Benefits, JCEB Questions for SEC—1999 , Q&A 3 [hereinafter JCEB Questions 1999].

Form S-8 is available for grants and awards to consultants and advisers only if the consultant or adviser is a natural person who provides services that would typically be performed by traditional employees.[48] The services cannot be related to an offer and sale of securities in a capital-raising transaction or directly or indirectly to promote or maintain a market for the issuer's securities.[49] This requirement generally doesn't preclude the offer and sale of securities via Form S-8 to any specific type of consultant or adviser;[50] rather, the specific character of services provided is assessed.[51] For example, an offer and sale to a financial consultant who advises the issuer on business strategy or compensation issues can be registered on Form S-8, whereas an offer and sale to a financial consultant who arranges the financing for a securities issuance cannot.[52] Persons who have a de facto employment relationship with the issuer, such as nonemployees providing services traditionally performed by employees, may also receive grants and awards on a Form S-8, as long as the compensation paid by the issuer for those services is the primary source of the person's earned income.[53]

[48] Securities Act Release No. 33-7646.

[49] Form S-8, General Instruction A.1(a)(1)(iii); 17 C.F.R. § 239.16b. *See also* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms, § 126.15 (Feb. 27, 2009) (last updated Sept. 21, 2020).

[50] *But see* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms, § 126.16 (Feb. 27, 2009) (last updated Sept. 21, 2020).

[51] Securities Act Release No. 33-7646.

[52] *See* Securities Act Release No. 33-7646, § II(A)(2). Additional examples of services, the performance of which would preclude use of Form S-8 include (1) brokers, dealers, and other persons who find investors; (2) consultants who provide investor relations; (3) consultants performing capital raising or promotional functions; (4) attorneys serving as counsel to the issuer or its underwriters; or (5) any participating broker-dealer in an offering. *See* Securities Act Release No. 33-7646, § II(A)(2).

[53] Securities Act Release No. 33-7645 (discussing de facto employment relationships and conforming the Rule 701 definition of employee to the Form S-8 definition).

Form S-8 isn't available for to register new offers and sales of securities to former employees or retirees of an issuer. It is available, however, to cover options retained by employees after their termination of employment or transferred by these employees for estate-planning purposes after termination of employment, as long as such transfers are permitted under the plan pursuant to which the awards originally occurred.[54] For example, option exercises by a former employee with respect to options granted before termination of employment are typically covered by a Form S-8, whereas grants and exercises of options made after termination of employment generally are not.[55]

[54] Form S-8, General Instruction A.1(a)(3); 17 C.F.R. § 239.16b; Registration and Reporting Requirements, Securities Act Release No. 33-6867, at § II(E)(3). Form S-8 is also available for the acquisition of issuer securities pursuant to intra-plan transfers among plan funds, if permitted under the plan. Securities Act Release No. 33-6867, § II(E)(3). The term “former employee” includes former consultants and former advisers. Securities Act Release No. 33-7646.

[55] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities

Act Forms, § 126.14 (Feb. 27, 2009) (last updated Sept. 21, 2020).

Form S-8 is available to register the exercise of employee stock options held by an employee's family members that were acquired by gift or domestic relations order. For these purposes, the term "family member" includes spouses, children, parents, in-laws, nieces, and nephews, former spouses (pursuant to a domestic relations order), any person sharing the employee's household (other than a tenant or employee), and any entity, trust, or foundation in which the employee or family members have a controlling interest.[56] The family member may acquire the option directly from the employee or indirectly via another family member of the employee. Whether acquired directly or indirectly, the transferee is treated like an employee for all purposes under Form S-8, including resale of the securities subject to the award.[57] Form S-8 cannot be used for the exercise of options transferred by an employee for value.[58]

[56] Form S-8, General Instruction A.1(a)(5); 17 C.F.R. § 239.16b.

[57] Availability of Form S-8 to such indirect transferees is at the discretion of each employer. Securities Act Release No. 33-7646, § III(A)(3). A family member who is an affiliate or who holds restricted securities acquired by the exercise of options before Form S-8 was filed can use Form S-8 for resales. Similarly, if the employee leaves the company, the family members can use Form S-8 for option exercises to the same extent available to a former employee. Securities Act Release No. 33-7646 § III(A)(3).

[58] Form S-8, General Instruction A.1(a)(5); 17 C.F.R. § 239.16b; Securities Act Release No. 33-7646 § III(A)(3). A transfer for value doesn't include a transfer under a domestic relations order or a transfer to an entity more than 50% owned by the optionee's family members in exchange for an interest in that entity. Securities Act Release No. 33-7646, § III(A)(3). Accordingly, Form S-8 isn't available for the exercise of options by a family trust or partnership under which the transfer to the family entity is made for cash.

Employee Benefit Plans. Form S-8 is only available for offers and sales made under an employee benefit plan, although the term "employee benefit plan" is expansively defined. The term includes any written purchase, savings, option, bonus appreciation, profit-sharing, thrift, incentive, pension, or similar plan, or written compensation contract solely for employees, consultants, or advisers as described above.[59] A written compensation agreement contract between an issuer and only one executive has been interpreted to be an employee benefit plan.[60]

[59] 1933 Act Reg. C, Rule 405, 17 C.F.R. § 230.405.

[60] JCEB Questions 1999 , Q&A 4 (stating that an individual option grant letter made outside of a plan is a written compensation contract as long as the letter clearly states that the option grant is for services rendered).

.30.20 Components of Form S-8 —

Form S-8 consists of two parts. Part I is a prospectus, which must be provided to participants in the applicable employee benefit plan but which is not required to be filed with the SEC.[61] Part II is a registration statement, which is filed with the SEC.

[61] Form S-8, General Instructions; 17 C.F.R. § 239.16b; 1933 Act Reg. C, Rule 428(b)(1), 17 C.F.R. § 230.428(b)(1) (requiring delivery to employees of Part I of Form S-8 but making no mention of Part II).

.30.20.10 Form S-8 Prospectus —

The Form S-8 prospectus consists of the document(s) containing the information required by Part I of Form S-8 together with the issuer disclosure documents filed with the SEC and incorporated by reference into the Form S-8 registration statement. The prospectus must include a description of the terms of the plan under which securities are being registered on the Form S-8 and a statement regarding the availability of:

(1) information about the issuer;[62]

(2) without charge, and upon oral or written request, the documents containing registrant information and employee benefit plan annual reports (if plan interests are being registered) that are incorporated by reference in the Form S-8 registration statement pursuant to Item 3 of Part II of the Form S-8; and

(3) without charge, and upon oral or written request, the other documents required to be delivered to participants pursuant to Rule 428(b).[63]

[62] 1933 Act Reg. C, Rule 428(a)(1), 17 C.F.R. § 230.428(a)(1). Such plan information includes general plan information, title of securities and total amount being offered, eligible plan participants, information regarding the purchase and sale of securities, time frame for electing to participate, resale restrictions, tax effects of participation, investment options, withdrawal from participation, forfeitures, and penalties. Form S-8, Part I Item 1, 17 C.F.R. § 239.16b.

[63] Form S-8, Part I Item 2, 17 C.F.R. § 239.16b; 1933 Act Reg. C, Rule 428(b), 17 C.F.R. § 230.428(b).

Documents providing information about the issuer may include the issuer's annual report, such as Form 10-K or Form 20-F, and quarterly and current reports, which are incorporated by reference in the Form S-8 registration statement.[64]

[64] 1933 Act Reg. C, Rule 428(a)(1), 17 C.F.R. § 230.428(a)(1).

Form S-8 doesn't require the preparation of a separate prospectus but allows issuers to use one or more existing documents—such as a summary plan description required by ERISA—to satisfy the prospectus delivery requirement, as long as the existing documents contain all the information required by Form S-8.

Practice Tip: When incorporating documents into a prospectus by reference, however, consideration should be given to whether the incorporation might subject documents to unintended legal requirements and separate enforcement and remedial rules. For example, it has been argued that combining SEC disclosure documents with ERISA disclosure materials subjects the SEC disclosure documents to ERISA's enforcement provisions.[65]

[65] *See, e.g.*, *Gearren v. McGraw-Hill Cos.*, 690 F. Supp. 2d 254, 271 through 273 (S.D.N.Y. 2010); *In re Citigroup ERISA Litigation*, No. 07 Civ. 9790, 2009 BL 184739 (S.D.N.Y. 2009); *In re Bausch & Lomb Inc. ERISA Litigation*, No. 06-CV-6297, 2008 BL 305917 (W.D.N.Y. 2008); *In re WorldCom, Inc. ERISA Litigation*, 263 F. Supp. 2d 760 (S.D.N.Y. 2003); *Hull v. Policy Management Sys. Corp.*, No. 3:00-788-17, 2001 BL 974 (D.S.C. 2001).

The prospectus should be written in plain English, with short sentences in the active voice.[66] The SEC has encouraged the use of a question-and-answer format as a means of communicating complex information in the prospectus.[67] If an issuer uses existing documents to satisfy the prospectus delivery requirement, each such document must contain a legend at the beginning indicating that it is part of a prospectus, satisfies the plain English requirements, and otherwise contains the information required by Part I of Form S-8.[68] An issuer may also designate only a portion of an existing document as part of the prospectus, as long as a legend at the beginning of the document sets forth the portions that make up the prospectus.[69]

[66] Form S-8, Part I Item 1; 17 C.F.R. § 239.16b (referencing Rule 421—the "plain English" provision); 1933 Act Reg. C, Rule 421(b), (d), 17 C.F.R. § 230.421(b), § 230.421 (d).

[67] Plain English Disclosure, Securities Act Release No. 33-7380 (Jan. 14, 1997).

[68] Securities Act Release No. 33-6867 (June 6, 1990).

[69] 1933 Act Reg. C, Rule 428(b)(1)(ii), 17 C.F.R. § 230.428(b)(1)(ii); Securities Act Release No. 33-6867 (June 6, 1990).

When delivering the prospectus, an issuer is also required to deliver or cause to be delivered any one of the following:

(1) the annual report for its latest fiscal year;[70]

(2) the latest prospectus filed pursuant to Rule 424(b) that contains audited financial statements for its latest fiscal year;[71] or

(3) its effective Form 10, Form 20-F, or Form 40-F registration statement containing audited financial statements for the registrant's latest fiscal year.[72]

[70] The annual report can be an annual report to security holders containing the information required by Rule 14-3(b) of the 1934 Act or an annual report provided on Form 10-K, 20-F or 40-F. 17 C.F.R. § 230.428(b)(2)(i)–(ii).

[71] Note, however, that this Rule 424(b) prospectus can only be used if its financial statements weren't incorporated by reference from another filing and if such prospectus "contains substantially the information required by SEC Rule 14a-3(b) [under the 1934 Act] or the registration statement was on Form S-1 or F-1." 1933 Act Reg. C, Rule 428(b)(2)(iii), 17 C.F.R. § 230.428(b)(2)(iii).

[72] 17 C.F.R. § 230.428(b)(2)(i)–(iv). Although one of these documents is required to be delivered to eligible employees pursuant to Rule 428, the documents can be incorporated by reference for registration statement purposes. the discussion at *Form S-8 Registration Statement.*

The SEC requires that delivery of the prospectus to eligible participants (or, for plans with selective participation, those selected by the issuer to participate) occur no later than the time of the offer. The common practice is to deliver the prospectus upon the grant of a compensatory equity award, including options, even though this may be well in advance of the date on which the option first becomes exercisable.[73] The issuer also must update the prospectus to reflect any material changes occurring during the period in which the offer is being made.[74] Participants should also receive, on request and at no charge, copies of any of the filings incorporated by reference in the Form S-8 registration statement. All materials that are distributed to shareholders must also be distributed to employees (and to other plan participants upon request), such as proxy statements and annual reports that are distributed to shareholders, must also be distributed to employees in a stock option plan or plan fund that invests in issuer securities, no later than the time such materials are sent to shareholders.[75]

[73] 17 C.F.R. § 230.428(b); *see also* Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 34-36345 (October 6, 1995) and Use of Electronic Media, Exchange Act Release No. 34-42728 (Apr. 28, 2000) (discussing the electronic delivery of the prospectus).

[74] 17 C.F.R. § 230.428(b)(1).

[75] 17 C.F.R. § 230.428(b)(5); Form S-8, Part I Item 2; 17 C.F.R. § 239.16b.

All documents constituting the Section 10(a) prospectus, other than the documents incorporated by reference pursuant to Item 3 of Form S-8, must be maintained by the issuer for five years after it is last used as part of the Section 10(a) prospectus. To the extent only a portion of a document is included in the Section 10(a) prospectus, the entire document must be maintained in the file. Upon request, the registrant must furnish to the SEC or its staff a copy of any or all of the documents included in the file. Part I of the Form S-8 lists the content requirements for the prospectus.

In addition, where an issuer registers securities for issuance under a plan still subject to shareholder approval, the prospectus must make the situation clear and a prospectus supplement should be distributed when the shareholder approval is obtained. When tax-qualified defined contribution plans are involved, these content requirements must be coordinated with the specific ERISA requirements applicable to summary plan descriptions[76] and, in appropriate instances, the disclosure requirements of ERISA § 404(c).[77] The presentation should not be confusing or misleading to participants. One document (or set of documents) that addresses all of these requirements is preferred, rather than multiple documents with parallel, overlapping, and sometimes inconsistent descriptions and references.

[76] 29 C.F.R. § 2520.102-3 (describing contents of a summary plan description).

[77] 29 C.F.R. § 2550.404c-1(a)(2).

.30.20.20 Form S-8 Registration Statement —

A significant portion of the information included in a Form S-8 registration statement is incorporated by reference to other previously filed reports of the issuer.[78] These reports include:

[78] Form S-8, Part II Item 3; 17 C.F.R. § 239.16b. For guidance in preparing the facing page, an issuer should rely upon the sample facing page included in the General Instructions to Form S-8. Additionally, Rules 402 and 403 of Regulation C of the 1933 Act provide information regarding type of paper, printing, binding, and pagination.

(1) one of the following:

• the issuer's latest annual report,

• the issuer's latest prospectus filed pursuant to Rule 424(b) containing audited financial statements for the latest fiscal year, or

• the issuer's effective registration statement on Form 10 or Form 20-F;

(2) the latest annual report of the plan, if plan interests are being registered;[79]

(3) all other reports filed pursuant to § 13(a) or 15(d) of the 1934 Act since the end of the fiscal year covered by the report used for (1); and

(4) a description of the securities to be offered.[80]

[79] Under certain circumstances, a participant's interest in a plan may itself be a separate security known as a "plan interest," which must also be registered. Plan interests typically arise when a participant's participation in the plan is both voluntary and contributory, although stock option plans and employee stock purchase plans don't create separate interests in the plan. The most likely situation in which interests in a plan would have to be registered is when a 401(k) plan offers a company stock fund. In that situation, an annual report of the plan, typically provided on Form 11-K (although in certain cases the information may be provided as part of the issuer's annual report), would have to be filed pursuant to Section 15(d) of the Exchange Act within 90 days of the fiscal year's end, provided that plans subject to ERISA may file the plan's financial statements within 180 days after the plan's fiscal year end. When plan interests are registered, the registrant must deliver to each participating employee, upon written or oral request, a copy of the most recent annual report of the plan, whether on Form 11-K or included as part of the registrant's annual report on Form 10-K. Recently, because of numerous "stock drop" lawsuits, in which plan participants brought claims against fiduciaries for including company stock as an investment option when the fiduciary allegedly knew that the stock price was going to drop, many companies are freezing or terminating their company stock funds. In such a situation, an 11-K would no longer need to be filed so long as a post-effective amendment to the applicable Form S-8 is filed that deregisters the offer and sale of the remaining securities and a Form 15 is filed terminating the registration of the securities under the Exchange Act.

[80] The forms and instruction are available from the SEC's website.

The Form S-8 registration statement consists of the facing page, plus the following items:

(1) a listing of documents incorporated by reference;

(2) a description of the securities being offered;

(3) the interests of named experts and counsel;

(4) information regarding indemnification of directors and officers;

(5) certain required exhibits; and

(6) undertakings.[81]

[81] Form S-8, Part II Items 3 through 9; 17 C.F.R. § 239.16b; Rule 404(a), 17 C.F.R. § 230.404(a).

If the securities being offered aren't registered under § 12 of the 1934 Act,[82] the Form S-8 registration statement must include a detailed description of such securities in accordance with Item 202 of Regulation S-K of the 1933 Act. The description, however, doesn't need to include plan interests, even if being registered.[83]

[82] Section 12 of the 1934 Act addresses when a class of securities must be registered under the 1934 Act. This includes any class of securities that is traded on a national securities exchange or that is issued by an issuer with assets exceeding $10 million and either held of record by 2,000 persons or 500 or more persons who are not accredited investors, subject to certain limited exempted types of securities. 1934 Act

§ 12(a), 12(g), *15 U.S.C. § 78 l*. For this purpose, "held of record" doesn't include "securities held by persons who received the securities pursuant to an employee compensation plan." A nonexclusive safe harbor provides that securities received pursuant to a compensatory benefit plan as defined in 1933 Act Rule 701(c) are covered by the employee compensation plan exemption. 1934 Act Rule 12g-1, 17 C.F.R. § 240.12g-1. *See also* the Division of Corporation Finance's Jumpstart Our Business Startups Act Frequently Asked Questions, Changes To The Requirements For Exchange Act Registration And Deregistration , providing questions and answers with respect to changes made to § 12(g) and § 15(d). *See also* SEC Adopts Amendments to Implement JOBS Act and FAST Act Changes for Exchange Act Registration Requirements (May 3, 2016). Interests in specified types of employee plans that are not transferrable except due to death and employee stock options issued pursuant to certain conditions are both exempt from the provisions of § 12(g). 1934 Act Rules 12h-1(g) and (f); *see also* Exemption Of Compensatory Employee Stock Options From Registration Under Section 12(g) of The Securities Exchange Act of 1934, Exchange Act Release No. 34-56887 (Dec. 3, 2007), 72 Fed. Reg. 69,554 (Dec. 7, 2007). 1934 Act Rule 12h-1(f) and 1934 Act Rule 12h-1(g) provide nonreporting and reporting issuers, respectively, with an exemption from § 12(g) registration of stock options issued under written compensatory stock option plans to their employees, directors, consultants, advisers, parent, or majority-owned subsidiaries. The exemption for nonreporting issuers includes certain additional conditions, including that: (1) the options and underlying shares may not be transferred prior to exercise, except on death or disability of the option holder, or to family members by gift or domestic relations order; and (2) the issuer must provide to option holders every six months the risk and financial information described in SEC Rule 701. For more on these requirements, see the discussion under "*Rule 701*". In certain respects, these conditions are similar to those under which the SEC has previously granted individual exemptions from the 1934 Act registration requirement for issuers with 500 or more option holders. Update to the Current Issues and Rulemaking Projects Outline, 12(g) Registration Relief Involving Employee Stock Option Plans (Mar. 29, 2001).

[83] Form S-8, Part II Item 4; 17 C.F.R. § 239.16b.

When using Form S-8, issuers must comply with Regulation S-X of the 1934 Act, which sets forth requirements regarding the financial statements included in the issuer's annual and interim 1934 Act reports that are incorporated by reference.[84] Regulation S-X generally requires that, if an issuer has been in existence for less than one fiscal year, financial statements prepared 135 days or more before the filing date of the Form S-8 registration statement must be updated.[85] However, if the Form S-8 effective date falls between 45 and 90 days after the end of an issuer's fiscal year, the filing need not include financial statements more current than the end of the third fiscal quarter, provided that the issuer:

[84] Regulation S-X of the 1934 Act, 17 C.F.R. § 210.

[85] Rule 3-01(a) of Regulation S-X, 17 C.F.R. § 210.3-01(a).

(1) reasonably and in good faith expects to report income after taxes, but before extraordinary items and cumulative effects of changes in accounting principles, for the most recent fiscal year for which financials aren't yet available; and

(2) has reported income after taxes, but before extraordinary items and cumulative effects of changes in accounting principles, for at least one of the two fiscal years immediately preceding the

most recent fiscal year.[86]

[86] 17 C.F.R. § 210.3-01(c). *See also* 17 C.F.R. § 210.3-01(b) (stating the conditions that an issuer must satisfy if the filing date is within 45 days of the end of the issuer's fiscal year and audited financial statements for the most recent fiscal year aren't available). The timeliness rules applicable to foreign private issuers are somewhat more lenient. 17 C.F.R. § 210.3-12(f). Generally, at the time of the offering, the last year of their audited financial statements may not be older than 15 months. Exchange Act Form 20-F, Part I Item 8.A.4; 17 C.F.R. § 249.220f. If the filing occurs more than nine months after the end of the last audited fiscal year, it should contain interim financial statements (unaudited) covering at least the first six months of the financial year. Exchange Act Form 20-F, Part I Item 8.A.5; 17 C.F.R. § 249.220f. These periods are extended to 18 months and 12 months, respectively, for offerings of securities (1) upon the exercise of outstanding rights granted by the issuer of the securities to be offered, if the rights are granted pro rata to all existing securityholders of the class of securities to which the rights attach;, (2) pursuant to a dividend or interest reinvestment plan, and (3) on the conversion of outstanding convertible securities or the exercise of outstanding transferable warrants issued by the issuer of the securities to be offered, or by one of its affiliates. Exchange Act Form 20-F, Part I Instruction 2 to Item 8; 17 C.F.R. § 249.220f.

Issuers who cannot comply with these conditions generally cannot file a new Form S-8 registration statement until they make a filing that includes the financial statements for that fiscal year.

Once an issuer has filed its annual report, any subsequent changes to the issuer's accounting principles wouldn't necessarily require a restatement on the Form S-8. Rather, an issuer is generally not required to update its previously issued financial statements to reflect the retrospective adjustments unless such change is a “material change[] in the registrant's affairs.” The issuer is responsible for determining if a change is material.[87]

[87] *See* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.40 (Aug. 14, 2009) (last updated Sept. 21, 2020).

Interests of named experts or counsel to the issuer that are substantial, within the meaning of Item 509 of Regulation S-K, must be disclosed in the Form S-8 registration statement.[88] The terms “expert” and “counsel” include the employer of the expert or counsel, as well as all attorneys and nonclerical personnel (in the case of named experts) participating in such matter.[89] This disclosure most commonly arises where an in-house legal staff member who participates in the plan registering its securities provides the counsel opinion for the Form S-8.

[88] Item 509 of Regulation S-K defines “substantial” according to a monetary limit: The interest of an expert or counsel won't be deemed substantial and doesn't have to be disclosed if the interest, including the fair market value of all securities of the registrant owned, received, or subject to options, warrants, or rights received or to be received by the expert or counsel, doesn't exceed $50,000. Item 509 of Regulation S-K, 17 C.F.R. § 229.509.

[89] Form S-8, Part II Item 5; 17 C.F.R. § 239.16b; Item 509 of Regulation S-K, 17 C.F.R. § 229.509.

The indemnification section of the Form S-8 registration statement requires information regarding any arrangement under which an officer, director, or other controlling person of the issuer is indemnified. These arrangements may include statutes, charters, by-laws, or contracts.[90]

[90] Form S-8, Part II Item 6; 17 C.F.R. § 239.16b; Item 702 of Regulation S-K, 17 C.F.R. § 229.702.

Although previously filed documents may be incorporated by reference into the registration statement, certain documents must be listed as exhibits in a Form S-8 registration statement.[91] These documents are:

[91] Instruction 2 to the Exhibit Table, Item 601(a) of Regulation S-K, 17 C.F.R. § 229.601(a).

(1) instruments that define the rights of security holders, such as the issuer's articles of incorporation and by-laws and the plan under which the securities are being offered;[92]

(2) an opinion of counsel, if the shares are newly issued, regarding their legality;[93]

(3) a letter regarding any unaudited interim financial statements;

(4) the consent of experts and counsel;[94]

(5) the consent of independent auditors (consenting to the incorporation by reference of their financial statements); and

(6) any powers of attorney.[95]

[92] The general practice is to file the plan document as an exhibit to the Form S-8 registration statement. Plans are generally filed as an item 4 or item 99 exhibit. Securities and Exchange Commission, Division of Corporation Finance, C&DI: Regulation S-K § 146.10 (July 3, 2008) (last updated Oct. 18, 2016). However, some issuers take the position that broad-based plans under which all participants are treated consistently and that don't define the rights of shareholders, such as 401(k) plans, aren't required to be filed. Item 601(b)(10)(iii)(C)(4) of Regulation S-K, 17 C.F.R. § 229.601(b)(10)(iii)(C)(4).

[93] Item 601 of Regulation S-K requires issuers registering securities to include, as an exhibit to the registration statement and Form S-8, an opinion of legal counsel regarding the legality of the securities being registered. The opinion of legal counsel must indicate whether the securities, when sold, will be legally issued, fully paid, and nonassessable and, if debt securities, whether they will be binding obligations of the issuer. 17 C.F.R. § 229.601(b)(5)(i); Form S-8, Part II Item 8(a); 17 C.F.R. § 239.16b. If the securities are being issued under a plan subject to ERISA, the issuer must generally provide either an opinion of counsel that confirms that the plan document complies with ERISA or a copy of a favorable determination letter from the IRS for the plan. 17 C.F.R. § 229.601(b)(5)(ii) through § 229.601(b)(5)(iii). In lieu of an opinion of counsel addressing ERISA compliance or a favorable determination letter, an issuer can include an undertaking that it will timely submit or has submitted the plan to the IRS and will make or has made any amendments required by the IRS. Form S-8, Part II Item 8(b); 17 C.F.R. § 239.16b.

[94] If, pursuant to Item 509 of Regulation S-K, an expert or counsel is named in the Form S-8 as having prepared or certified any part thereof, Item 601(b)(23) requires that the written consent of such expert or counsel be filed as an exhibit to Form S-8. 17

C.F.R. § 229.601(b)(23).

[95] Form S-8, Part II Item 8; 17 C.F.R. § 239.16b; 17 C.F.R. § 229.601.

The Form S-8 registration statement also includes specific undertakings. An issuer must undertake:

(1) to file a post-effective amendment disclosing any material information about the plan not previously disclosed in the Form S-8 registration statement and removing from registration any unsold securities remaining at the end of the offering;

(2) to deem a new registration statement any annual report filed subsequent to the registration statement; and

(3) to ask the court to determine if indemnification is against public policy, if any of the issuer's officers or directors claim indemnification for liabilities arising under the 1933 Act.[96]

[96] Form S-8, Part II Item 9; 17 C.F.R. § 239.16b; Item 512 of Regulation S-K, 17 C.F.R. § 229.512.

The issuer, as well as certain executive officers of the issuer and a majority of its board of directors, must sign the Form S-8 registration statement, either personally or pursuant to a power of attorney. The 1933 Act currently requires manual signatures, typed signatures, or duplicated or facsimile versions of manual signatures for Form S-8. If typed, duplicated, or facsimile signatures are used, and even if the filing is electronic, the issuer must still obtain manual signatures and retain them for five years, in case the SEC requests review of such signatures.[97] If an issuer relies on a power of attorney for the required officer and director signatures , the issuer must file manually signed copies of the power of attorney. Additionally, if the name of any officer signing on behalf of the issuer is signed pursuant to a power of attorney, certified copies of a resolution of the issuer's board of directors authorizing the signature must also be filed.[98]

[97] General requirements regarding the signature pages are contained in 1933 Act Reg. C, Rule 402, 17 C.F.R. § 230.402, and Rule 302 of Regulation S-T, 17 C.F.R. § 232.302. The requirements of the Electronic Signatures in Global and National Commerce Act, Pub. L. No. 106-229 (codified at 15 U.S.C. § 7001 *et seq.*) are probably not implicated by these rules. *See*, *e.g.*, Application Of The Electronic Signatures In Global And National Commerce Act To Record Retention Requirements Pertaining To Issuers Under The 1933 Act, 1934 Act And Regulation S-T, Securities Act Release No. 33-7985 (June 14, 2001), 66 Fed. Reg. 33,175, 33,176 (June 21, 2001), § III. In light of the difficulties satisfying the manual signature retention requirement due to circumstances arising from Covid-19, SEC staff has stated that it won't recommend SEC enforcement action if: “[(1)] a signatory retains a manually signed signature page or other document authenticating, acknowledging, or otherwise adopting his or her signature that appears in typed form within the electronic filing and provides such document, as promptly as reasonably practicable, to the filer for retention in the ordinary course pursuant to Rule 302(b); [(2)] such document indicates the date and time when the signature was executed; and [(3)] the filer establishes and maintains policies and procedures governing this process.” Staff Statement Regarding Rule 302(b) of Regulation S-T in Light of COVID-19 Concerns.

[98] 17 C.F.R. § 229.601(b)(24).

.30.30 Filing the Form S-8 Registration Statement —

An issuer must file the Form S-8 registration statement before the offer date of the securities being registered.[99] Form S-8 is effective automatically upon filing. As discussed above, an offer for the shares of common stock underlying options is considered made on the date when the options first become exercisable. However, the SEC has taken the position that a Form S-8 registration statement will be effective for securities underlying an option if it is filed before the option is actually exercised, without regard to when the option becomes exercisable.[100] Because issuers typically aren't certain when participants will exercise their options, the Form S-8 registration statement is usually filed no later than the date on which options under the plan become exercisable.

[99] 1933 Act § 5, 15 U.S.C. § 77e *et seq*. *See* Form S-8, General Instruction D; 1933 Act Reg. C, Rule 456, 17 C.F.R. § 230.456; 1933 Act Reg. C, Rule 462(a), 17 C.F.R. § 230.462(a). *See also* A.3 of the General Instructions for information on electronic filings; 17 C.F.R. § 239.16b.

[100] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Sections § 239.15 (Nov. 26, 2008). The general rule is that once an option becomes exercisable, an offer is made and a registration statement must be on file. The SEC treats Form S-8 issuances more liberally, based on the employer-employee relationship. *See id.*

.30.40 Post-Effective Amendment —

If there are subsequent material changes to the disclosed information, or the need arises to include information not previously disclosed, after an issuer has filed a Form S-8 registration statement, the issuer must file a post-effective amendment to the Form S-8.[101] A post-effective amendment should include an explanatory note explaining the amendment. One of the more common uses of the post-effective amendment is to deregister any remaining securities registered on a Form S-8 if the plan under which they were registered will no longer be in use.

[101] An issuer may file a post-effective amendment to a previously filed Form S-8, provided that the issuer continues to meet the Form S-8 requirements. A post-effective amendment is effective as of its filing date. 1933 Act Reg. C, Rule 464(a), 17 C.F.R. § 230.464(a).

A post-effective amendment may not be used to register additional shares. A Form S-8, rather than a post-effective amendment to a prior Form S-8, must be filed to register additional securities under a plan.[102]

[102] Form S-8, General Instruction E; 17 C.F.R. § 239.16b. *See* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.43 (Nov. 09, 2016) (last updated Sept. 21, 2020).

Under certain circumstances, an issuer may use a post-effective amendment to enable registered securities under one plan to be issued under another plan. This limited alternative is only available when the issuer adopts a new plan, expressly terminates any further issuances under the old plan, and authorizes any remaining shares under the old plan to be issued under the new plan. If a post-effective amendment indicates that a registration statement will also cover the issuance of shares under the new plan once such shares are no longer issuable under the old plan, then those unissued shares could be issued under the new plan without new or transferred filing fees.[103]

[103] To be comply with Item 512(a)(1)(iii) of Regulation S-K, the post-effective amendment should identify both the old plan and the new plan on the cover page, and describe how shares that won't be issued under the old plan have or may become authorized for issuance under the new plan.. Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Forms § 126.43 (Nov. 09, 2016) (last updated Sept. 21, 2020).

.30.50 Transfer of Filing Fees —

An issuer may transfer the filing fees associated with unsold securities under a previously filed Form S-8 registration statement to a new one if the offering under the initial registration statement is terminated.[104] To do so, the issuer must include its name, the file number, and initial filing date of the earlier registration statement from which the offset is claimed, and the dollar amount of the offset as a note to the Calculation of Registration Fee table on the new Form S-8.[105] Additionally, the issuer should quantify the amount of unsold securities from the prior registration statement associated with the claimed offset and disclose how the previous registration concluded.[106]

[104] 17 C.F.R. § 230.457(p). *See also* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.42 (Nov. 09, 2016) (last updated Sept. 21, 2020).

[105] *See* Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.44 (Nov. 09, 2016) (last updated Sept. 21, 2020).

[106] Securities and Exchange Commission, Division of Corporation Finance, C&DI: Securities Act Forms § 126.44 (Nov. 09, 2016) (last updated Sept. 21, 2020).

For more on Form S-8 registration, see *Form S-8 Rules*, 44 CPS §III; 362 T.M., *Securities Law Aspects of Employee Benefit Plans*, §III.

.40 Exemptions from Registration under the 1933 Act in Connection with Compensatory Arrangements107 107 This section discusses the exemptions from registration under the 1933 Act most often used by issuers in connection with offers and sales of securities to employees and service providers. Other exemptions under the 1933 Act include § 3(a)(11) (the intrastate offering exemption), § 3(a)(4) (the exemption for not-for-profit issuers) and Regulation A (conditional small issues exemption). These exemptions may, however, be appropriate for certain issuers. —

Where a compensatory arrangement involves the offer and sale of a non-exempt security, an issuer may rely on an applicable exemption from registration as an alternative to registration. Finding an exemption is often a necessity for companies that are not public reporting companies[108] (including subsidiaries of public companies) or when Form S-8 otherwise is unavailable and it may be too difficult or impracticable for an issuer to comply with the requirements of other registration forms. Although the SEC has enumerated specific criteria related to the availability of exemptions, this is not the case for all exemptions; even in situations where the criteria are enumerated, determining whether the requirements have been satisfied often involves the exercise of judgment by the issuer and its counsel.

[108] A public company (or “reporting” company) is a company whose securities are required to be registered with the SEC pursuant to § 12 of the 1934 Act (and who is therefore required to file periodic reports with the SEC) or who is subject to the reporting requirements of § 15(d) of the 1934 Act.

Although the availability of an exemption for a particular offering is based on several factors, three such factors have a significant impact on the analysis and its outcome. The first factor is the number and sophistication of the offerees. As a general rule, the fewer the offerees, the easier it will be for an issuer to find an exemption. The SEC also distinguishes between accredited investors, who are presumed by their earnings history, net worth, or status with the issuer to be sophisticated enough to evaluate the merits of the offering,[109] and all other investors, who are presumed to need the protections of federal securities laws. For some purposes of the 1933 Act, accredited investors are excluded in calculating the number of purchasers. For more, see the discussion of exemptions from registration, below.

[109] An accredited investor is an individual who meets any one of the following conditions: (1) is a

director or executive officer of the issuer, (2) has a net worth, or joint net worth with his or her spouse, of at least $1 million, (3) has had an income in excess of $200,000 in each of the two most recent years, or joint income with his or her spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year, (4) holds in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the SEC has designated as qualifying an individual for accredited investor status, or (5) is a “knowledgeable employee,” as defined in rule 3c-5(a)(4) under the Investment Company Act of 1940 (17 C.F.R.270.3c-5(a)(4)), of the issuer of the securities being offered or sold where the issuer would be an investment company, as defined in section 3 of such act, but for the exclusion provided by either section 3(c)(1) or section 3(c)(7) of such act. 1933 Act Reg. D, Rule 501(a), 17 C.F.R. § 230.501(a). For purposes of this definition of accredited investor, “executive officer” means the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Executive officers of subsidiaries may be deemed executive officers of the issuer if they perform such policy-making functions for the issuer. 17 C.F.R. § 230.501(f). On Dec. 29, 2011, the SEC adopted changes to the standard in Rule 501(a) to exclude the value of a person's primary residence from his or her net worth for purposes of determining whether the individual is an accredited investor. Net Worth Standard for Accredited Investors, Securities Act Release No. 33-9287, *77 Fed. Reg. 81,793* (Dec. 29, 2011), and a technical correction issued as Securities Act Release No. 33-9287A, 77 Fed. Reg. 18,684 (March 28, 2012). The change was required by Dodd-Frank Act § 413(a). *See also* Securities Act Release No. 33-9415 (July 10, 2013) and Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Questions 255.48 and .49 (clarifying accredited investor criteria) (last updated Nov. 6, 2017). Beginning in 2014, Section 413 of the Dodd-Frank Act requires the SEC to review the accredited investor definition every four years to determine whether it should be adjusted. The statute requires the Government Accountability Office to conduct a study and report on alternative criteria for defining accredited investor for Rule 506 purposes. the GAO report at Alternative Criteria for Qualifying As an Accredited Investor Should Be Considered. (July 2013).

The second factor is the size of the offering. Certain exemptions cease to be available as the size of an offering increases,[110] and other exemptions become available only with additional disclosure to participants.[111] As the size of the offering increases, the issuer's financial risk of noncompliance also increases.

[110] For example, the exemption under Rule 504 of Regulation D is limited to offers with an aggregate offer price not in excess of $5 million.

[111] For example, the disclosure requirements under Rule 506, an exemption that places no limit on the aggregate offering price, are greater than the disclosure requirements of Rule 504, an exemption that limits the aggregate offering price to $5 million.

The third factor is the availability of information, particularly financial information, about the issuer. For example, an issuer may not be able to rely on a particular exemption unless the issuer has or is willing to incur the expense to produce financial statements that are reconciled to generally accepted accounting principles in the U.S. (U.S. GAAP).[112] An issuer with little or no prior operating history can sometimes find it difficult to produce the requisite offering materials to comply with the disclosure requirements applicable to a particular exemption.

[112] Since 1973, the Financial Accounting Standards Board (FASB), an independent board, has been responsible for establishing U.S. GAAP. Its official publications are called Statements of Financial Accounting Concepts (SFAC), Statements of Financial Accounting Standards (SFAS)

(now codified as Accounting Standards Codification Topics (ASC)), and Interpretations of Financial Accounting Standards. Effective March 4, 2008, foreign private issuers may be permitted to produce financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), without reconciliation to U.S. GAAP. *See*, *e.g.*, 1933 Act Reg. E, Rule 701(e)(4), *17 C.F.R. § 701(e)(4)*; Acceptance From Foreign Private Issuers Of Financial Statements Prepared In Accordance With International Financial Reporting Standards Without Reconciliation To U.S. GAAP, Securities Act Release No. 33-8879 (Dec. 21, 2007), 73 Fed. Reg. 986, 1004 (Jan. 4, 2008), § VIII (adopting rules to accept financial statements prepared in accordance with IFRS as issued by the IASB).

Finally, an issuer sometimes structures a securities program to eliminate or delay an offer so that neither registration nor an exemption is needed.

Example : Private companies that want to place common stock in the hands of employees sometimes makes outright grants of bonus or restricted stock in reliance on a no sale theory. A company can also grant options that are not exercisable until the issuer otherwise registers the underlying common stock pursuant to an initial public offering, and then use a Form S-8 to register common stock underlying the option grants after the public offering occurs.

The following is an analysis of the principal exemptions available to an issuer seeking to offer and sell issuer securities in connection with compensatory offerings.

.40.10 Private Placement Exemption —

An offer and sale of securities by an issuer that doesn't involve a public offering is known as a private placement. As discussed below, § 4(2) of the 1933 Act is the statutory basis for such placements and Regulation D of the 1933 Act provides a safe harbor for this exemption. Other forms of private placements that are not in compliance with Regulation D are permissible. For more, see this discussion of Regulation D, below.

.40.10.10 § 4(2) —

Section 4(2) of the 1933 Act exempts from registration any transaction that does not involve a public offering. [113] The statute provides no specific limitations or guidelines to assess the availability of the exemption. The two key factors that are used to assess the availability of the exemption are the number and level of sophistication of the offerees and the manner in which the offer occurs or the relationship of the offerees to each other.

[113] 15 U.S.C. § 77d(2).

The Supreme Court set forth the initial test for identifying a transaction that does not involve a public offering in *SEC v. Ralston Purina Co.*,[114] holding that the applicability of § 4(2) should "turn on whether the particular class of persons affected needs the protection of the [1933] Act."[115] Explaining that the number of offerees is not determinative as to the availability of § 4(2), "[because] the statute would seem to apply to a 'public offering' whether to few or many,"[116] the Court nevertheless left open the door for the SEC to impose a numerical limit for purposes of investigating exemption claims.[117]

[114] 346 U.S. 119 (1953).

[115] *SEC v. Ralston Purina Co.*, 346 U.S. 125. The Court found that offers made by Ralston Purina over a four-year period to virtually all of its employees were not exempt under § 4(2) because the employees did not have access to the kind of information, which a registration statement would disclose. The Court explained that "[a]n offering

to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" *Id.*

[116] *SEC v. Ralson Purina Co.* 346 U.S. 125

[117] Nonpublic Offering Exemption, Securities Act Release No. 33-4552 (Nov. 6, 1962) (stating that (1) the number of persons to whom the offering is extended is relevant only to the question of whether they have the requisite association with and knowledge of the issuer to make the exemption available, and (2) an offering restricted to key employees may not qualify for the exemption).

The U.S. Court of Appeals for the Fifth Circuit has developed a more detailed four-factor test to determine the availability of a § 4(2) exemption. In *Doran v. Petroleum Management Corp.*,[118] the court identified the following relevant factors: "(i) the number of offerees and their relationship to each other and the issuer, (ii) the number of units offered, (iii) the size of the offering and (iv) the manner of the offering."[119] Of these factors, the court found the first to be the most critical because the likelihood of an offering being public is increased with the number of offerees. The court reasoned that, in an offering to a large number of offerees, the offerees cannot have a relationship with each other; thus, the issuer would make available to them information that would otherwise be available through a registration statement. While expanding "availability of information" to mean either disclosure of or effective access to such information, the court cautioned that, when relying on an offeree's access to information to support the exemption, the offeree's sophistication and relationship with the issuer become critical.[120]

[118] 545 F.2d 893 (5th Cir. 1977), *appeal after remand*, 576 F.2d 91 (5th Cir. 1978).

[119] *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 900. In *Doran*, the Fifth Circuit reversed the district court's holding that an offer and sale of a limited partnership interest in an oil-drilling venture to four investors, at least one of whom was a sophisticated investor, was a private placement.

[120] *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 905-06 (citing *Gilligan*, *Will & Co. v. SEC*, 267 F.2d 461 (2d Cir. 1959)). The court focused on (1) the offerees' relationship to the issuer, because a close relationship with the issuer may indicate access to information, and (2) sophistication of the offerees, because sophistication is not a substitute for access to information. *See id.* at 902-03. The court reasoned that "access" means a relationship based on factors such as employment, family, or economic bargaining power that enabled an offeree to obtain access to information that registration would disclose. *See id.* at 903. A § 4(2) exemption does not require a privileged or insider relationship between an issuer and offeree. *See SEC v. Spence & Green Chem. Co.*, 612 F.2d 896, 1 EXC 443 (5th Cir. 1980), *cert. denied*, 449 U.S. 1082 (1981) (finding that an offer to 1100 shareholders was not exempt under § 4(2) because they didn't have a special relationship with the issuer that allowed them realistic access to the necessary information).

The *Doran* factors have, for the most part, become the standard to determine the availability of the § 4(2) exemption. Courts in other circuits have followed the reasoning set forth in the *Doran* line of cases, even if not explicitly using the four-factor test.[121] Even though the *Doran* court didn't devote much attention to the number of units offered and size of the offering,[122] an issuer shouldn't assume that the SEC will take the same position. The SEC has indicated that the size of an offering may raise questions as to whether it can be exempt under § 4(2).[123]

[121] *See*, *e.g.*, *United States v. Arutunoff*, 1 F.3d 1112 (10th Cir. 1993), *cert. denied sub nom. DeVries v. United States*, 510 U.S. 1017 (1993) (relying on *Doran* to find that a

jury couldn't conclude that a pyramid scheme involving 100 potential investors was not exempt under § 4(2)); *Mark v. FSC Sec. Corp.*, 870 F.2d 331 (6th Cir. 1989) (relying on *Doran* to find that an offer to 28 diverse investors that lived in 12 different states was not exempt under § 4(2)); *Van Dyke v. Coburn Enter. Inc.*, 873 F.2d 1094 (8th Cir. 1989) (finding that an offer and sale by an issuer to 12 potential offerees was not a public offering because the investors had access to the necessary information, even if it was not furnished to them by the issuer); *Western Fed. Corp. v. Erickson*, 739 F.2d 1439 (9th Cir. 1984) (relying on *Doran* to find that an offer to 66 offerees was not exempt under § 4(2) because the requisite relationships didn't exist between the issuer and all of the offerees).

[122] The court merely noted that the offering involved a small number of units and relatively modest financial stakes. 545 F.2d 900.

[123] Securities Act Release No. 33-4552 (Nov. 6, 1962).

An issuer relying on the § 4(2) exemption for an offering can make a subsequent public or registered offering without the need to integrate the two.[124] Integration is the doctrine that requires an issuer to treat multiple offerings as a single offering for the purpose of determining whether the registration requirements of the 1933 Act apply.[125] Whether two offerings should be integrated is based on consideration of the following factors:

[124] 1933 Act Rule 152, 17 C.F.R. § 230.152. Rule 152, which provides a safe harbor from integration for § 4(2) offerings, states: “The phrase ‘transactions by an issuer not involving any public offering’ in section 4(2) shall be deemed to apply to transactions not involving any public offering at the time of said transactions although subsequently thereto the issuer decides to make a public offering and/or files a registration statement.”

[125] The Regulation of Securities Offerings, Securities Act Release No. 33-7606A, at § X(A) (Nov. 17, 1998).

- whether the sales are part of a single plan of financing;
- whether the sales involve issuance of the same class of securities;
- whether the sales have been made at or about the same time;
- whether the same type of consideration is received; and
- whether the sales are made for the same general purpose.[126]

[126] *See SEC v. Murphy*, 626 F.2d 633, 645-46 (9th Cir. 1980); Securities Act Release 33-4552 (Nov. 6, 1962).

Section 4(2) is deemed to apply to the transaction that did not involve a public offering at the time it was made.

Securities sold in reliance on § 4(2) are considered “restricted securities” and can be resold in the U.S. only pursuant to an effective registration statement or an exemption from registration[127] or in reliance on the safe harbor in Rule 144, which is discussed later in this chapter.

[127] Rule 502(d), 17 C.F.R. § 230.502(d).

.40.10.20 Rule 506 of Regulation D —

Issuers of compensatory equity can rely on Rule 506 of Regulation D, a safe harbor for transactions deemed exempt under § 4(2) of the 1933 Act.[128] Rule 506 places no limit on the aggregate offering price[129] but does limit the number of purchasers (rather than the number of offerees).

[128] Revision of Certain Exemptions from Registration for Transactions Involving Limited Offer and Sales, Securities Act Release No. 33-6389 (March 8, 1982). Rule 506 was effective as of April 15, 1982, replacing Rule 146. *See* Securities Act Release No. 33-6389, at *1 (March 8, 1982). Regulation D, the private placement exemption adopted by the SEC in response to passage of the Small Business Investment Incentive Act of 1980, comprises Rules 501 through 508. *See* Securities Act Release No. 33-6389, § I and § II(A), at *2(March 8, 1982). Rules 501 through 503, 507, and 508 consist of definitions and conditions that apply to Rule 506 (and to offerings under Rule 504).

[129] "Aggregate offering price" means the sum of all cash, services, property, notes, cancellation of debt, or other consideration to be received by an issuer for the issuance of securities. Rule 501(c) of Regulation D, 17 C.F.R. § 230.501(c), for the full definition.

Rule 506 exempts an offer and sale to 35 or fewer purchasers, excluding any purchasers who are accredited investors or otherwise excludable under the rule,[130] with each purchaser, alone or with a purchaser representative, meeting the requisite sophistication standard. This standard requires that a purchaser, or their representative, have sufficient knowledge and experience in financial and business matters to evaluate the merits and risks of an investment or that the issuer reasonably believe, immediately before the sale, that the purchaser can satisfy the standard.[131] The purchaser representative both expands the universe of eligible participants in a Rule 506 offering to unsophisticated purchasers, and ensures that purchasers will have access to the knowledge and experience necessary for an informed investment decision.

[130] Rule 506(b)(2)(i), 17 C.F.R. § 230.506(b)(2)(i). In addition to accredited investors, certain other purchasers are excluded, including (1) relatives, spouse, or any relative of a spouse who has the same address as the purchaser; (2) any trust in which the purchaser and any of the persons specified in clauses (1) or (3) have more than a 50% beneficial interest; and (3) any corporation or other organization of which a purchaser and persons specified in clauses (1) or (2) collectively are beneficial owners of more than 50% of the equity securities or equity interests. 17 C.F.R. § 230.501(e).

[131] A purchaser representative is an individual who acts on behalf of or with one or more nonaccredited investors in evaluating a proposed investment. To be a purchaser representative, an individual must satisfy all of the requirements set forth in Rule 501(h) or the issuer must reasonably believe that the individual satisfies all of the criteria. A purchaser may have more than one purchaser representative. 17 C.F.R. § 230.506(b)(2)(ii).

Under Rule 506, the required disclosure of financial and nonfinancial information can be extensive. Nonaccredited investors participating in an offering under Rule 506 must receive certain disclosure regarding the issuer, the nature of which is determined by the issuer's status under the 1934 Act and the size of the offering.[132] However, if the offering is limited to accredited investors, no specific disclosure is required, regardless of the aggregate offering price.[133] Where an offering includes both accredited and nonaccredited investors, the SEC recommends that an issuer provide to accredited investors all disclosures provided to nonaccredited investors to ensure compliance with the general antifraud provisions of the 1934 Act.[134]

[132] 17 C.F.R. § 230.502(b)(2).

[133] 17 C.F.R. § 230.502(b)(1). Nevertheless, an issuer should disclose information

necessary to satisfy the general antifraud provisions of the 1934 Act. Such disclosure should provide employees with both the details of the investment available to them and the consequences of investment, as well as information about the issuer's business and financial results that are relevant to an investment decision.

[134] Note, Rule 502(b)(1), 17 C.F.R. § 230.502(b)(1).

Where the issuer is not a public reporting company under the 1934 Act, the financial information required to be provided to nonaccredited investors increases as the aggregate offering price of the offering increases.[135] In offerings over $7.5 million, the issuer must furnish the information required on a registration statement that the issuer is entitled to use, with certain limited exceptions to the information that must be audited.[136] If the offering is up to $7.5 million, the issuer must provide the financial information required on Form S-1 for smaller reporting companies, with certain limited exceptions to the information that must be audited.[137] If the offering is up to $2 million, the issuer must provide the information required in Article 8 of Regulation S-X, except that only the issuer's balance sheet must be audited.[138] An issuer that is a foreign private issuer eligible to use Form 20-F must disclose the information required on a registration statement that it is eligible to use.[139] The nonfinancial disclosure for the issuer consists of either the information required in Part II of Form 1-A or the same kind of information required in Part I of any registration statement available to the issuer.[140]

[135] 17 C.F.R. § 230.502(b)(2). Disclosure must be furnished only to the extent material to an understanding of the issuer, its business, and the securities being offered. 17 C.F.R. § 230.502(b)(2)(i).

[136] 17 C.F.R. § 230.502(b)(2)(i)(B)(3).

[137] 17 C.F.R. § 230.502(b)(2)(i)(B)(2).

[138] 17 C.F.R. § 230.502(b)(2)(i)(B)(1). § 210.8-01 through § 210.8-08 of Regulation S-X; Securities Act Release No. 33-8876 (Dec. 19, 2007), 73 Fed.Reg. 934, 953 through 956.

[139] *17 C.F.R. § 1230.502(b)(2)(i)(C).*

[140] 17 C.F.R. § 230.502(b)(2)(i)(A). To rely on Form 1-A, the issuer must be eligible to use Regulation A. *Id.*

Where the issuer is a public reporting company under the 1934 Act, the size of the offering does not affect the required disclosure to nonaccredited investors. This type of issuer must disclose its annual report and proxy for the most recent fiscal year and the information contained in any report or document that the issuer is required to file under §§ 13(a), 14(a), and 15(d) of the 1934 Act subsequent to the filing of the annual report and include a brief discussion of securities being offered, and use of proceeds from the sale and material changes in the issuer's affairs that are not discussed in other documents furnished.[141]

[141] 17 C.F.R. § 230.502(b)(2)(ii).

Apart from the disclosure described above, all issuers must disclose a significant amount of additional information, regardless of whether they are reporting companies. This disclosure includes advising investors that they have the opportunity to ask questions and to receive and review printed materials.[142] The issuer also must electronically file a Form D with the SEC no later than 15 calendar days, or the next business day if the 15th day falls on a Saturday, Sunday, or holiday, after the first sale of securities in reliance on Regulation D.[143] With respect to stock option plans, this filing can be made after the grant of options but no later than 15 days after the exercise of the first option, which may be administratively more convenient for the issuer. The Form D may be filed prior to the first sale.[144]

[142] The additional disclosures required are, in summary: (1) certain exhibits filed as part of issuer's registration statement or report; (2) if the employee is not an accredited investor, a summary of material information provided to accredited investors by the issuer; (3) answers to the employees' questions about the terms and conditions of the offer; (4) if the offer is in connection with a business combination or exchange offer, information about terms or arrangements that are materially different from those for other security holders; and (5) information on limitations on resale.

[143] Rule 503, 17 C.F.R. § 230.503. One copy must be signed manually by an authorized agent of the issuer. 17 C.F.R. § 230.503(b). *See generally* Electronic Filing and Revision of Form D, Securities Act Release No. 33-8891 (Feb. 6, 2008), 73 Fed. Reg. 10,592 (Feb. 27, 2008). An issuer that fails to comply with Rule 503 may be enjoined by a court from using Rule 506. Rule 507(a), 17 C.F.R. § 230.507(a).

[144] Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Forms § 130.12 (Feb. 27, 2009) (noting an issuer that has submitted a Form D indicating a sale has yet to occur is not required to file an amendment solely to reflect the first sale).

Offers under Rule 506 are subject to the general terms and conditions of Regulation D regarding integration and solicitation.[145] Rule 506 offers are generally not integrated with any other Regulation D offer made more than six months before or six months after the Rule 506 offering. Offers and sales under employee benefit plans are disregarded when determining whether there has been a cessation of offers and sales for a period of six months.[146] If an issuer makes two offers under Regulation D during a six-month period, integration is not automatic. Rather, the issuer must first determine whether the securities offered are of a same or similar class as those offered or sold under Rule 506, using the five factors outlined in Rule 502(a).[147] Notwithstanding these factors, two offers under Rule 506 made within a six-month period solely to accredited investors should not jeopardize the exemption for either one, as Rule 506 doesn't limit the aggregate offering price or the number of purchasers if they are all accredited investors.[148]

[145] 17 C.F.R. § 230.502. Rule 508 of Regulation D sets forth the circumstances under which a failure to comply with the terms and conditions of Rule 506 will not result in the loss of the exemption. On July 10, 2013, the SEC adopted a final rule that removed the general solicitation ban from certain Rule 506 offerings in which sales of securities are limited to accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors. The existing provisions of Rule 506 that apply to offerings without general solicitation or advertising weren't affected by the change. The final rule also amended Form D.

[146] 17 C.F.R. § 230.502(a)

[147] Rule 502(a) adopts the factors applicable to § 4(2). For more on these factors, see the discussion at § 4(2).

[148] Rule 155(b) provides a safe harbor to allow issuers to switch from an abandoned private offering to a registered public offering. To qualify for the safe harbor, the private offering must satisfy the relevant exemption under § 4(2) or Rule 506. The safe harbor eliminates concerns that the abandoned private offering and registered offering would be integrated, which would cause the private placement pre-filing offers to be deemed gun-jumping violations in connection with the registered offering. Switches from an abandoned registered public offering to a private offering are also covered by Rule 155(b). Integration of Abandoned Offerings, Securities Act Release No. 33-7943 (Jan. 26, 2001).

Other Regulation D provisions regarding resale and the filing of notices apply to offerings under Rule 506. Securities sold in reliance on Rule 506 are considered restricted securities and can be resold in the U.S. only pursuant to an effective registration statement, an exemption from registration,[149] or in reliance on Rule 144.

[149] 17 C.F.R. § 230.502(d). This rule also instructs the issuer on what steps to take to ensure that the purchasers in the offering are not underwriters.

.40.10.30 Small Offerings under Rules 504 Regulation D —

For offerings with an aggregate offering price that doesn't exceed $5 million, the 1933 Act provides exemptions, on the theory that registration of such offerings generally isn't necessary for protection of the public interest due to the small amount of securities involved or the limited character of the offer.[150] These exemptions are available under Rule 504 of Regulation D, which are discussed below.[151]

[150] 1933 Act § 3(b), 15 U.S.C. § 77c(b); Securities Act Release No. 33-6188 (Feb. 1, 1980). The statute limits exemptions under § 3(b) to offers with an aggregate amount that doesn't exceed $5 million.

[151] Rule 504 was amended as of Jan. 20, 2017, to increase the aggregate amount of securities that may be offered and sold under the rule to $5 million per twelve-month period and to disqualify certain bad actors, under terms substantially similar to those found in Rule 506, from participating in Rule 504 offerings. Exemptions to Facilitate Intrastate and Regional Securities Offerings, 81 Fed. Reg. 83,494 (Nov. 21, 2016) (codified in relevant part at 17 C.F.R. pt. 230). Rule 505 was repealed as the Rule 504 amendments rendered it largely redundant. *Id.*

Although Rule 504 of Regulation D differs from Rule 506 in the aggregate size of the offering, it is subject to many of the same terms and conditions of Regulation D. The aggregate offering price under Rule 504 cannot exceed $5 million, less the aggregate offering price for all securities sold within the 12 months before the start of and during the offering under Rule 504 in reliance on any exemption under § 3(b) of the 1933 Act or in violation of § 5(a).[152]

[152] Rule 504(b)(2), 17 C.F.R. § 230.504(b)(2).

Example : If an issuer sells securities worth $1 million on June 1, 2017, under Rule 504 and then commences an offering under Rule 504 on Dec. 1, 2017, it may sell no more than an additional $4 million of securities under such offering, and the issuer cannot sell any additional securities under Rule 504 until Dec. 1, 2018.[153]

[153] Note 1, Rule 504(b)(2), 17 C.F.R. § 230.504(b)(2).

The number of investors that may participate in the offering under Rule 504 is unlimited. An issuer is not required to provide disclosure to purchasers,[154] although providing disclosure is usually advisable to comply with the general anti-fraud provisions of the 1934 Act. However, the SEC does prohibit use of Rule 504 by certain issuers. To rely on Rule 504, an issuer cannot be: (1) subject to the reporting requirements of § 13 or § 15(d) of the 1934 Act; (2) an investment company; or (3) a development stage company that either has no specific business plan or purpose, or has indicated that its business plan is to engage in a transaction with an unidentified company or other person.[155]

[154] 17 C.F.R. § 230.504(b)(1) (stating that the provisions of Rule 502(b) regarding disclosure are not applicable to offerings under Rule 504).

[155] 17 C.F.R. § 230.504(a).

Offers under Rule 504 need not be integrated with any other Regulation D offer that is made more than six months before or six months after such offering.[156] As with a Rule 506 offering, if an issuer makes offers under Rule 504 during a six-month period, integration isn't automatic.[157] An issuer relying on Rule 504 must file a Form D with the SEC no later than 15 days after the first sale of securities.[158] The conditions under which an issuer will be disqualified from relying on the exemption under Rule 504 are substantially the same as those applicable to Rule 506, as described above.[159]

[156] 17 C.F.R. § 230.502(a). Offers and sales under an employee benefit plan are disregarded when determining whether integration is required.

[157] For more on the integration rules, see the discussion at Regulation D.

[158] Rule 503(a), 17 C.F.R. § 230.503(a).

[159] Rule 507, 17 C.F.R. § 230.507; Rule 508, 17 C.F.R. § 230.508.

.40.20 Regulation A+ —

Section 3(b)(2) of the 1933 Act, added by § 401(a)(2) of the JOBS Act, requires the SEC to exempt from the registration requirements equity securities, debt securities, and debt securities convertible or exchangeable to equity interests, and guarantees of such securities, if the aggregate offering amount of the securities offered and sold within the previous 12 months does not exceed $50 million. The securities cannot be restricted securities within the meaning of the federal securities laws.

To implement the JOBS Act requirements, the SEC amended Regulation A, which is an existing exemption from registration for small offerings of securities up to $5 million within a 12-month period. Referred to as "Regulation A+, " the amended rules[160] enable companies to offer and sell up to $50 million of securities within a 12-month period, subject to eligibility, disclosure, and reporting requirements. The rules provide for two tiers of offerings:

[160] Securities Act Release No. 33-9741 (March 25, 2015).

- Tier 1 consists of securities offerings of up to $20 million in a 12-month period, with not more than $6 million in offers by selling security holders that are affiliates of the issuer.

- Tier 2 consists of securities offerings of up to $50 million in a 12-month period, with not more than $15 million in offers by selling security holders that are affiliates of the issuer.

For offerings up to $20 million, the company could elect whether to proceed under Tier 1 or 2. Under either tier, companies are subject to basic requirements, including ones addressing issuer eligibility and disclosure that are drawn from the existing provisions of Regulation A. Tier 2 offerings are subject to additional requirements. The amount of securities an investor may purchase in a Tier 2 offering is limited to no more than 10% of the greater of the investor's, alone or together with a spouse's, annual income or net worth.[161]

[161] *See* Updated Investor Bulletin: Regulation A (May 24, 2019).

Securities in Tier 2 offerings may be exempt from mandatory registration under § 12(g) of the 1934 Act, if the issuer meets certain conditions.

Regulation A+ provides for the preemption of state securities law registration and qualification requirements for securities offered or sold to Tier 2 offerings; however, Tier 1 offerings are not preempted from such requirements.

.40.30 Rule 701 —

Rule 701[162] provides a limited, but widely used, exemption for an offering directed to employees by an issuer that is not subject to the periodic reporting requirements of the 1934 Act.[163] An issuer that becomes a public reporting company under the 1934 Act after having made an offer under Rule 701 may continue to rely on Rule 701 to complete the offer and sell the securities to employees.[164]

[162] On Nov. 24, 2020, the SEC proposed amendments to Form S-8 and Rule 701 to modernize the frameworks. *See* SEC Proposes Amendments to Modernize Framework for Securities Offerings and Sales to Workers.

[163] Rule 701(b)(1), 17 C.F.R. § 230.701(b)(1).

[164] 17 C.F.R. § 230.701(b)(2). *See* Joint Committee On Employee Benefits, JCEB Questions For SEC-2000 , Q&A 6 [hereinafter JCEB Questions 2000] (stating that if an issuer makes an offer under Rule 701, the issuer must continue under Rule 701 for the offering period that spans the IPO date).

The offering must be pursuant to a written compensation contract or "compensatory benefit plan," which is defined as any purchase, savings, option, bonus, stock appreciation, profit-sharing, thrift, deferred compensation, or pension or similar plan.[165] An issuer may rely on Rule 701 for sales solely to employees, officers, directors, and certain consultants and advisers of the issuer, its parent, and majority-owned subsidiaries of the issuer and its parent. For purposes of Rule 701, the definitions of "employee", "consultant", and "adviser" are substantially the same as the definitions for purposes of registration on Form S-8.[166] The offer must be restricted to current employees; sales to former or retired employees are permitted only if the initial offer occurred during their employment.[167] Thus, the restrictions on the use of Rule 701 closely parallel the restrictions on the use of Form S-8.

[165] 17 C.F.R. § 230.701(c). The differences between an employee benefit plan under Rule 405 and a compensatory benefit plan appear to be insignificant. A copy of the plan document must be provided to employees. 17 C.F.R. § 230.701(e). Generally, Rule 701 is available only to an issuer, and not to its affiliates. Preliminary Note 4 to Rule 701, 17 C.F.R. § 230.701.

[166] 17 C.F.R. § 230.701(c).

[167] 17 C.F.R. § 230.701(c).

Rule 701 allows an issuer to sell to a participant, during any rolling 12-month period, securities for which the aggregate sales price[168] doesn't exceed the *greatest* of: (1) $1 million; (2) 15% of the total assets of the issuer; or (3) 15% of the outstanding amount of the class of securities being offered and sold. In determining the aggregate amount of sales, both 15-percent tests are measured as of the issuer's most recent balance sheet date, if no older than its last fiscal year end.[169]

[168] An issuer may offer any amount of securities in reliance on Rule 701. 17 C.F.R. § 230.701(d)(2).

[169] The 15% of assets or outstanding securities is determined for the applicable 12-month offering period, which is a fixed 12-month period, determined by the issuer (for example, a calendar year, fiscal year, or plan year). Joint Committee On Employee Benefits, JCEB Questions For SEC-1999 , Q&A 12 . *See also* Arclight Sys. LLC, SEC No-Action Letter (Jan. 17, 2002), in which the SEC staff considered three groups of securities with minimal differences as one class of securities for the purpose of Rule 701 as they were substantially similar in character and afforded the holders substantially similar rights and privileges.

DK:NA_ARCLIGHTSYSTEMS_011702_NEW; https://www.bloomberglaw.com/product/bec/document/XALSEI.

The Rule 701 limit for a private company that acquires another private company includes the aggregate sales price and amount of securities for which the target company claimed the Rule 701 exemption during the same 12-month period for which the acquirer is making the determination.[170]

[170] *See* Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Questions 271.19 (last updated Nov. 6, 2017).

Moreover, if the acquired company has offered securities up to the Rule 701 limit, but the acquiring company still has an amount left before reaching the limit, the leftover amount will remain available to the acquiring company for postmerger sales.[171] If an issuer subject to the reporting requirements of the 1934 Act acquires a private company that issued stock and stock options under Rule 701, the securities will continue to be subject to Rule 701, even if converted to stock and stock options of the acquiring corporation.[172]

[171] *See* JCEB Questions 2000, Q&A 13.

[172] *See* JCEB Questions 2000, Q&A 12. *See also* Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Q&A 271.17 and 271.18 (last updated Nov. 6, 2017).

The disclosure requirements under Rule 701 vary, depending on the aggregate sales price. For sales that do not exceed $10 million within a rolling 12-month period, Rule 701 requires the issuer to provide participants with a copy of the plan document only.[173] However, due to the antifraud provisions of the 1934 Act, issuers commonly provide a disclosure document summarizing the plan's key provisions and risk factors.

[173] 17 C.F.R. § 230.701(e).

Further, in the event that an issuer conducts a stock option repricing and issues replacement stock options, the original and repriced option need not both be counted for purposes of compliance with the Rule 701 limits. The SEC staff has commented that Rule 701 “is concerned with sales, not offers [and] recognizes that calling the [replacement] option grant a ‘sale’ for purposes of Rule 701 is a fiction created for administrative convenience.”[174]

[174] Joint Committee On Employee Benefits, Jceb Questions For Sec-2001 , Q&A 2, [hereinafter JCEB QUESTIONS 2001]. For more on option repricing, see the discussion at Special Considerations in Option Repricing.

Rule 701 requires additional disclosure if sales during any 12-month period exceed $10 million. If sales are likely to exceed the $10 million threshold during the coming 12-month period, an issuer should make the required disclosure before the threshold is reached. If disclosure has not been provided to all participants within a reasonable period of time before the sale of securities, the issuer will lose the exemption for the entire offering once sales exceed $10 million. However, with respect to options, the SEC permits an issuer to provide the disclosure of information within a reasonable time before their exercise.[175] The required disclosure for offerings exceeding the $10 million threshold consists of:

[175] JCEB Questions 1999, Q&A 14.

(1) a copy of the summary plan description, if the plan is subject to ERISA;

(2) a summary of the plan's material terms, which is normally satisfied by distribution of a plan description or similar document prepared in connection with the offering;

(3) risk factors associated with an investment in the securities; and

(4) the issuer's financial statements required to be furnished by Part F/S of Form 1-A (Regulation A Offering Statement).[176]

[176] *See* Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Q&A 271.21 (last updated Nov. 6, 2017). Financial statements furnished under the fourth clause must either be prepared in accordance with U.S. GAAP, reconciled to U.S. GAAP, or prepared in accordance with IFRS as issued by the IASB. The financial statements need not be audited; however, if the issuer has audited financial statements that it prepares for other purposes, it should include them. The issuer could elect to provide financial statements that follow the requirements of either Tier 1 or Tier 2 Regulation A offerings.

Shares subject to stock options are considered sold, for purposes of calculating the $10 million threshold, when they are awarded to employees, rather than on the occurrence of a subsequent event such as vesting or exercise. For stock options, the $10 million threshold is determined by using the exercise price of the options; the fair market value of the underlying stock at the time the option is granted or exercised is not relevant. Grants made during different 12-month periods need not be aggregated, even if such grants are exercised during the same 12-month period.[177] As a result, an issuer should be able to determine, at the time it grants options, whether it will exceed the $10 million threshold.[178]

[177] JCEB Questions 1999, at Q&A 10.

[178] In January 2005, the SEC carried out its first Rule 701 enforcement action and charged Google, Inc. with failing to register the issuance of option grants to employees or provide required financial information to the option recipients. According to the SEC, Google Inc. issued over $80 million in stock options to its employees in the two years preceding its initial public offering, but failed to register the securities or make the mandated financial disclosures. To settle the charges, Google Inc. and its general counsel agreed to cease and desist from violating the registration and related financial disclosure requirements. They were not fined. SEC Charges Google and its General Counsel David C. Drummond with Failure to Register Over $80 Million in Employee Stock Options Prior to IPO, Jan. 13, 2005 (modified Jan. 13, 2005).

The SEC permits an exception to the disclosure requirements described above for an issuer that, at the time of an initial public offering, has outstanding stock options granted under Rule 701. In such a case, the issuer can satisfy the disclosure requirements by delivery of a Form S-8 prospectus[179] and compliance with the general reporting requirements of the 1934 Act.[180] Rule 701 doesn't require an issuer to make any filing with the SEC or other federal authority, either to perfect the exemption or to report on sales.

[179] For more, see the discussion at Filing the Form S-8 Registration Statement and Delivering the Prospectus.

[180] JCEB Questions 2000, Q&A 11.

Shares sold in reliance on Rule 701 are considered restricted securities for 1933 Act purposes and can be resold in the U.S. only pursuant to an effective registration statement, an exemption from registration, or in reliance on Rule 144.[181]

[181] 17 C.F.R. § 230.701(g).

For more on exemptions from registration under the 1933 Act, see *Exemptions*, 44 CPS §II.D.2; 362 T.M., *Securities Law Aspects of Employee Benefit Plans*, §II.D.2.

.50 Special Considerations in Option Repricing —

In a declining market, it is not unusual for outstanding stock options to be underwater. In an effort to retain and motivate option holders, issuers may wish to exchange the underwater options for replacement options or other securities.[182]

[182] *See, e.g.*, John J. Cannon III, Doreen E. Lilienfeld, Gillian Emmett Moldowan & Matthew Behrens, Revisiting Stock Option Repricing, March 20, 2020.

The SEC generally views an option exchange program as an issuer tender offer under Rule 13e-4 of the 1934 Act, which governs tender offers,[183] reasoning that the decision of an executive to accept the offer is an investment decision and not merely a compensation decision.[184] The SEC has exempted certain issuer self-tender offer transactions from Rule 13e-4, but has stopped short of directly stating that such offers do not constitute a tender offer.[185] Accordingly, issuers making offers to repurchase options may need to comply with Rule 13e-4, which requires, among other things, that:

[183] 1934 Act Rule 13e-4, 17 C.F.R. § 240.13e-4 (generally requiring an issuer making a tender offer to file certain documents with the SEC and disclose the tender offer to all of the holders of record and beneficial owners of securities of the class of equity security which is the subject of the tender offer). Because the 1934 Act doesn't include a definition of “tender offer,” the courts have developed various tests to make the determination. In *Hoover Co. v. Fuqua Indus.*, No. C79-1062A, *1979 WL 1244* (N.D. Ohio June 11, 1979), the court adopted the following eight-factor test to determine whether an offer was a tender offer: (1) whether there is an active and widespread solicitation of public shareholders for shares of an issuer; (2) whether the solicitation is made for a substantial percentage of the issuer's stock; (3) whether the offer to purchase is made at a premium over the prevailing market price; (4) whether the terms of the offer are firm; (5) whether the offer is contingent on the tender of a fixed minimum number of shares, and perhaps subject to a ceiling of a fixed number to be purchased; (6) whether the offer is open for only a limited period of time; (7) whether the offerees are subjected to pressure to sell their stock; and (8) whether the public announcements of a purchasing program concerning the target company precede or accompany a rapid accumulation of large amounts of target company securities. Numerous courts have followed this eight-factor test. *See*, *e.g.*, *Polinsky v. MCA Inc.*, 680 F.2d 1286 (9th Cir. 1982); *Milstein v. Huck*, 600 F. Supp. 254, 263-64 (E.D.N.Y. 1984); *Energy Ventures Inc. v. Appalachian Co.,* 587 F. Supp. 734, 740 (D. Del. 1984); *E.H.I. of Fla. Inc. v. Ins. Co. of N. Am.*, 499 F. Supp. 1053 (D. Pa. 1980). Other courts have followed a two-pronged approach that defines a tender offer to involve (1) a publicly announced intention by the purchaser to acquire a substantial block of the stock of the target company for purposes of acquiring control thereof, and (2) a subsequent rapid acquisition by the purchaser of large blocks of stock through open market and privately negotiated purchases. *S-G Secs. Inc. v. Fuqua Inv. Co.*, 466 F. Supp. 1144 (D. Mass. 1978). The courts have since applied both tests to issuer self-tender offers. *See*, *e.g.*, *SEC v. Carter Hawley Hale Stores Inc.*, 760 F.2d 945 (9th Cir. 1985). Without relying on either of these tests, some courts have found that tender offers did not exist where securities were purchased from a small group of sophisticated investors. *See, e.g.*, *Kennecott Copper Corp. v. Curtiss-Wright Corp.*, 584 F.2d 1195 (2d Cir. 1978); *Brascan Ltd. v. Edper Equities Ltd.*, 477 F. Supp. 733 (S.D.N.Y. 1979); *Financial Gen. Bankshares Inc. v. Lance*, No. 78-0278, 1978 BL 327 (D.D.C. July 30, 1978).

[184] Update To The Current Issues And Rulemaking Projects Outline (modified Oct. 31, 2003) [hereinafter Exemptive Order Update]. In the Exemptive Order Update, the SEC provided that exchange offers are “open to a large number of employees, [and] are not limited to executive or senior officers of the issuers.” However, the Exemptive Order Update doesn't explain when a series of individually negotiated offers to repurchase options from certain employees constitutes a tender offer subject to Rule 13e-4. For this reason, issuers generally treat all option exchange programs as tender offers, regardless of the number of offerees.

[185] *See, e.g.,* South Dakota State Med. Holding Co., SEC No-Action Letter (Dec. 20, 1997); Westamerica Bancorp., SEC No-Action Letter (June 20, 1996) SEC NAL 56014; Brock Exploration Co., SEC No-Action Letter (June 30, 1980) SEC NAL 53080. In these no-action letters, the SEC reasoned that the offer was not a tender offer because (1) the programs were open to all current employees that owned the issuer stock, (2) the programs were open for a minimum of 20 days, (3) the decision to participate was at the sole discretion of the employee, (4) the issuer did not encourage or discourage participation, (5) the total amount of the repurchase did not exceed 5% of the issuer's outstanding stock, and (6) the repurchase price was based on a formula.

- the offer be open to all holders of the securities that are the subject of the tender offer;
- the consideration paid to any security holder during the exchange offer be the highest consideration paid to any other security holder during such exchange offer; and
- the issuer file a tender offer statement (a Schedule TO) on the commencement of a tender offer for any class of the issuer's securities.[186]

[186] Schedule TO, 17 C.F.R. § 240.14d-100 (requiring disclosure of a wide range of information, including the terms and purpose of the transaction and source and amount of funds and financial statements). In October 1999, the SEC combined the previously existing schedule for issuer and third-party tender offers into one new schedule, called “Schedule TO,” and the Schedule TO-I is the initial tender offer statement by an issuer. Regulation of Takeovers and Security Holder Communications, Securities Act Release No. 33-7760 (Oct. 22, 1999).

The Division of Corporation Finance of the SEC has issued an exemptive order[187] under the 1934 Act for issuer exchange offers that are conducted for compensatory purposes if the issuer is eligible to use a registration statement on Form S-8. In the order, the SEC provided exemptive relief from two of the requirements of Rule 13e-4, the all holders rule[188] and the best price rule,[189] as long as the program is conducted purely for compensatory purposes and certain other criteria are satisfied.[190] The exemptive order doesn't define “compensatory purpose,” but the term is broadly construed. Therefore, an issuer should ensure that the compensatory purpose of its option exchange program is clearly documented. Participants in an option exchange program need not receive an additional benefit, as long as the program is part of the issuer's overall compensation policy. For example, an option exchange program that is part of an issuer's practice of moving incentive compensation from options to cash or other equity awards is likely to be viewed as having a compensatory purpose. An issuer also has the flexibility to exclude categories of executives from participating in an option exchange program, as long as the exclusion is based on a compensatory purpose.[191]

[187] No-Action, Interpretive And/Or Exemptive Letter: Issuer Exchange Offers Conducted For Compensatory Purposes [hereinafter Exemptive Order].

[188] Generally, the all holders rule requires companies to make the same offer with the same prices on the same terms to all shareholders of a given class of securities. Accordingly, a company cannot exclude specific groups of executives or option holders, such as top executives

and officers, from a buy-back program extended to rank-and-file employees. Such restrictions will not apply to option exchange offers under the exemptive order, giving companies greater flexibility in such exchange offers. LookSmart, Ltd., SEC No-Action Letter (Mar. 20, 2001) [hereinafter LookSmart Letter], in which the SEC granted an exemption from Rule 13e-4(f)(8)(i) to permit LookSmart to exclude special options from participation in the offer and to exclude option holders who will not have been continuously employed by the company through the expiration of the offer.

[189] Generally, the best price rule requires that, in the event the price offered is increased during the course of the tender offer, the higher price must be paid to all shareholders whose shares are purchased in the offer, including shares tendered prior to the date of the price increase. LookSmart Letter (SEC granted an exemption from Rule 13e-4(f)(8)(ii) to permit LookSmart to require tendering option holders to tender both eligible options and any special options they own, although such option holders will receive the same consideration as those tendering option holders who do not hold special options).

[190] The other requirements are that: (i) the issuer be eligible to use Form S-8, (ii) the options subject to the exchange offer be issued under an employee benefit plan, as defined in Rule 405 under the 1933 Act, (iii) the securities offered in the exchange offer be issued under such an employee benefit plan, and (iv) the issuer disclose in the offer to purchase the essential features and significance of the exchange offer, including risks that options holders should consider in deciding to accept the exchange offer. Additionally, the options subject to the repurchase offer must have been issued under an employee benefit plan. *See* Exemptive Order.

[191] LookSmart, Ltd., SEC No-Action Letter (Mar. 20, 2001).

To commence an option exchange program, an issuer must:

- distribute the offer to purchase to eligible executives;
- file a Schedule TO-I and applicable filing fee with the SEC; and
- distribute a variety of documents used to encourage and assist eligible participants.

An exchange offer must remain open for at least 20 business days from the date of commencement (counting the commencement date as the first day).[192] Additionally, such programs generally require shareholder approval.[193]

[192] 1934 Act Rule 13e-4(f)(1)(i), 17 C.F.R. § 240.13e-4(f)(1)(i).

[193] Prior to commencing an option exchange program, issuers should consult with their accountants and tax advisers to avoid any unexpected tax or accounting consequences. For example, an option exchange may raise certain tax issues, such as the status of incentive stock options or deductibility under I.R.C. § 162(m).

If an issuer is considering an option repricing, there are a number of alternative structures that can be implemented. These methods include buying back options for cash, exchanging options for new repriced options or for other equity awards such as restricted stock, or by amending the exercise prices of the outstanding options.[194] The methods have various securities law, accounting, tax, and governance implications that would need to be considered in choosing the best approach for the particular issuer and circumstances.

[194] If available under the terms of the options, the issuer would not be expected to include a tender offer. In order to design an option exchange program that doesn't result in adverse tax or accounting consequences, an issuer should work closely with its accountant.

For more on special considerations in option repricing, see Option *Repricing as a Tender Offer*, 44 CPS § IX.B.; 362 T.M., *Securities Law Aspects of Employee Benefit Plans*, IX.B.

.60 Limitations on Resales of Issuer Securities —

The 1933 Act does not permit an issuer to do indirectly what it precludes the issuer from doing directly. As noted above, an issuer cannot sell securities to the public without registering the offer and sale under the 1933 Act or fitting the offer and sale within one of the exemptions from registration. The 1933 Act also does not allow an issuer to sell securities to third parties only to have the third parties, in turn, sell the securities to the public without complying with these 1933 Act requirements.

The prohibition on sales by third parties on behalf of the issuer is effected, at least in part, by the 1933 Act's broad definition of the term "underwriter" which includes "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking."[195] Given its breadth, this definition is unclear as to whether certain individuals, such as executive officers, would be acting as underwriters when they sell securities acquired from an issuer pursuant to a compensatory plan or arrangement.

[195] 1933 Act, § 2(a)(11), 15 U.S.C. § 77b(a)(11).

Rule 144 of the 1933 Act provides a safe harbor for resales of restricted securities by all persons, whether or not affiliates of an issuer, and resales of securities of an issuer by its affiliates (that is, control securities).[196] A person who sells securities in compliance with the provisions of Rule 144 will not be deemed an underwriter for purposes of the 1933 Act.[197] Failure to comply with the provisions of Rule 144 is not a violation of the 1933 Act; rather, it removes the nonrebuttable presumption afforded by the Rule 144 safe harbor against deemed underwriter status.[198] For this reason, affiliates generally comply with the Rule 144 resale restrictions.

[196] 1933 Act Rule 144, 17 C.F.R. § 230.144. Control securities are securities acquired by an affiliate in a registered public offering or on the open market that are held by affiliates of the issuer. Form S-8, General Instruction C(1)(a); 17 C.F.R. § 239.16b.

[197] 17 C.F.R. § 230.144(b).

[198] *See* 17 C.F.R. § 230.144(b).

For purposes of Rule 144, restricted securities are any securities acquired directly or indirectly from the issuer in one or more transactions or chains of transactions not involving a public offering registered under the 1933 Act.[199] Securities acquired pursuant to Rule 701, or pursuant to a private placement under Rule 506 of Regulation D, are restricted securities within the meaning of Rule 144.[200] The use of the term "restricted" in the context of compensation programs can be confusing because the term is sometimes used to describe securities that are not vested (*i.e.*, subject to forfeiture in certain circumstances) or that are subject to transfer or other restrictions imposed by contract on the award holder by an issuer. For example, in the context of most long-term incentive plans, the term "restricted stock" usually means a compensation award that is subject to vesting and other forfeiture conditions imposed by the issuer on the award holder. Shares of restricted stock would not be "restricted securities" within the meaning of Rule 144 if the shares were acquired pursuant to an offering registered on Form S-8 or were awarded in a manner that complies with the SEC's no-action position governing awards of bonus stock.[201]

[199] 17 C.F.R. § 230.144(a)(3).

[200] *See* 17 C.F.R. § 230.144(a)(3); Securities Act Release No. 33-7645 (Feb. 25, 1999). However, 90 days after a Rule 701 issuer becomes subject to the reporting requirements of the

1934 Act, nonaffiliates may resell the securities without complying with the Rule 144 current public information, holding period, volume, and notice restrictions; affiliates may also resell the securities without complying with the holding period requirement. 17 C.F.R. § 230.701(g).

[201] Securities Act Release No. 33-6281 (Jan. 15, 1981), 46 Fed. Reg. 8446, § III(B). *See also* Intelligent Elecs. Inc., SEC No-Action Letter (Aug. 20, 1991) SEC NAL 24572; Tejas Gas Corp., SEC No-Action Letter (July 20, 1989) (both stating that awards of bonus stock are not restricted securities, so that nonaffiliates could resell the shares without restriction and affiliates would be subject to Rule 144, except for the holding period requirement) SEC NAL 6601.

An affiliate of an issuer, or a person affiliated with an issuer, is a person who directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the issuer.[202] The SEC has not offered more specific guidance on how to determine who is an affiliate, and applying the definition to specific executives or other service providers can be difficult, especially because status with an issuer may change over time. All securities held by an affiliate, whether registered or unregistered, are control securities.

[202] 1933 Act Reg. C, Rule 405, 17 C.F.R. § 230.405.

For Rule 144 to be used as a safe harbor, adequate current public information must be available with respect to the issuer.[203] To determine the adequacy of information, Rule 144 distinguishes between issuers that are subject to the 1934 Act and those that are not.[204] Public information about an issuer will be deemed adequate if the issuer has been subject to the reporting requirements of § 13 or § 15(d) of the 1934 Act for at least 90 days immediately preceding the sale, and has filed all reports required under the 1934 Act during the 12 months preceding the sale.[205] The person whose securities are being resold can rely on the issuer's statement that it has complied with the reporting requirements.[206] If the issuer is not subject to § 13 or § 15(d) of the 1934 Act, publicly available information will be deemed adequate if it is substantially the same as the information specified in Rule 15c2-11 of the 1934 Act.[207]

[203] 17 C.F.R. § 230.144(c).

[204] 17 C.F.R. § 230.144(c)(1), § 230.144(c)(2).

[205] 17 C.F.R. § 230.144(c)(1). The issuer may have securities registered under § 12 of the 1934 Act or pursuant to the 1933 Act.

[206] 17 C.F.R. § 230.144(c)(1). The statement can be in the issuer's most recent quarterly or annual report or a separately written statement. *Id.*

[207] 17 C.F.R. § 230.144(c)(2). Rule 15c2-11 of the 1934 Act, which addresses information regarding an issuer that a broker-dealer must make available, requires various types of information, including the name of the issuer, title and class of the security, number of shares of the security outstanding, nature of the issuer's business, and financial information regarding the issuer. 1934 Act Rule 15c2-11(a)(5), 17 C.F.R. § 240.15c2-11(a)(5).

The extent to which Rule 144 applies to resales of securities of an issuer depends on whether the individual selling the securities is an affiliate of the issuer and whether the securities to be resold are restricted securities within the meaning of Rule 144. Affiliates selling securities that are *not* restricted securities (that is, control securities) are subject to the volume and manner-of-sale limitations set forth below, but not to the holding periods set forth in the rule. All persons selling restricted securities are subject to the volume, manner-of-sale, and holding period requirements of Rule 144. Nonaffiliates may resell securities that are not restricted securities without compliance with Rule 144. Each of these provisions is discussed below.

The Rule 144 volume limitation provides that the amount of securities affiliates can sell during any three-month period generally cannot exceed the greater of 1% of the total shares of that class outstanding, or the average weekly trading volume over the preceding four weeks on all national securities exchanges and/or reported through the automated quotation system of a registered securities association.[208] Similar volume limitations apply to the sale of restricted securities by nonaffiliates. The method for determining the amount of restricted securities generally depends on the nature of the person or entity on whose account they are being sold.[209] For example, the method used when the securities are sold on behalf of a donee[210] differs from the method when the sale is on behalf of a trust.[211] However, the sale of certain securities, such as securities sold pursuant to a registration statement, may be disregarded when determining the amount.[212]

[208] 17 C.F.R. § 230.144(e)(1). To determine compliance with this volume limit, sales by all persons covered by the broad definition of affiliate must be considered.

[209] 17 C.F.R. § 230.144(e)(3)(ii)–(vi). Determination of the amount also depends on whether the securities are convertible. 17 C.F.R. § 230.144(e)(3)(i).

[210] 17 C.F.R. § 230.144(e)(3)(iii).

[211] 17 C.F.R. § 230.144(e)(3)(iv). *See also* 17 C.F.R. § 230.144(e)(3)(ii) (method for pledgee); 17 C.F.R. § 230.144(e)(3)(v) (method for the estate of a deceased person).

[212] 17 C.F.R. § 230.144(e)(3)(vii). In addition, securities sold pursuant to (1) an exemption under Regulation A of the 1933 Act, (2) an exempt transaction under § 4 of the 1933 Act not involving a public offering, and (3) Regulation S under the 1933 Act may be disregarded in the determination. *Id.*

The Rule 144 manner-of-sale provisions require sales to be made pursuant to unsolicited brokers' transactions or in transactions directly with a market maker.[213] Rule 144 prohibits the seller of securities from soliciting, or arranging for the solicitation of, orders to buy the securities in anticipation of, or in connection with, the offer and sale of the securities to any person other than the broker who executes the sales order.[214] The manner-of-sale provisions are not applicable to sales of securities for the account of a decedent's estate or the beneficiary of such an estate if the estate or the beneficiary is not an affiliate of the issuer.[215]

[213] 17 C.F.R. § 230.144(f)(1).

[214] 17 C.F.R. § 230.144(f)(2).

[215] 17 C.F.R. § 230.144(f)(3). *See* Resales of Securities, Securities Act Release No. 33-6286 (Feb. 6, 1981).

Finally, for sales made in reliance on Rule 144, a notice of sale on Form 144 must be filed at the time the order to sell is placed with the broker or the securities are sold to the market maker.[216] Form 144, which is signed by the person on whose account the securities are to be sold, must be filed with the SEC and the principal national securities exchange, if any, on which the securities are listed.[217] However, no notice is required for a Rule 144 sale when the number of securities does not exceed 5,000 shares or other units and the aggregate sale price does not exceed $50,000, measured over a three-month period.[218]

[216] 17 C.F.R. § 230.144(h).

[217] Form 144 is filed with the SEC at its principal office in Washington, D.C. *See* 17 C.F.R. § 230.144(h). *See also* Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules § 136.09 (March 4, 2011) (last updated Nov. 6, 2017) (explaining that, if Form 144 is filed by mail, the requirements of Rule 144(h) are met if the Form is mailed on the same day as the placing of a sale order or the execution of the sale).

[218] 17 C.F.R. § 230.144(h).

Rule 144 generally imposes a six-month holding requirement for reporting issuers (one year for non-reporting issuers) on resales of restricted securities by affiliates and nonaffiliates.[219] This holding period begins on the later of:

[219] 17 C.F.R. § 230.144(d)(1); Securities Act Release No. 33-8869, 72 Fed.Reg. 71546, § VII. The holding requirement is one year if the issuer has not been a reporting company for at least 90 days prior to the sale. *Id* Prior to Feb. 15, 2008, all resales of restricted securities were subject to a holding requirement of one year. 72 Fed.Reg. 71546, at 71548 through 71549, § II(B)(1).

- the date on which the securities were acquired from the issuer or its affiliate; and
- the date of any Rule 144 resale by the affiliate who acquired the securities from the issuer or any subsequent holder.

For executives or other affiliate service providers who acquire the securities via a cash purchase, rather than by other means such as the exercise of a derivative security, the holding period doesn't begin until the issuer or its affiliate receives the purchase price.[220]

[220] *See* Securities Act Release No. 33-8869, 72 Fed.Reg. 71546, § VII.

The holding period for restricted securities acquired from the exercise of an employee stock option begins on the date of exercise of the option.[221] The holding period for restricted securities that an employee receives pursuant to an individually negotiated employment agreement begins when investment risk for the securities passes to the employee, (that is, the date that the employee is deemed to have paid for them), which generally is the securities' vesting date.[222] However, for restricted shares and restricted share units, it is the date of the agreement so long as:

[221] National Patent Dev. Corp., SEC No-Action Letter (Apr. 13, 1972) SEC NAL 34325; Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Q&A 132.11 (last updated Nov. 6, 2017).

[222] *See, e.g.*, Pullman Inc., SEC No-Action Letter (Sept. 6, 1976) (stating that the full purchase price for restricted shares is not deemed paid until all restrictions relating to termination of employment lapse) SEC NAL 3074; Federated Investors Inc., SEC No-Action Letter (Feb. 2, 1976) SEC NAL 40984; Ralph M. Parsons Co., SEC No-Action Letter (March 11, 1974) SEC NAL 14774; SSignal Cos. Inc., SEC No-Action Letter (Mar. 4, 1974) SEC NAL 11551.

- the vesting of the securities is conditioned solely on continued employment or satisfaction of performance conditions not tied to the employee's individual performance, and
- the employee pays no further consideration for the securities.[223]

[223] *See, e.g.*, Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Q&A 532.06 (last updated October 19, 2016).

As noted above, the holding period doesn't apply to resales of control securities unless they are also restricted securities.

Under certain conditions, Rule 144 permits a holder of unregistered securities to tack the holding period for such securities to either that of another security owned by that holder or that of a prior holder of the unregistered securities. Rule 144(d)(3)(ii) states that securities acquired from the issuer solely in exchange for other securities of the same issuer surrendered for conversion are deemed to have been acquired on the date that the surrendered securities were acquired.[224] For example, Rule 144(d)(3)(ii) would apply to the exercise of employee stock options, when previously issued shares of the issuer's common stock are tendered as payment.

[224] 17 C.F.R. § 230.144(d)(3)(ii).

In a no-action letter,[225] the SEC allowed tacking the holding period for the options to that of the underlying securities, solely to the extent that the number of shares received equaled the number of shares tendered. The SEC did not condition tacking on the use of the shorter of the two holding periods. In situations involving the exercise of employee stock options without the tendering of previously acquired securities, whether tacking is permitted depends on whether the option holder assumed an investment risk with respect to the grant of the option.[226] In a no-action letter,[227] the SEC permitted the holding period for options granted in return for a cancellation of indebtedness to be tacked to the holding period for issuer common stock representing the option spread issued in a cashless option exercise, but did not permit tacking for a similar exercise of options granted in consideration for other canceled vested stock purchase rights or as an inducement for continued employment.

[225] Commercial Shearing, Inc., SEC No-Action Letter (Feb. 9, 1981) SEC NAL 6463. Tacking is not permitted for those shares received in excess of the number tendered. *Id.*

[226] Note 2 to 1933 Act Rule 144(d)(3)(x), *17 C.F.R. § 230.244(d)(3)(x)*; Securities Act Release No. 33-8869, 72 Fed. Reg. 71546, § VII (providing where options "are not purchased for cash or other property and do not create any investment risk to the holder" the underlying securities will be deemed acquired at the time of exercise of the option and payment in full of the exercise price); Malden Trust Corp., SEC No-Action Letter (Feb. 21, 1989) SEC NAL 7577 (stating that the purchase for cash or other property of a warrant or other right is an investment risk but that "the grant of an employee stock option does not create any investment risk")

[227] Bell Sports Holding Corp., SEC No-Action Letter (May 19, 1992) SEC NAL 13251. *But see* Communications Systems., SEC No-Action Letter (Jan. 17, 1983) SEC NAL 32923 (refusing to permit a nonemployee to tack holding periods in the cashless exercise of options granted in consideration for relinquishment of a prior option to purchase shares of a predecessor of the issuer).

The SEC has generally concluded that employee stock options granted for purposes of employment inducement or retention do not cause the holder to assume investment risk. Accordingly, the SEC generally doesn't permit tacking of the holding periods of such options.[228] This position is consistent with the SEC view there is no purchase of the common stock until the exercise price is paid.[229]

[228] Bell Sports Holding Corp., SEC No-Action Letter (May 19, 1992) SEC NAL 13251; Malden Trust Corporation, SEC No-Action Letter (Feb. 21, 1989) SEC NAL 7577; *also* Note 2 to 1933 Act Rule 144(d)(3)(x), *17 C.F.R. § 230.244(d)(3)(x)*.

[229] 1933 Act Rule 144(d)(1), 17 C.F.R. § 230.144(d)(1).

Example: The SEC wouldn't permit an option holder who exercised an option and received issuer common stock representing the option spread without paying any further consideration to tack the holding period of the option to that of the common stock.[230]

[230] Malden Trust Corporation, SEC No-Action Letter (Feb. 21, 1989). *But see* ADAC Labs., SEC No-Action Letter (Oct. 5, 1988) SEC NAL 58908 (permitting a consultant who exchanged an option for shares of common stock of the issuer equal to the value of the option spread to tack the holding period of the option with that of the common stock). In 1988, options granted to consultants couldn't be registered on Form S-8,, suggesting that the SEC didn't consider this

option to be an employee option. For more, see the discussion under Form S-8 regarding the use of Form S-8 for consultants. In other situations involving options granted to nonemployees, the SEC has permitted optionees to exchange stock options for unregistered shares of common stock of the issuer, without the payment of cash or any other consideration, and to tack the holding period for the option to that of the underlying security. *See, e.g.*, Tech Squared Inc., SEC No-Action Letter (May 4, 1999) SEC NAL 26334; Bell Sports No-Action Letter, SEC NAL 13251. *See* Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, Q&A 532.11 (last updated Nov. 6, 2017).

The provisions of Rule 144 involving tacking the holding period of a prior holder are equally relevant to transfers or bequests of unregistered securities. Securities acquired from an affiliate of the issuer by gift are deemed to have been acquired by the donee when acquired by the donor.[231] When an affiliate of the issuer is also the settlor of a trust, securities acquired from the settlor by the trust, or from the trust by the beneficiaries of the trust, are deemed to have been acquired when acquired by the settlor.[232] Upon the death of an affiliate of the issuer, the estate or beneficiaries "step into [the affiliate's] shoes" and are deemed to have acquired the securities as of the date the affiliate acquired them.[233]

[231] 17 C.F.R. § 230.144(d)(3)(v).

[232] 17 C.F.R. § 230.144(d)(3)(vi). Securities Act Release No. 33-6099, Q&A 31 (Aug. 2, 1979) (stating that tacking is permitted when securities held by the trust were donated by the seller, but is not permitted when securities held by the trust were sold by the seller).

[233] 17 C.F.R. § 230.144(d)(3)(vii). No holding period is required if the estate or beneficiary is not an affiliate of the issuer. *Id.*

Nonaffiliates generally may resell restricted securities without regard to the volume and manner-of-sale limitations of Rule 144 after holding them for at least six months, as long as the individual has not been an affiliate during the three-month period before the sale and the adequate public information requirements are met.[234]

[234] 1933 Act Rule 230.144(b)(1), 17 C.F.R.§ 230.144(b)(1); Securities Act Release No. 33-8869, 72 Fed. Reg. 71546, § VII. If adequate current public information about the issuer isn't available, then the holding requirement is one year. *Id.*

An issuer may avoid the limitations imposed by Rule 144 if the issuer chooses to register resales through a registration statement pursuant to Part II of Form S-8 and files a separate reoffer prospectus under Form S-8 containing the disclosure specified in Part I of Form S-3 instead of the S-8/Reoffer Prospectus.[235] The S-8/Reoffer Prospectus is used to register the resale of control securities held by affiliates, and the resale of restricted securities whether or not held by affiliates,[236] of the issuer. The SEC imposes no limitations on such registration as long as the use of Form S-3, or Form F-3, in the case of a foreign private issuer, is available to the issuer. However, if Form S-3 or F-3 isn't available, then the amount of securities to be reoffered or resold via the S-8/Reoffer Prospectus by any person during any three-month period may not exceed the amount specified in Rule 144(e).[237]

[235] The information required by Part I of Form S-3 is extensive relative to that required by Part I of Form S-8. Form S-3 is used for registration of securities to be offered in specified types of transactions by issuers who meet minimum eligibility requirements regarding availability of current public information and financial condition. For more, see the General Instructions for Form S-3. Although it is generally not necessary to file Form S-8 prospectuses with the SEC, a prospectus prepared for a Form S-8 used to register the resale of control securities and restricted securities must be filed with the SEC.

[236] For more, see the discussion of control securities, under Limitations on Resales of Issuer

Securities.

[237] Form S-8, General Instruction C(2); 17 C.F.R. § 239.16b; *See also* 17 C.F.R. § 230.144(e).

For more on the Rule 144 limitations on resale of issuer securities, see *Resales by Participants*, 44 CPS §II.G.; 315 T.M., *U.S. Federal Securities Law Aspects of Merger and Acquisition Transactions*, IV.A.; 362 T.M., *Securities Law Aspects of Employee Benefit Plans*, II.G.