

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 240

[Release No. 34-56887; International Series Release No. 1305; File No. S7-14-07]

RIN 3235-AJ91

### Exemption of Compensatory Employee Stock Options From Registration Under Section 12(G) of the Securities Exchange Act of 1934

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** We are adopting two exemptions from the registration requirements of the Securities Exchange Act of 1934 for compensatory employee stock options. The first exemption will be available to issuers that are not required to file periodic reports under the Exchange Act. The second exemption will be available to issuers that are required to file those reports because they have registered under Exchange Act Section 12 a class of security or are required to file reports pursuant to Exchange Act Section 15(d). The exemptions will apply only to the issuer's compensatory employee stock options and will not extend to the class of securities underlying those options.

**DATES:** *Effective Date:* December 7, 2007.

**FOR FURTHER INFORMATION CONTACT:** Amy M. Starr, Senior Special Counsel to the Director, at (202) 551-3115, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are amending rule 12h-1<sup>1</sup> under the Securities Exchange Act of 1934.<sup>2</sup>

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### I. Introduction and Background

#### A. Proposing Release and Public Comment Letters

On July 5, 2007, we proposed amendments to Exchange Act Rule 12h-1 to provide two exemptions from Exchange Act Section 12(g)<sup>3</sup> registration for compensatory employee stock options.<sup>4</sup> The first proposed exemption applied to compensatory employee stock options of an issuer that did not have a class of security registered under Exchange Act Section 12<sup>5</sup> and was not subject to the reporting requirements of Exchange Act Section 15(d),<sup>6</sup> provided certain conditions were met. The proposed exemption built on a line of no-action letters issued by the staff of the Division of Corporation Finance that granted relief from Exchange Act Section 12(g) registration to private, non-reporting issuers for their compensatory employee stock options.<sup>7</sup> The second proposed exemption applied to compensatory employee stock options of issuers that were required to file periodic reports under the Exchange Act because they had registered under Section 12 the class of

<sup>3</sup> 15 U.S.C. 78l(g).

<sup>4</sup> *Exemption of Compensatory Employee Stock Options from Registration Under Section 12(g) of the Securities Exchange Act of 1934*, Release No. 34-56010 (Jul. 10, 2007) [72 FR 37608] (“Proposing Release”).

<sup>5</sup> 15 U.S.C. 78l.

<sup>6</sup> 15 U.S.C. 78o(d).

<sup>7</sup> See, e.g., no-action letters to Starbucks Corporation (available Apr. 2, 1992); Kinko's, Inc. (available Nov. 30, 1999); Mitchell International Holding, Inc. (available Dec. 27, 2000) (“Mitchell International”); AMIS Holdings, Inc. (available Jul. 30, 2001) (“AMIS Holdings”); Headstrong Corporation (available Feb. 28, 2003); and VG Holding Corporation (available Oct. 31, 2006) (“VG Holding”).

equity security underlying those options.

In response to our request for comment on the Proposing Release, we received twelve comment letters from various persons, all of whom expressed support for the need for the proposed exemptions.<sup>8</sup> Commenters expressed differing concerns about the scope of the exemptions, and the transferability restrictions and information conditions of the proposed exemption for private, non-reporting issuers. After considering commenters' views, we are adopting amendments to Exchange Act Rule 12h-1, substantially as proposed, with some modifications including:

- Exemption for private, non-reporting issuers:
  - Elimination of transferability and ownership restrictions on holders of shares issued on exercise of compensatory employee stock options; and
  - Elimination of an issuer's obligation to provide certain required information to holders of shares received on exercise of compensatory employee stock options.
- Exemption for public reporting issuers:
  - Expansion of the category of issuers eligible to rely on the exemption to include any issuer required to file periodic reports under Exchange Act Section 13<sup>9</sup> or Section 15(d).

#### B. Employee Stock Options and Exchange Act Section 12(g)

In the 1980s, private, non-reporting issuers began using compensatory employee stock options<sup>10</sup> to compensate a broader range of employees, including executive, middle, and lower-level employees, directors, and consultants.<sup>11</sup> Compensatory

<sup>8</sup> See letters from American Bar Association, Committee on Federal Regulation of Securities (“ABA”); America's Community Bankers (“ACB”); Center for Audit Quality (“CAQ”); Deloitte & Touche LLP (“D & T”); Drinker Biddle & Reath LLP (“Drinker”); Ernst & Young LLP (“E & Y”); Freescale Semiconductor (“Freescale”); KPMG LLP (“KPMG”); Andrew Ross, Partner, Loeb & Loeb (“Ross”); New York State Society of Certified Public Accountants (“NYSSCPA”); Pink Sheets LLC (“Pink Sheets”); and Simpson Thacher & Bartlett LLP (“Simpson”).

<sup>9</sup> 15 U.S.C. 78m.

<sup>10</sup> Throughout this release, for purposes of the exemption for private, non-reporting issuers, we use the term “compensatory employee stock options” to refer to stock options issued to employees, directors, consultants, and advisors (to the extent permitted under Securities Act Rule 701 [17 CFR 230.701]). For reporting issuers, the phrase also refers to those persons described in General Instruction A.1(a) to Form S-8 [17 CFR 239.16b].

<sup>11</sup> The National Center for Employee Ownership surveyed 275 venture capital-backed private businesses in the technology and telecommunications businesses. Of these firms,

<sup>1</sup> 17 CFR 240.12h-1.

<sup>2</sup> 15 U.S.C. 78a et seq.

employee stock options provide a method to use non-cash compensation to attract, retain, and motivate company employees, directors, and consultants.<sup>12</sup> Since the 1990s, a number of private, non-reporting issuers have granted compensatory employee stock options to 500 or more employees, directors, and consultants.<sup>13</sup>

Under Exchange Act Section 12(g), an issuer with 500 or more holders of record of a class of equity security and assets in excess of \$10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration.<sup>14</sup> Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act.<sup>15</sup> Accordingly, an issuer with 500 or more

77% provided options to all employees while 23% provided them only to select employees. "New Data Show Venture-Backed Companies Still Issue Options Broadly," [http://www.nceo.org/library/option\\_venturebacked.html](http://www.nceo.org/library/option_venturebacked.html); see also J. Hand, 2005 "Give Everyone a Prize? Employee Stock Options in Private Venture-Backed Firms," Working Paper, Kenan-Flagler Business School, UNC Chapel Hill, available at <http://ssrn.com/abstract=599904> ("Hand Paper") (study investigating the impacts on the equity values of private venture-backed firms of the organizational depth to which they grant employee stock options).

Securities Act Rule 701, which provides an exemption from Securities Act registration for non-reporting issuers for offerings of securities to employees, directors, consultants and advisors, and specified others, pursuant to written compensatory benefit plans or agreements, has given private issuers great flexibility in granting compensatory employee stock options to employees (and other eligible persons) at all levels. See Rule 701(c) [17 CFR 230.701(c)]; and *Rule 701 Exempt Offerings Pursuant to Compensatory Arrangements*, Release No. 33-7645 (Mar. 8, 1999) [64 FR 11095] ("Rule 701 Release"). See also *Compensatory Benefit Plans and Contracts*, Release No. 33-6768 (Apr. 14, 1988) [53 FR 12918].

<sup>12</sup> See Hand Paper, note 11 *supra*.

<sup>13</sup> See no-action letters cited at note 7 *supra*.

<sup>14</sup> The asset threshold was set originally at \$1 million in Section 12(g). Pursuant to its authority under Section 12(h) of the Exchange Act, the Commission has increased the amount three times; from \$1 million to \$3 million in 1982 (*System of Classification for Purposes of Exempting Smaller Issuers From Certain Reporting and Other Requirements*, Release No. 34-18647 (Apr. 13, 1982)[47 FR 17046]), from \$3 million to \$5 million in 1986 (*Reporting by Small Issuers*, Release No. 34-23406 (Jul. 8, 1986) [51 FR 253601]), and from \$5 million to \$10 million in 1996 (*Relief from Reporting by Small Issuers*, Release No. 34-37157 (May 1, 1996) [61 FR 21353]).

<sup>15</sup> Exchange Act Section 3(a)(11) [15 U.S.C. 78c(a)(11)] defines equity security to include any right to purchase a security (such as options) and Exchange Act Rule 3a11-1 [17 CFR 240.3a11-1] explicitly includes options in the definition of equity security for purposes of Exchange Act Sections 12(g) and 16 [15 U.S.C. 78l(g) and 78p]. Exchange Act Section 12(g)(5) [15 U.S.C. 78l(g)(5)] defines class to include "all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges."

optionholders and more than \$10 million in assets is required to register that class of options under the Exchange Act, absent an available exemption. While there is an exemption from Exchange Act Section 12(g) registration for interests and participations in certain other types of employee compensation plans involving securities,<sup>16</sup> currently there is no exemption for compensatory employee stock options.

The addition of Section 12(g) to the Exchange Act in 1964 was intended "to extend to investors in certain over-the-counter securities the same protection now afforded to those in listed securities by providing that the issuers of certain securities now traded over the counter shall be subject to the same requirements that now apply to issuers of securities listed on an exchange."<sup>17</sup> Further, Exchange Act Section 12(g) extended the disclosure and other Exchange Act safeguards to unlisted securities as a means to prevent fraud.<sup>18</sup>

A number of private, non-reporting issuers faced with registration under Exchange Act Section 12(g) due solely to their compensatory employee stock options being held by 500 or more holders of record (as well as having more than \$10 million in assets) at the end of their fiscal year have requested registration relief from our Division of Corporation Finance.<sup>19</sup> Since 1992, the Division has provided relief through no-action letters<sup>20</sup> to these private issuers

<sup>16</sup> The exemption from registration under Exchange Act Section 12(g) which is contained in Exchange Act Rule 12h-1(a), was adopted in 1965, for "[a]ny interest or participation in an employee stock bonus, stock purchase, profit sharing, pension, retirement, incentive, thrift, savings or similar plan which is not transferable by the holder except in the event of death or mental incompetency, or any security issued solely to fund such plans." Rule 12h-1 is intended to exempt from Section 12(g) registration the same types of employee benefit plan interests as Section 3(a)(2) [15 U.S.C. 77c(a)(2)] of the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] exempts from Securities Act registration and, thus, does not cover stock options. See, e.g., L. Loss and J. Seligman, *Securities Regulations*, 3d., at § 6-A-4.

<sup>17</sup> House of Representatives Report No. 1418 (1964), 88th Cong., 2d Sess., HR 679, p.1. See also Section 3(c) of the Securities Act Amendments of 1964, Pub. L. 88-467; 78 Stat. 565.

<sup>18</sup> Senate Committee Report, No. 379 (1963), 88th Cong., 1st Sess., p. 63.

<sup>19</sup> The Division has delegated authority to grant (but not deny) applications for exemption under Exchange Act Section 12(h). See Rule 200.30-1(e)(7) [17 CFR 200.30-1(e)(7)].

<sup>20</sup> For the conditions necessary to receive relief under these letters and orders see, e.g., the no-action letter to Mitchell International, note 7 *supra* (for the pre-2001 relief) and the no-action letters to AMIS Holdings, note 7 *supra*; ISE Labs, Inc. (available Jun. 2, 2003); Jazz Semiconductor, Inc. (available Nov. 21, 2005) ("Jazz Semiconductor"); and VG Holding, note 7 *supra* (for the expanded relief beginning in 2001).

when specified conditions were present. More recently, the Advisory Committee on Smaller Public Companies, in its Final Report, recommended that we provide Exchange Act Section 12(g) registration relief for compensatory employee stock options.<sup>21</sup>

As we discussed further in the Proposing Release, we believe that it is appropriate at this time to adopt two new exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees, directors, consultants, and advisors of the issuer, its parents, and majority-owned subsidiaries of the issuer or its parents.<sup>22</sup>

## II. Discussion of Exemptions

We are adopting two amendments to Exchange Act Rule 12h-1 as proposed, with some modifications. These amendments will:

- Provide an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans; and
- Provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock

<sup>21</sup> *Final Report of the Advisory Committee on Smaller Public Companies to the Securities and Exchange Commission*, Apr. 23, 2006 at 87 ("Final Report of the Advisory Committee").

<sup>22</sup> The exemption for private, non-reporting issuers allows compensatory employee stock options to be held only by those persons described in Securities Act Rule 701(c) [17 CFR 230.701(c)] (including permitted transferees), while the exemption for reporting issuers also allows options to be held by those persons described in General Instruction A.1(a) to Form S-8. Securities Act Rule 701(c) lists the categories of persons to whom offers and sales of securities under written compensatory benefit plans or contracts may be made in reliance on Securities Act Rule 701 by an issuer, its parents, and majority-owned subsidiaries of the issuer or its parents. The categories of persons are: employees (including specified insurance agents); directors; general partners; trustees (where the issuer is a business trust); officers; consultants and advisors (under certain conditions); family members who acquire their securities from such persons through gifts or domestic relations orders; and former employees, directors, general partners, trustees, officers, consultants and advisors only if such persons were employed by or providing services to the issuer at the time the securities were offered. The exemption also allows options to be transferred to (and held by) family members (as described in Securities Act Rule 701) through gifts or domestic relations orders, or to an executor or guardian of the optionholder upon the death or disability of the optionholder. For ease of discussion, in this release we use the phrase "employees, directors, consultants and advisors of the issuer" to refer to those persons described in Securities Act Rule 701(c) and transferees permitted by the exemption. For reporting issuers, the exemption will cover grants of options made prior to and after the issuer becomes subject to the Exchange Act reporting requirements.

options of issuers that have registered under Exchange Act Section 12 a class of security or are required to file reports pursuant to Exchange Act Section 15(d).

Given the differences between issuers that are required to file periodic reports under the Exchange Act and those issuers that do not have such an obligation, including the nature of the trading markets and the amount of publicly available information, we believe that it is appropriate to adopt separate exemptions for these different types of issuers.

#### *A. Exemption for Compensatory Employee Stock Options of Issuers That Are Not Exchange Act Reporting Issuers*

We believe it is appropriate to provide an exemption from Exchange Act registration, based on the factors identified in Exchange Act Section 12(h),<sup>23</sup> for compensatory employee stock options of issuers that are not required to file reports under the Exchange Act.<sup>24</sup> We believe that an exemption from Exchange Act registration of compensatory employee stock options for private, non-reporting issuers will provide useful certainty to those issuers in their compensation decisions and will help them avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders. The availability of this exemption is subject to specified limitations, including limitations

<sup>23</sup> Exchange Act Section 12(h) provides for exemptive authority with regard to certain provisions of the Exchange Act. Included in Exchange Act Section 12(h) is the authority to create appropriate exemptions from the Exchange Act registration requirements. Under Exchange Act Section 12(h), the Commission may exempt a class of securities by rules and regulations or by order if it “finds, by reason of the number of public investors, amount of trading interest in the securities, the number and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors.” Exchange Act Section 12(h) [15 U.S.C. 78(h)].

<sup>24</sup> We believe that the exemption is consistent with the exemption provided for other employee benefit plans in Exchange Act Rule 12b-1, which is not available for stock option plans, the compensatory employee stock options issued pursuant to such plans, or the securities issued on exercise of such compensatory employee stock options. We believe that the characteristics of many employee benefit plans, which are by their own terms limited to employees, not available to the general public, and subject to transfer restrictions, obviate the need for applicability of all the rules and regulations aimed at public trading markets. In addition, because many of the conditions in the exemption refer to certain Securities Act Rule 701 definitions and requirements, we believe that the exemption from Exchange Act Section 12(g) registration will allow non-reporting issuers to continue to rely on Securities Act Rule 701 in offering and selling compensatory employee stock options and the shares issued on exercise of those options.

concerning permitted optionholders, transferability, and provision of information. We believe that the conditions to the exemption and the existing statutory provisions and rules provide holders of compensatory employee stock options in private, non-reporting issuers appropriate disclosure and investor protections under the federal securities laws, given the compensatory circumstances of the securities issuance and the restrictions on transferability of the compensatory employee stock options. As such, we believe that the exemption is in the public interest, in that it would clarify and routinize the basis for an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options so private, non-reporting issuers would be able to continue to use compensatory employee stock options and would provide appropriate investor protections for optionholders.

#### 1. Eligible Issuers

The amendment we are adopting today will provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of the following types of issuers:

- Issuers that do not have a class of securities registered under Exchange Act Section 12; and
- Issuers that are not subject to the reporting requirements of Exchange Act Section 15(d).<sup>25</sup>

The exemption will be available only to those issuers that are not required to report under the Exchange Act. As such, the exemption will terminate once the issuer becomes subject to the reporting requirements of the Exchange Act. The exemption also will terminate if the issuer no longer satisfies the conditions to the exemption.<sup>26</sup>

#### 2. Eligible Compensatory Employee Stock Options

The exemption for compensatory employee stock options will:

- Apply only to compensatory employee stock options that are issued under a written compensatory stock

<sup>25</sup> Under Exchange Act Section 15(d), an issuer’s “duty to file [reports under Section 15(d)] is automatically suspended if and so long as any issue of securities of such issuer is registered pursuant to section 12 of this title.” [15 U.S.C. 78o(d)].

<sup>26</sup> The exemption under Exchange Act Section 12 will allow issuers 120 calendar days to register the class of options once an issuer no longer is able to rely on the exemption. Currently, the no-action letter relief terminates once an issuer becomes subject to the Exchange Act reporting requirements. *See, e.g.,* no-action letter to VG Holding, note 7 *supra*. Moreover, the exemption will not be available if the issuer was required, but failed, to register another class of equity security under the Exchange Act.

option plan<sup>27</sup> that is limited to employees, directors, consultants, and advisors of the issuer, its parents, or majority-owned subsidiaries of the issuer or its parents;<sup>28</sup>

- Apply to all compensatory employee stock options issued under all written compensatory stock option plans on a combined basis where the securities underlying the compensatory employee stock options are of the same class of securities of the issuer, with the exemptive conditions applying to the compensatory employee stock options issued under each option plan; and
- Not extend to any class of securities received or to be received on exercise of the compensatory employee stock options.

The exemption covers all compensatory employee stock options meeting the conditions of the exemption, even if the compensatory employee stock options are issued under separate written option plans of the issuer, its parents, or majority-owned subsidiaries of the issuer or its parents.<sup>29</sup> For the purpose of the exemption, the compensatory employee stock options will be considered to belong to the same class of equity security of the issuer if the same class of securities of the issuer will be issuable on exercise of the compensatory employee stock options.<sup>30</sup> While one commenter

<sup>27</sup> Securities Act Rule 701 is available only for offers and sales of compensatory employee stock options and the shares issuable upon exercise of those options that are issued under written compensatory employee benefit plans of an issuer, its parents, or majority-owned subsidiaries of the issuer or its parents. *See* Securities Act Rule 701(c) [17 CFR 230.701(c)]. Thus, the requirement that the options be issued under written compensatory stock option plans will not impose a new obligation on issuers relying on Securities Act Rule 701 in offering and selling compensatory employee stock options or the shares issued on exercise of those options.

<sup>28</sup> The exemption for the compensatory employee stock options will not extend to other rights issued in connection with the compensatory employee stock options, such as stock appreciation rights. Any such other rights will be evaluated separately for purposes of Exchange Act Section 12(g) registration. Some commenters had requested that the exemption apply to all compensation arrangements involving securities, including restricted stock units, stock appreciation rights, and other rights or securities. *See* letters from ABA and Freescale. Consistent with the scope of the staff no-action letters granting Section 12(g) registration relief for compensatory employee stock options, at this time we believe the exemption should address only compensatory employee stock options. We, therefore, are not expanding the scope of the exemption beyond compensatory employee stock options.

<sup>29</sup> In response to comment (*see* letter from ABA), we have clarified that the options may be granted under plans of the issuer, its parents, and majority-owned subsidiaries of the issuer or its parents.

<sup>30</sup> *See* Exchange Act Section 12(g)(5) [15 U.S.C. 78l(g)(5)].

requested that we allow companies to determine whether a particular group of compensatory employee stock options was the same class as other compensatory employee stock options for purposes of determining whether it had met the 500 holder threshold,<sup>31</sup> we are adopting the exemption as proposed in this regard.<sup>32</sup> We believe that, solely for purposes of determining whether the Rule 12h-1 exemption is available, it is important to establish uniformity in evaluating whether there are 500 or more holders of compensatory employee stock options and so that issuers appropriately analyze when Exchange Act Section 12(g) applies to their compensatory employee stock options.<sup>33</sup>

The exemption, as adopted, applies to the compensatory employee stock options only and not to the securities issued (or to be issued) on exercise of the compensatory employee stock options. Thus, the issuer will have to apply the registration requirements of Exchange Act Section 12 to the class of equity security underlying the compensatory employee stock options without regard to the exemption.<sup>34</sup>

### 3. Eligible Option Plan Participants

The exemption is available only where the class of persons eligible to receive compensatory employee stock options under the stock option plans is limited to those persons described in the exemption. These eligible optionholders are the same as those participants permitted under Securities Act Rule 701 and include:<sup>35</sup>

- Employees of the issuer, its parents, or majority-owned, direct or indirect, subsidiaries of the issuer or its parents;
- Directors of the issuer, its parents, or majority-owned, direct or indirect,

subsidiaries of the issuer or its parents; and

- Consultants and advisors of the issuer, its parents, or majority-owned, direct or indirect, subsidiaries of the issuer or its parents.

As adopted, the exemption is limited to those situations where compensatory employee stock options may be held only by those persons who are permitted to hold or be granted compensatory employee stock options under Securities Act Rule 701 and their permitted transferees.<sup>36</sup> We believe that the experience of issuers and their counsels with Securities Act Rule 701 will ease compliance with and limit uncertainty regarding the exemption.<sup>37</sup>

Just as Securities Act Rule 701 was designed specifically not to be available for capital-raising transactions, the exemption will apply only to employee stock options issued for compensatory purposes. The restrictions on the eligible participants in the stock option plans are intended to assure that the exemption is limited to employee stock options issued solely for compensatory purposes.<sup>38</sup>

### 4. Option Terms

#### a. Compensatory Employee Stock Option Transferability Restrictions

The exemption is available only where there are certain restrictions on the transferability by an optionholder of those options and, prior to the exercise of the options, the shares issuable on exercise of those options.<sup>39</sup> Specifically, the exemption is available only if:

- The compensatory employee stock options and, prior to exercise, the shares to be received on exercise of those

options cannot be transferred except, as permitted by the exemption:<sup>40</sup>

- To family members (as defined in Securities Act Rule 701) by gift or pursuant to domestic relations orders; and

—On death or disability of the optionholder;<sup>41</sup>

- There can be no other permitted pledges, gifts, hypothecations, or other transfers of the compensatory employee stock options, or shares issuable on exercise of those options, prior to exercise, until the issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption; provided that there may be:

—Transfers back to the issuer; or

—Transfers in connection with a change of control or other acquisition transactions involving the issuer if, following such transaction, the options no longer will be outstanding and the issuer no longer will be relying on the exemption;<sup>42</sup> and

- The compensatory employee stock options or the securities issuable upon exercise of those options cannot be the subject of a short position, a “put equivalent position”<sup>43</sup> or a “call equivalent position”<sup>44</sup> by the optionholder, prior to exercise, until the issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption; provided that the options may be subject to repurchase rights of the issuer or the optionholder may participate in a change of control or other acquisition transaction involving the issuer.

As adopted, the conditions provide that, except with regard to the limited

<sup>36</sup> In this regard, we note that this category of eligible optionholders is broader than the category of persons to whom employee benefit securities, including compensatory employee stock options, may be offered and sold by reporting issuers using a Form S-8 registration statement. See General Instruction A.1(a) to Form S-8. As we note below, the exemption for reporting issuers will allow eligible optionholders to satisfy the definitions contained in either Securities Act Rule 701 or Form S-8 because an issuer may grant options both prior to and after it becomes subject to the periodic reporting requirements of the Exchange Act.

<sup>37</sup> Some commenters were concerned that the terms of outstanding options may not contain all the restrictive provisions of the exemption. (See letters from Drinker and Ross). We believe that our elimination of the restrictions on holders of shares received on exercise of an option and the modification of the transferability conditions affecting optionholders should address these concerns.

<sup>38</sup> All option grants and exercises must, of course, comply with the requirements of the Securities Act.

<sup>39</sup> The exemption does not impose any limitations on the ability of current or former employees, directors, consultants, or advisors of an issuer to retain or exercise their compensatory employee stock options.

<sup>40</sup> The transferability restrictions are not intended to supersede other transferability restrictions imposed for other reasons, including under the Internal Revenue Code of 1986, as amended [26 U.S.C. 422(b)(5)].

<sup>41</sup> These permitted transferees are intended to be the same as those permitted under Securities Act Rule 701(c) as well as executors or guardians of an optionholder on the death or disability of the optionholder. See note 22 *supra*.

<sup>42</sup> After an issuer becomes subject to the reporting requirements of the Exchange Act, the issuer will be able to rely on the exemption for Exchange Act reporting issuers only if it becomes subject to Exchange Act reporting as a result of its Exchange Act Section 12 registration of a class of security or pursuant to Exchange Act Section 15(d).

<sup>43</sup> 17 CFR 240.16a-1(h). Rule 16a-1(h) defines a “put equivalent position” as a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option position.

<sup>44</sup> 17 CFR 240.16a-1(b). Rule 16a-1(b) defines a “call equivalent position” as a derivative security position that increases in value as the value of the underlying equity increases, including, but not limited to, a long convertible security, a long call option, and a short put option position.

<sup>31</sup> See letter from ABA.

<sup>32</sup> One commenter suggested that the class of options should only include those options issued after the effective date of the exemption that satisfied the conditions of the exemption. See letter from Drinker. We are not adopting such a provision. Under the Exchange Act, the class of equity security is not determined based on when the securities are issued. The exemption provides that the class of compensatory employee stock options for purposes of the exemption includes all compensatory employee stock options on the same class of the issuer's securities regardless of whether the plan is a plan of the issuer, its parents, or majority-owned subsidiaries of the issuer or its parents. No distinction is made in the exemption as to when those options are issued.

<sup>33</sup> This provision will not affect the separate class analysis under Exchange Act Section 12(g)(5) for other purposes.

<sup>34</sup> For example, if an issuer had more than \$10 million in assets and 500 or more holders of a class of equity security underlying the compensatory employee stock options as of the end of its fiscal year, it would have to register under Exchange Act Section 12 that class of equity security.

<sup>35</sup> See the discussion at note 22 *supra*.

permitted transfers specified in the conditions, an optionholder cannot be permitted, prior to exercise, to pledge, hypothecate, or otherwise transfer the compensatory employee stock options or the shares underlying those options, including through a short position, a "put equivalent position," or a "call equivalent position," until the issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption.<sup>45</sup> For the exemption to be available, these transfer restrictions will have to apply to options outstanding at the time that the issuer is relying on the exemption.

The restrictions on transfer of the compensatory employee stock options and the shares underlying those options, prior to exercise, are intended to limit the possibility for a trading market to develop for the compensatory employee stock options while the issuer is relying on the exemption. These restrictions also are intended to assure that an optionholder is not able to profit from the compensatory employee stock options or the securities to be received on exercise of those options (except from permitted payments or transfers as described in the exemption), until the issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption.

In response to comments, we have modified the transferability condition to permit optionholders to receive compensation for their options from the issuer or arising from a change of control or other acquisition transaction after which the options no longer will be outstanding and the issuer no longer will be relying on the exemption.<sup>46</sup>

Commenters also were concerned that a requirement for an issuer to repurchase the shares or options due to state law limitations on transfer restrictions could have adverse accounting consequences to companies.<sup>47</sup> As a result, we have modified the transferability conditions to eliminate a requirement for an issuer to repurchase options if an express prohibition on transfer of options is not

permitted under applicable state law. Instead, the condition permits the issuer to provide that it may repurchase the options in the event of an impermissible transfer. Issuers also may provide that the options terminate in such an event. We note that compensatory employee stock option plans or written stock option agreements generally restrict the persons who may exercise the options, so providing for a termination of an option in the event of an impermissible transfer would, in many cases, already be contemplated by the terms of the written stock option agreement or plan.

We proposed that the transferability restrictions apply to holders of shares issued on exercise of the options. In response to comments,<sup>48</sup> we have not adopted this condition of the exemption. We understand from commenters that private, non-reporting issuers normally already have shareholder agreements and other mechanisms to restrict the transfer of shares received on exercise of options prior to the time the issuer becomes subject to the reporting requirements of the Exchange Act or is involved in a change of control or other acquisition transaction involving the issuer.<sup>49</sup> We also understand that private, non-reporting issuers do not anticipate that optionholders will exercise their options prior to a liquidity event, such as an initial public offering or sale of the company, or prior to termination of the options.<sup>50</sup>

We are not adopting as a condition to the exemption separate transferability restrictions on holders of the shares received on exercise of the compensatory employee stock options. While we acknowledged in the Proposing Release the existence of company-imposed and securities law transferability restrictions, we are

<sup>48</sup> See letters from ABA, Drinker, Ross, and Simpson.

<sup>49</sup> See letters from ABA, Freescale, Ross, and Simpson.

<sup>50</sup> In expressing their views that the proposed transferability restrictions should not be expected to affect a private company's ability to value the compensatory employee stock options under Financial Accounting Standards Board Statement of Financial Accounting Standards No. 123R (revised 2004) *Share-Based Payment* (FAS 123R), some commenters noted that in valuing employee stock options for purposes of FAS 123R, private, non-reporting issuers use an expected term assumption that does not anticipate early exercise of the options. See letters from CAQ, E&Y, and KPMG. These commenters noted that employees of non-public companies normally do not have an incentive to exercise a vested option early due to the lack of a market for the underlying shares. These commenters observed that non-public company employees typically hold their options until they have incentive to exercise such as at the end of their terms, termination of employment, or until a liquidity event, such as an initial public offering or sale of the company occurs.

persuaded to modify the exemption in light of the additional concerns that commenters believed the proposed transferability restrictions would raise. In modifying the exemption, we have considered the treatment of compensatory employee stock options under Securities Act Rule 701 as restricted securities as defined in Securities Act Rule 144,<sup>51</sup> the fact that optionholders typically do not exercise their options prior to their termination or a liquidity event and the fact that, if exercised, most private companies take steps to restrict transferability of shares received on exercise of compensatory employee stock options, so that there is a limited possibility of a market developing in the securities issued on exercise of immediately exercisable compensatory employee stock options. In addition, we have considered a commenter's view that imposing separate transferability restrictions on the holders of shares received on exercise of compensatory employee stock options may affect a company's decision to use stock options for compensatory purposes.<sup>52</sup> We also note that the exemptions we are adopting today do not impact the continued potential applicability of Exchange Act Section 12(g) to the securities issued on exercise of the options.

We also are not adopting the proposed restriction on other shares of the same class of equity security as those underlying the options. We believe that this restriction is no longer necessary because we have not adopted transferability restrictions on holders of securities received on exercise of compensatory employee stock options. In addition, we have taken into account one commenter's concern that the transferability restrictions on the optionholder with respect to shares of the same class as those issuable on exercise of the options would affect an optionholder's ability to dispose of other securities of the issuer that the optionholder owned.<sup>53</sup>

As proposed, the exemption would have provided that there could be no market, process, or methodology that would permit optionholders, prior to exercise, to receive compensation or consideration for their options, the shares issuable on exercise of the options, or shares of the same class of equity security as those underlying those options. Commenters noted that generally there is no market for the securities underlying the options while

<sup>51</sup> 17 CFR 230.144. See, e.g., Securities Act Rule 701(g).

<sup>52</sup> See letter from ABA. See also, letter from Ross.

<sup>53</sup> See letter from Ross.

<sup>45</sup> The current no-action letters contain similar conditions on transferability of the options, although the rule as adopted clarifies the limitations on the ability of optionholders to engage in certain derivative transactions prior to exercise, such as restrictions on an optionholder from entering into a "put equivalent position" or "call equivalent position" until the issuer becomes subject to the reporting requirements of the Exchange Act, or is no longer relying on the exemption. See, e.g., no-action letter to VG Holding, note 7 *supra*. In addition, the amendment as adopted does not restrict holders of shares following exercise of compensatory employee stock options.

<sup>46</sup> See letters from ABA, Ross, and Simpson.

<sup>47</sup> See letters from CAQ, D&T, E&Y, and KPMG.

the issuer is a private, non-reporting entity.<sup>54</sup> Commenters were concerned that optionholders should not be disadvantaged from receiving payments from an issuer or in connection with a change of control or other corporate transaction involving an issuer, either with respect to their options or shares of the issuer they already own.<sup>55</sup> In light of these comments, we do not believe the exemption should impair an optionholder's ability to participate in transactions involving the issuer's securities they already own and we do not believe the exemption should restrict an issuer or other shareholders from engaging in particular transactions due to the issuer's reliance on the exemption.

#### b. Permitted Exercisability of Compensatory Employee Stock Options

The exemption will not require that there be any restriction on the timing of the exercise of the compensatory employee stock options:

- By the optionholder (regardless of whether the optionholder continues to be an employee, director, consultant or advisor of the issuer);
- In the event of the death or disability of the optionholder, by the estate or guardian of the optionholder; or
- By a family member (as defined in Securities Act Rule 701) who acquired the options through a gift or domestic relations order.

#### 5. Required Information

We are adopting the proposed requirement that the issuer provide information to optionholders with certain modifications. In response to comment, we are not adopting a requirement for issuers to provide information to holders of shares received on exercise of compensatory employee stock options after exercise or for issuers to provide optionholders access to their books and records.<sup>56</sup>

As adopted, the information condition will require the issuer, for purposes of the exemption, to periodically provide the following information to optionholders:<sup>57</sup>

- The same risk and financial information that would be required to

be provided under Securities Act Rule 701 if securities sold in reliance on Securities Act Rule 701 in a 12-month period exceeded \$5 million (as such provision may be modified<sup>58</sup>), with the optionholders being provided every six months required information, including financial statements that are not more than 180 days old.<sup>59</sup>

The issuer will be permitted to provide the required information to the optionholders either by:

- Physical or electronic<sup>60</sup> delivery of the information; or
- Notice to the optionholders of:
  - The availability of the information on an Internet site that may be password-protected;<sup>61</sup> and
  - Any password needed to access the information.

In Securities Act Rule 701, we established the type of information that employees holding compensatory employee stock options must be provided before the exercise of those options.<sup>62</sup> The Securities Act Rule 701

<sup>58</sup> One commenter suggested that the exemption take into account changes in the dollar threshold in Securities Act Rule 701. See letter from ABA. The rule text, as proposed and adopted, refers only to the relevant paragraph of Securities Act Rule 701 and does not include a separate dollar threshold. Therefore, any change in the dollar threshold in Securities Act Rule 701 would apply to the exemption.

<sup>59</sup> See Securities Act Rule 701(e) [17 CFR 230.701(e)] for a description of the risk factor and financial statement requirements. The required information will have to be provided under the terms of the exemption, once an issuer is relying on the exemption regardless of whether the issuer would be required to provide the information under Securities Act Rule 701 (for example, because the issuer did not sell \$5 million in securities in a 12-month period in reliance on Securities Act Rule 701). The financial statement requirements under Securities Act Rule 701 refers to financial statements of Part F/S of Form 1-A [17 CFR 239.90]. Part F/S of Form 1-A does not require audited financial statements unless an issuer has prepared them for other purposes. Otherwise, Part F/S of Form 1-A permits an issuer to provide two years of unaudited financial statements.

<sup>60</sup> Electronic delivery of such information will have to be made in compliance with the Commission's interpretations regarding the electronic delivery of information. See, e.g., "Use of Electronic Media," Release No. 34-42728 (Apr. 28, 2000) [65 FR 25843].

<sup>61</sup> A password-protected closed-system intranet site accessible to employees also would be a permitted method to provide the required information to those persons having access to such site.

<sup>62</sup> See Rule 701 Release, note 11 *supra*. "The type and amount of disclosure needed in a compensatory securities transaction differs from that needed in a capital-raising transaction. In a bona fide compensatory arrangement, the issuer is concerned primarily with compensating the employee-investor rather than maximizing its proceeds from the sale. Because the compensated individual has some business relationship, perhaps extending over a long period of time, with the securities issuer, that person will have acquired some, and in many cases, a substantial amount of knowledge about the enterprise. The amount and type of disclosure

information provisions provide optionholders and other persons who purchase securities without registration under Securities Act Rule 701 with important information. While one commenter objected to the provision of information condition,<sup>63</sup> we believe that the ongoing provision of the same information is necessary and appropriate for purposes of the exemption from Exchange Act registration.<sup>64</sup> While requiring private, non-reporting issuers to provide information, as adopted, the exemption will allow flexibility in the means of providing the information by permitting physical, electronic, or Internet-based delivery.

Securities Act Rule 701 provides that the required information must be provided to an optionholder a reasonable period of time before the date of exercise of the compensatory employee stock options. Securities Act Rule 701 also requires that the required financial statements be as of a date no more than 180 days before the sale of the securities (which in the case of compensatory employee stock options is the date of exercise of the options). We believe that the exemption from Exchange Act registration presents the need for ongoing information to be provided to optionholders. As such, the exemption requires that, once an issuer has 500 or more optionholders, the optionholders must be provided every six months the required information, including financial statements that are not more than 180 days old.

We believe that our experience with Securities Act Rule 701 and the combined conditions of the exemption, including the eligibility and transferability provisions, make it appropriate to require the same risk and financial information as required under Securities Act Rule 701, as noted above, rather than essentially the same

required for this person is not the same as for the typical investor with no particular connection with the issuer." *Id.*

<sup>63</sup> See letter from ABA.

<sup>64</sup> As the Commission reminded issuers when it adopted the amendments to Securities Act Rule 701 in 1999, issuers should be aware that compliance with the minimum disclosure standards for Securities Act Rule 701 may not necessarily satisfy the antifraud standards of the securities laws. See Rule 701 Release, note 11 *supra*. (Preliminary Note 1 to Rule 701 states that issuers and other persons acting on their behalf have an obligation to provide investors with disclosure adequate to satisfy the antifraud provisions of the federal securities laws.) We recognize that the Advisory Committee has recommended modifications to Securities Act Rule 701 that would affect the thresholds that would trigger the disclosure provisions of that rule. Our amendments do not address the Advisory Committee's recommendations regarding Securities Act Rule 701. See Final Report of the Advisory Committee, note 21 *supra*, at p. 92-93.

<sup>54</sup> See letters from ABA, Freescale, Ross, and Simpson.

<sup>55</sup> See letters from ABA, Freescale, Ross, and Simpson.

<sup>56</sup> See letter from ABA.

<sup>57</sup> In response to comment (see letters from ABA and Ross), we are clarifying that the information conditions may commence once a company has 500 or more optionholders and may terminate once the company becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption.

Exchange Act information and reports as if it was subject to the Exchange Act reporting requirements in the context of an ongoing reporting exemption relating to compensatory employee stock options.<sup>65</sup> As such, we believe that the scope of information that the optionholders will be provided under the exemption is not inconsistent with investor protection and the public interest.<sup>66</sup>

One commenter objected to the proposed condition that the issuer make its books and records available for inspection by the optionholder and holders of shares received on exercise of compensatory employee stock options to the same extent that they are available to other shareholders of the issuer.<sup>67</sup> This commenter stated that such a requirement may go beyond or be inconsistent with state law requirements. We are not adopting the books and records element of the information condition. We believe that holders of such shares can exercise their state law rights to inspect corporate books and records. Moreover, because optionholders, as such, are not shareholders, we agree with the commenter that it is not necessary to

<sup>65</sup> As the Commission also recognized when it adopted the Securities Act Rule 701 amendments in 1999, and because many issuers that have 500 or more optionholders and more than \$10 million in assets are likely to have received venture capital financing (see for example the data in the Hand Paper, note 11 *supra*), we believe that many of these issuers already have prepared the type of disclosure required in their normal course of business, either for using other exemptions, such as Regulation D, or for other purposes. As a result, the disclosure requirement generally will be less burdensome for them. In adopting the amendments to Securities Act Rule 701, we stated that a minimum level of disclosure was essential to meet even the reduced level of information needed to inform compensatory-type investors such as employees and consultants. See Rule 701 Release, note 11 *supra*.

<sup>66</sup> For a private, non-reporting issuer with a significant number of optionholders (and with more than \$10 million in assets at the end of its fiscal year), we believe it is likely that such issuer either already is obligated to provide the same information to optionholders due to sales of securities in reliance on Securities Act Rule 701 or already prepares and, as such, provides such information to its shareholders. One commenter also stated that many private, non-reporting issuers prepare financial statements, including audited financial statements, for other purposes. See letter from E&Y. Moreover, because of the transferability restrictions on the compensatory employee stock options and, prior to exercise, the shares to be received on exercise of those options, optionholders will have limited investment decisions to make, until the issuer becomes subject to the reporting requirements of the Exchange Act or is engaged in an acquisition transaction affecting the options. Consequently, we believe that the disclosure required under the exemption is the appropriate level of disclosure to be provided optionholders until the issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption.

<sup>67</sup> See letter from ABA.

extend the books and records inspection right to them if it is not already provided for under applicable state law.

To permit issuers to safeguard proprietary or confidential information that may be contained in the information to be provided, the exemption will permit provision of the disclosure to be conditioned on the optionholder agreeing to maintain the confidentiality of the information.<sup>68</sup> In response to a commenter,<sup>69</sup> we are not adopting the proposed provision that would have required an issuer to allow inspection of the documents at one of the described issuer offices if an optionholder chooses not to enter into such a confidentiality agreement. Under the exemption, as adopted, the issuer is not required to provide the information to a particular optionholder if the holder does not agree to keep the information to be provided pursuant to the exemption confidential.<sup>70</sup> Therefore, the exemption, as adopted, permits an issuer to take steps to protect the confidentiality of its information.

The proposal also would have required that the issuer provide the required information to holders of shares received on exercise of options. We have revised the information condition to apply only to optionholders in light of concern regarding the potential misuse of information by non-employees or former employees of a company.<sup>71</sup> The amendments, as adopted, do not condition the exemption on transferability restrictions on the underlying shares similar to those applicable to the compensatory employee stock options. One commenter expressed concern that the information delivery conditions would treat these company shareholders differently than other company shareholders.<sup>72</sup> Since the exemption applies only to the compensatory employee stock options and not to the shares received on exercise of the compensatory employee stock options, we believe our revisions should address concerns in this regard and provide companies flexibility in addressing confidentiality and share transferability issues.

<sup>68</sup> This provision is consistent with the related information provision under Securities Act Rule 701.

<sup>69</sup> See letter from ABA.

<sup>70</sup> This provision does not affect an issuer's information delivery obligation under Securities Act Rule 701.

<sup>71</sup> See letter from ABA.

<sup>72</sup> See letter from ABA.

6. Issuer Obligation To Impose the Conditions to the Exemption

We are adopting essentially as proposed the requirement that, for the exemption to be available, a private, non-reporting issuer must include the necessary limitations and conditions in the written stock option plans, within the terms of the individual written option agreements, or in another enforceable written agreement. Some commenters were concerned about the need to include the conditions and obligations in option plans or option agreements and one commenter suggested that the conditions and restrictions should only have to be satisfied in practice.<sup>73</sup> We believe that the nature of the exemption necessitates the inclusion of the conditions to the exemption in an enforceable written agreement or agreements between the issuer and the optionholders, or in the issuer's by-laws or certificate of incorporation. By allowing the conditions and obligations to be included in any enforceable written agreement or in the issuer's certificate of incorporation or by-laws, we also believe that the modified condition will provide issuers necessary flexibility in where to include the conditions in their agreements with optionholders.

#### *B. Exemption for Compensatory Employee Stock Options of Exchange Act Reporting Issuers*

To provide certainty regarding the obligations of issuers that already have registered securities under the Exchange Act or are required to file reports under the Exchange Act pursuant to Exchange Act Section 15(d), we are adopting an exemption from Exchange Act registration for compensatory employee stock options of these reporting issuers.<sup>74</sup> While the proposed exemption would have been available only for an issuer that had registered under Exchange Act Section 12 the class of equity security underlying the compensatory employee stock options, in response to comment,<sup>75</sup> we are expanding the eligibility for this exemption to all issuers required to file periodic reports pursuant to Exchange

<sup>73</sup> See, e.g., letters from ABA, Drinker, and Ross. While one commenter suggested eliminating any requirement for the conditions to be embodied in an agreement (see letter from ABA), we believe that the condition must be enforceable by the optionholder. Further, we believe the issuer must have written evidence that it satisfies this condition.

<sup>74</sup> We believe the exemption will provide important guidance regarding, and an appropriate exemption to, eligible issuers from the Exchange Act registration requirement for compensatory employee stock options.

<sup>75</sup> See letter from ABA.

Act Section 13 or Exchange Act Section 15(d). The filing of Exchange Act reports pursuant to Exchange Act Sections 13 or 15(d) will provide the appropriate information to optionholders.

As with the exemption for private, non-reporting issuers, the exemption for issuers subject to the reporting requirements of the Exchange Act will be available only where the options are issued pursuant to a written compensatory stock option plan. We have revised the exemption, in response to comment,<sup>76</sup> to provide that the class of persons eligible to receive or hold compensatory employee stock options under the stock option plans includes those participants permitted to be granted options under an issuer's Form S-8, as well as to those participants permitted under Securities Act Rule 701.<sup>77</sup> We have made this change to take into account the fact that, for a reporting issuer, compensatory employee stock options may have been granted before, and may be granted after, the issuer becomes subject to the Exchange Act reporting requirements.

We also have modified the optionholder eligibility condition to address the concerns of some commenters that the exemption still should be available to reporting issuers even where a small number of optionholders may not necessarily fall within the permitted categories of optionholders.<sup>78</sup> We are adopting a provision that will permit the exemption to continue to be available even if there is an insignificant deviation from satisfying the eligibility conditions of the exemption.<sup>79</sup> This

<sup>76</sup> See letter from ABA.

<sup>77</sup> This expansion will make the categories of eligible optionholders consistent under both exemptions. See the discussion under "Eligible Option Plan Participants," above, for a description of the eligible optionholders.

<sup>78</sup> See letters from ABA, Drinker, and Ross. Commenters noted that options could be held by persons that previously had been granted options by the issuer, or by another entity acquired by the issuer. One commenter also was concerned about options held by former employees of an acquired entity who would not be considered eligible optionholders under Form S-8.

<sup>79</sup> While we are allowing the exemption to be available to reporting issuers that have insignificant deviations from the eligibility conditions, we are not adopting a similar provision for private, non-reporting issuers. We believe this distinction is appropriate because reporting issuers are subject to all of the disclosure requirements under the periodic reporting rules of the Exchange Act and also are subject to staff review. The concept of allowing an insignificant deviation from required conditions also is included in Regulation D and Regulation A under the Securities Act [17 CFR 230.260 and 17 CFR 230.508]. We believe that issuers are familiar with the concept under the Securities Act and applying a similar concept to the exemption under the Exchange Act will assist issuers in avoiding unintentional failures to satisfy the exemption conditions.

provision will allow reporting issuers to rely on the exemption if the number of optionholders that do not meet the eligibility condition are insignificant both as to the aggregate number of optionholders and number of outstanding options. Further, following the effective date of the exemption, to be able to rely on the exemption, including the insignificant deviation provision, the issuer must have made a good faith and reasonable attempt to comply with the conditions of the exemption.

The exemption from Section 12(g) registration for compensatory employee stock options of Exchange Act reporting issuers does not include any information conditions, other than those arising from the registration of a class of security under the Exchange Act or arising under Exchange Act Section 15(d).

We are not conditioning the availability of the exemption on the issuer being current in its Exchange Act reporting. As we noted in the proposing release, we believe it would seem inappropriate for the issuer to lose the exemption, and be required to register a class of compensatory employee stock options under Exchange Act Section 12(g), because it was late in filing a required Exchange Act report and, for the days before that report was filed, was not "current" in its Exchange Act reporting. One commenter agreed with this approach.<sup>80</sup>

While we had proposed that the exemption apply only where the issuers had registered the class of equity security underlying the compensatory employee stock options, which would provide optionholders the protections of Exchange Act Sections 13(e)<sup>81</sup> and 14(e),<sup>82</sup> we agree with one commenter that the exemption should be available to all issuers required to file periodic reports under the Exchange Act.<sup>83</sup> For those issuers required to file periodic reports pursuant to Exchange Act Section 15(d), the exemption will no longer be available once their obligation to file reports under Exchange Act Section 15(d) is suspended. In that case, to maintain the exemption, the issuer would have to register a class of security under Exchange Act Section 12.

We believe that once an issuer has 500 or more optionholders it is more likely that it will have 500 or more holders of the shares underlying the

options and therefore will be required to register that class under Exchange Act Section 12 if it also has more than \$10 million in assets. In addition, if the issuer becomes a private, non-reporting issuer due to the suspension or termination of its reporting obligation, it may rely on the exemption for the compensatory employee stock options of private, non-reporting issuers if the conditions to that exemption are satisfied.

### C. Registering When No Longer Eligible for Exemption

If a private, non-reporting issuer becomes ineligible to rely on the exemption, the issuer will be permitted up to 120 calendar days from the date it became ineligible to rely on the exemption to file a registration statement to register under Exchange Act Section 12(g) the class of compensatory employee stock options. For a reporting issuer that becomes ineligible to rely on the exemption, the issuer will be permitted up to 60 calendar days from the date it became ineligible to rely on the exemption to file a registration statement to register under Exchange Act Section 12(g) the class of compensatory employee stock options or a class of security. We have revised the transition provision for private, non-reporting issuers in response to a commenter's concern that 60 days would not be sufficient for private, non-reporting issuers to prepare a Form 10 registration statement including audited financial statements.<sup>84</sup> We have retained the 60 day time period for reporting issuers because they already would have been required to prepare and file periodic reports under the Exchange Act, including audited financial statements.

## III. Paperwork Reduction Act

### A. Background

Certain provisions of the amendments to Exchange Act Rule 12h-1<sup>85</sup> contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>86</sup> We published a notice requesting comment on the collection of information requirements in the Proposing Release and submitted these to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA.<sup>87</sup> OMB approved the collection and the control number is 3235-0632. An agency may not conduct or sponsor, and a person is

<sup>80</sup> See letter from ABA.

<sup>81</sup> 15 U.S.C. 78m(e).

<sup>82</sup> 15 U.S.C. 78n(e).

<sup>83</sup> See letter from ABA. Exchange Act Section 14(e) would, of course, continue to apply regardless of whether the issuer had registered the class of equity security underlying the compensatory employee stock options.

<sup>84</sup> See letter from ABA.

<sup>85</sup> 17 CFR 240.12h-1.

<sup>86</sup> 44 U.S.C. 3501 *et seq.*

<sup>87</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.



not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for this information is:

- Exchange Act Rule 12h-1.

The hours and costs associated with preparation of notices, maintaining Internet sites, and preparation of information to be disclosed to optionholders for private, non-reporting issuers relying on the exemption from Exchange Act Section 12(g)<sup>88</sup> registration constitute cost burdens imposed by the collection of information. The exemption available to reporting issuers will not constitute new collections of information. The amendments will not affect existing collections of information.

The exemptions from Exchange Act Section 12(g) registration are being adopted pursuant to the Exchange Act. The information collection requirements related to the exemption for private, non-reporting issuers are a condition to reliance on the exemption. There is no mandatory retention period for the information disclosed and the information disclosed is not required to be filed with the Commission.

#### *B. Summary of Collection of Information*

Our amendments to Exchange Act Rule 12h-1 will provide an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans. The amendments also will provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of issuers that are subject to the periodic reporting requirements of the Exchange Act pursuant to Exchange Act Section 13 or Section 15(d).

The requirements regarding notice of information availability, Internet availability of information, and, for certain issuers, the preparation of information related to the exemption from Exchange Act Section 12(g) for compensatory employee stock options of private, non-reporting issuers constitute a new collection of information under the Exchange Act. The information provision in the exemption for private, non-reporting issuers is not a new collection of information for those private, non-reporting issuers that also are required to provide such information to optionholders pursuant to Securities Act Rule 701<sup>89</sup> or that already prepare

and provide such information to their shareholders.

The collection of information is required for those private, non-reporting issuers that rely on the exemption because they had 500 or more optionholders and more than \$10 million in assets at the end of their fiscal year. The issuers likely to use the exemption are those private, non-reporting issuers that had more than \$10 million in assets and had used stock options to compensate employees, directors, consultants, and advisors on a broad basis. The exemption from Section 12(g) registration for compensatory employee stock options of reporting issuers that are subject to the periodic reporting requirements of the Exchange Act pursuant to Exchange Act Section 13 or Section 15(d) does not impose any new collection of information on these reporting issuers.

#### *C. Summary of Comments*

None of the commenters addressed our request for comment on the PRA analysis and, accordingly, we have not revised our PRA estimates.

#### *D. Paperwork Reduction Act Burden Estimates*

For purposes of the PRA, we estimate that the annual burden for responding to the collection of information in the exemption will not increase significantly for most private, non-reporting issuers, due to the current disclosure provisions of Securities Act Rule 701 and the probability that such issuers already prepare such information for other purposes. The costs may increase for those private, non-reporting issuers who are not relying on Securities Act Rule 701 when they grant compensatory employee stock options or who do not prepare the information for other purposes. The cost of providing such information may increase because of the requirement in the exemption for private, non-reporting issuers to provide the required information.

Our estimates represent the burden for private, non-reporting issuers eligible to rely on the exemption. Because the registration provisions of Exchange Act Section 12(g) apply only to an issuer with 500 or more holders of record of a class of equity security and assets in excess of \$10 million at the end of its most recently ended fiscal year, only those private, non-reporting issuers satisfying those thresholds will be subject to the collection of information. The Division of Corporation Finance has granted no-action relief from registration of compensatory employee stock options

to 30 private, non-reporting issuers during the period 1992 through 2006. If we assume that approximately 3 new private, non-reporting issuers will be relying on the exemption each year and that a certain number of private, non-reporting issuers will no longer be relying on the exemption because they have become reporting issuers, have been acquired, or have terminated business, we estimate that approximately 40 private, non-reporting issuers each year may be relying on the exemption. The exemption for private, non-reporting issuers would terminate once such issuer became subject to the reporting requirements of the Exchange Act or was no longer relying on the exemption. Thus, the number of private, non-reporting issuers that may rely on the exemption may vary from year to year.

For purposes of the PRA, we estimate the annual paperwork burden for private, non-reporting issuers desiring to rely on the exemption and to comply with our collection of information requirements to be approximately 20 hours of in-house issuer personnel time and to be approximately \$24,000 for the services of outside professionals.<sup>90</sup> These estimates include the time and the cost of preparing and reviewing the information and making the information available to optionholders. We assume that the same number of private, non-reporting issuers will rely on the exemption each year.

We estimate that 25% of the burden of preparation and provision of the information required by the exemption is carried by the issuer internally and that 75% of the burden is carried by outside professionals retained by the issuer at an average cost of \$400 per hour.<sup>91</sup> The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

### **IV. Cost-Benefit Analysis**

#### *A. Background*

Compensatory stock options provide a method to use non-cash compensation to attract, retain, and motivate issuer employees, directors and consultants. Since the 1990s, a number of private, non-reporting issuers have granted

<sup>90</sup> For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest whole number and the cost totals have been rounded to the nearest hundred.

<sup>91</sup> In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of \$400 as the average cost of outside professionals that assist issuers in preparing disclosures for offerings.

<sup>88</sup> 15 U.S.C. 78l(g).

<sup>89</sup> 17 CFR 230.701.

compensatory employee stock options to 500 or more employees, directors, and consultants. Compensatory employee stock options also are used routinely by issuers required to report under the Exchange Act.

Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security for purposes of the Exchange Act. Under Exchange Act Section 12(g), an issuer with 500 or more holders of record of a class of equity security and assets in excess of \$10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. While there is an exemption from Exchange Act Section 12(g) registration for interests and participations in certain other types of employee compensation plans involving securities, currently there is no exemption for compensatory employee stock options.

#### B. Summary of Amendments

We are adopting two exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees, directors, consultants, and advisors of the issuer.

One amendment to Exchange Act Rule 12h-1 will provide an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of an issuer that does not have a class of securities registered under Exchange Act Section 12 and is not subject to the reporting requirements of Exchange Act Section 15(d), where the following conditions are present:

- Eligible optionholders are limited to employees, directors, consultants, and advisors of the issuer, its parents, or majority-owned subsidiaries of the issuer or its parents and permitted transferees;
- Transferability by optionholders of compensatory employee stock options and, prior to exercise, the shares to be received on exercise of those options is restricted; and
- Risk and financial information is provided to optionholders that is of the type that would be required under Securities Act Rule 701 if securities sold in reliance on Securities Act Rule 701 exceeded \$5 million in a 12-month period.

The second amendment to Exchange Act Rule 12h-1 will provide an exemption for compensatory employee stock options of issuers that are required to file reports under the Exchange Act

pursuant to Exchange Act Section 13 or Exchange Act Section 15(d).

#### 1. Expected Benefits

Benefits of the exemption for private, non-reporting issuers are likely to include the following: (1) Lower costs to, and reduced uncertainty for, private, non-reporting issuers desiring relief from registration under Section 12(g) for compensatory employee stock options issued to employees, directors, consultants, and advisors for compensatory purposes; (2) benefits to private, non-reporting issuers in designing and implementing employee stock option plans without regard to concerns arising from Exchange Act Section 12(g) registration of the compensatory employee stock options; (3) benefits to private, non-reporting issuers arising from the use of electronic or Internet-based methods of providing the information necessary to satisfy the information requirement of the exemption; and (4) benefits to optionholders of private, non-reporting issuers arising from the required provision of information under the exemption.

Private, non-reporting issuers would benefit from cost savings as a result of the exemption from Section 12(g) registration of their compensatory employee stock options. A number of private, non-reporting issuers that have 500 or more optionholders and assets in excess of \$10 million have hired attorneys and requested no-action relief from the Division of Corporation Finance with regard to the registration of the options. The conditions to no-action relief from the Division include information provision conditions that are more extensive than in the exemption. The exemption, which is available if the provisions of the exemption are satisfied, will reduce the legal and other costs to a private, non-reporting issuer arising from the no-action request and relief. Such cost savings include reduced legal and accounting fees arising from both the request for no-action relief and for preparation of reports equivalent to Exchange Act reports of a reporting issuer on an ongoing basis. Because we expect that a number of the issuers that may take advantage of the exemption may be smaller issuers, these cost savings could be significant relative to revenues.

The amendments require the same information that the issuer otherwise would be required to provide if securities sold in reliance on Securities Act Rule 701 exceeded \$5 million during any consecutive 12-month period. Thus, for private, non-reporting

issuers with a significant number of optionholders (and with more than \$10 million in assets at the end of its fiscal year), it is likely that such issuer either already is obligated to provide the same information to optionholders due to sales of securities in reliance on Securities Act Rule 701, or already prepares and, as such, provides such information to its shareholders.<sup>92</sup> Further, any private, non-reporting issuer that has received no-action relief regarding registration of its compensatory employee stock options will face reduced disclosure costs under the exemption.

The amendment also will benefit private, non-reporting issuers by providing the less expensive alternative of electronic or Internet-based methods of providing the information necessary to satisfy the information requirement of the exemption.

Private, non-reporting issuers also will benefit from the certainty that the exemption will provide in designing and implementing compensation programs and employee stock option plans. The amendments identify the eligibility provisions and transfer restrictions that need to be contained in compensatory stock option plans or other written agreements, thereby lessening the need for issuers, at the time that Section 12(g) registration relief is needed for the compensatory employee stock options, to amend their stock option plans and outstanding options to include provisions that would be necessary to obtain no-action relief. The exemption will help private, non-reporting issuers avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders.

Optionholders also will benefit from the exemption. The exemption assures the provision of the information every six months, including financial information that is not more than 180 days old, to optionholders. Employees, directors, consultants, and advisors would benefit from the exemption because private, non-reporting issuers will be able to use options for compensatory purposes without concern that the option grants will subject the issuer to Exchange Act registration.

The exemption for reporting issuers also will benefit optionholders and holders of shares received on exercise of

<sup>92</sup> One commenter noted that "they expect that most non-public companies with the number of compensatory optionholders necessary to benefit from the proposed exemption are likely to already be obtaining audited financial statements for other business and financial purposes." Letter from E&Y.

options. Optionholders and holders of shares received on exercise of options will have access to the issuer's publicly filed Exchange Act reports. Further, if the issuer has registered under Exchange Act Section 12 the class of equity security underlying the compensatory employee stock options, certain provisions of Exchange Act Sections 13 and 14 would apply to the options and the securities issuable on exercise of the options. Holders of shares issued on exercise of those options would have the same rights as other shareholders of the issuer. Thus, the exemption eliminates a possible disincentive for issuers to use certain compensatory employee stock options. This may be a benefit if this type of compensation is useful in attracting and retaining qualified employees that increase the issuer's competitiveness.

## 2. Expected Costs

Issuers will be required to satisfy the provisions of the amendments to avoid registering under Exchange Act Section 12(g) their compensatory employee stock options if the registration thresholds are met at the end of the issuer's fiscal year. Private, non-reporting issuers may incur certain costs to rely on the exemption including (1) costs to amend their existing employee stock option plans if the plans and option grants do not contain the restrictive and information provisions of the exemption; (2) costs arising from preparing and providing the information required by the exemption to the extent that the issuer does not already prepare or provide such information for other purposes; and (3) costs of maintaining an Internet site on which the information may be available if the issuer chooses to use that method to provide the required information to optionholders.

We believe that the provisions of the exemption are consistent in many respects with the restrictive provisions of other laws and rules governing option grants and, thus, the costs to private, non-reporting issuers should not be increased. The exemption provisions also are consistent with or are more flexible than the existing conditions for obtaining no-action relief from the Division of Corporation Finance. Therefore, the costs to private, non-reporting issuers to prepare the information required by the exemption may be the same or less than the current costs to the issuer relying on registration relief provided in a no-action letter issued by the Division of Corporation Finance.

Those private, non-reporting issuers who do not already prepare the required

information will face costs if they desire to avail themselves of the exemption. In addition to the costs discussed in the Paperwork Reduction Act analysis,<sup>93</sup> as described below, issuers may face costs in maintaining the confidentiality of the information required to be provided, including preparation and enforcement of confidentiality agreements entered into with optionholders. It should be noted, however, that these increased costs will be borne voluntarily, as it is within the issuer's control as to the number of optionholders it may have. Issuers are able to perform their own cost-benefit analysis to determine whether to comply with the conditions to the exemption or avoid issuing options to 500 or more optionholders.

Private, non-reporting issuers may incur costs in providing the information required under the exemption. These costs may include printing and sending the information or making the information available on an Internet site.

The Division of Corporation Finance has granted no-action relief from registration of compensatory employee stock options to 30 private, non-reporting issuers during the period 1992 through 2006. If we assume that approximately 3 new private, non-reporting issuers will be relying on the exemption each year and that a certain number of private, non-reporting issuers will no longer be relying on the exemption because they have become reporting issuers, have been acquired, or have terminated business, we estimate that approximately 40 private, non-reporting issuers each year may be relying on the exemption. The exemption for private, non-reporting issuers will terminate once such issuer becomes subject to the reporting requirements of the Exchange Act or is no longer relying on the exemption. Thus, the number of private, non-reporting issuers that may rely on the exemption may vary from year to year.

For purposes of the Paperwork Reduction Act, we have estimated that the annual paperwork burden for private, non-reporting issuers desiring to rely on the exemption and to comply with our collection of information requirements to be approximately 20 hours of in-house issuer personnel time, which is equivalent to \$3,500, and to be approximately \$24,000 for the services of outside professionals, for a total paperwork burden cost of \$27,500.<sup>94</sup>

<sup>93</sup> See discussion under "PAPERWORK REDUCTION ACT," above.

<sup>94</sup> For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest

These estimates include the time and the cost of preparing and reviewing the information and making the information available to optionholders. We have assumed that the same number of private, non-reporting issuers would rely on the exemption each year. We have estimated that 25% of the burden of preparation and provision of the information required by the exemption would be carried by the private, non-reporting issuer internally and that 75% of the burden would be carried by outside professionals retained by the private, non-reporting issuer at an average cost of \$400 per hour.<sup>95</sup>

Although a private, non-reporting issuer relying on the exemption will benefit from cost savings associated with not having to register the compensatory employee stock options as a separate class of equity security under the Exchange Act, or obtaining no-action relief, by not doing so, an optionholder will not have the benefit of the disclosures contained in Exchange Act reports that the issuer otherwise would be obligated to file with us, including audited financial statements, or the disclosures required to be provided under the terms of the no-action relief.

Optionholders also will not be able to freely sell their options while the private, non-reporting issuer is relying on the exemption. Optionholders will not be able to realize value from the options or, prior to exercise of the options, the shares to be issued on exercise of the options until after the private, non-reporting issuer becomes subject to the reporting requirements of the Exchange Act or is not relying on the exemption, other than as a result of certain permitted transfers. Many private, non-reporting issuers that grant options, however, currently restrict the transfer of securities held by holders of shares received on exercise of options, in most cases until after the issuer becomes subject to the reporting requirements of the Exchange Act or unless the issuer is acquired by another entity. In some cases, private, non-reporting issuers retain the right to repurchase options or shares received on exercise of an option. Any exercise of such repurchase right by the issuer would be a cost to such issuer.

whole number and the cost totals have been rounded to the nearest hundred.

<sup>95</sup> In connection with other recent rulemakings, we have had discussions with several private law firms to estimate an hourly rate of \$400 as the average cost of outside professionals that assist issuers in preparing disclosures and conducting registered offerings. Consistent with recent rulemaking releases, we estimate the value of work performed by the company internally at a cost of \$175 per hour.

### V. Consideration of Burden on Competition and Promotion of Efficiency, Competition and Capital Formation Analysis

Section 23(a)(2)<sup>96</sup> of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition, Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. We are adopting an exemption for private, non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans. We also are adopting an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options of issuers that are subject to the reporting requirements of the Exchange Act pursuant to Exchange Act Section 13 or Exchange Act Section 15(d).

We expect that the exemption for private, non-reporting issuers from Exchange Act registration of compensatory employee stock options will provide necessary certainty to those issuers in their compensation decisions and will help them avoid becoming subject to the registration and reporting requirements of the Exchange Act prior to the time they have public shareholders. We anticipate that the exemption would save such private, non-reporting issuers costs and will not require that companies make their confidential issuer information public prior to the issuer voluntarily determining to become a public reporting issuer or being required to register a class of equity security under the Exchange Act. Further, we anticipate that the exemption will continue to provide private, non-reporting issuers freedom to determine appropriate methods of compensating their employees, directors, consultants, and advisors without concern that they will be required to register their compensatory employee stock options as a class of equity security under Exchange Act Section 12. Thus, the exemption eliminates a possible disincentive for issuers to use certain compensatory employee stock options. This may be a benefit if this type of compensation is useful in attracting and retaining qualified employees that increase the private, non-reporting issuer's competitiveness.

The exemption for reporting issuers will provide certainty regarding the obligations of issuers that already are subject to the reporting requirements of the Exchange Act pursuant to Exchange Act Section 13 or Exchange Act Section 15(d) to register their compensatory employee stock options under the Exchange Act. In addition, in the case of these reporting issuers, the optionholders would have access to the issuer's publicly filed Exchange Act reports and, if the issuer has registered under Exchange Act Section 12 the class of equity security underlying the options, the appropriate provisions of Sections 13 and 14 would apply to the compensatory employee stock options and the equity securities issuable on exercise of those options.

Section 3(f)<sup>97</sup> of the Exchange Act requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

We believe that the exemption from Exchange Act registration for the compensatory stock options may beneficially affect the issuer's ability to compete for employees because it will allow such issuers to continue to use employee stock options in their compensation programs, thus enabling them to compete for such employees with both private, non-reporting issuers and public reporting issuers. The exemption also will provide an eligible issuer a more efficient, available exemption from Exchange Act Section 12(g) registration of compensatory employee stock options, instead of such issuer having to seek no-action relief or an exemptive order under Exchange Act Section 12(h).

The exemptions do not relate to or affect capital formation, as the compensatory employee stock options covered by the exemptions are issued for compensatory and not capital raising purposes.

The exemptions will allow eligible issuers to continue to have freedom to determine appropriate methods of compensating their employees, directors, consultants, and advisors. For private, non-reporting issuers, these compensation decisions could be made without concern that the issuer will become subject to the Exchange Act reporting requirements before they have public shareholders.

### VI. Regulatory Flexibility Act Certification

The Commission hereby certifies pursuant to 5 U.S.C. 605(b) that the two exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options issued under employee stock option plans that are limited to employees, directors, consultants, and advisors of the issuer, its parents, and the majority-owned subsidiaries of the issuer or its parents will not have a significant economic impact on a substantial number of small entities. We prepared an Initial Regulatory Flexibility Act Analysis in which we stated that the proposed exemption would not affect issuers that are small entities because small entities do not satisfy the asset threshold of Section 12(g) and therefore the exemptions would not be needed by such entities until their asset size increased to more than \$10 million at the end of a fiscal year. We stated, therefore, that there may not be a large number of small entities that may be impacted. Because we received no comment disagreeing with that conclusion we are certifying that the two exemptions will not have a significant economic impact on a substantial number of small entities.

### VII. Administrative Procedure Act

Section 553(d) of the Administrative Procedure Act generally provides that, unless an exception applies, a substantive rule may not be made effective less than 30 days after notice of the rule has been published in the **Federal Register**. One exception to the 30-day requirement is if such rule grants or recognizes an exemption or relieves a restriction. We are adopting two exemptions designed to relieve issuers from the registration requirements of Section 12(g) for compensatory employee stock options. The rules only affect issuers that issue stock options as compensation to their employees, directors, consultants, and advisors. Even after the rules are effective, issuers may still register the compensatory employee stock options under Exchange Act Section 12(g) as before; however, the new amendments to Exchange Act Rule 12h-1 grant exemptions to the requirement, relieving eligible issuers of the Exchange Act registration obligations, subject to certain conditions. Immediate effectiveness will provide certainty to issuers that provide compensatory employee stock options to their current or future employees, directors, consultants, and advisors as a form of compensation. Eligible issuers that satisfy the conditions to the

<sup>96</sup> 15 U.S.C. 78w(a)(2).

<sup>97</sup> 15 U.S.C. 78c(f).

exemptions can make compensation decisions without having to register under Exchange Act Section 12(g) the compensatory employee stock options or seek a no-action letter from the staff of the Commission or an exemption under Section 12(h) from the Commission for such registration relief.

### VIII. Statutory Basis and Text of Rule Amendments

We are amending Exchange Act Rule 12h-1 under the authority in Sections 12, 23, and 36 of the Exchange Act, as amended.

#### List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

#### Text of Rule

■ For the reasons set out in the preamble, we are amending Title 17, Chapter II of the Code of Federal Regulations as follows:

### PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 1. The authority citation for part 240 continues to read in part as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

■ 2. Amend § 240.12h-1 to remove “and” at the end of paragraph (d), and add paragraphs (f) and (g) to read as follows:

#### § 240.12h-1 Exemptions from registration under section 12(g) of the Act.

\* \* \* \* \*

(f)(1) Stock options issued under written compensatory stock option plans under the following conditions:

(i) The issuer of the equity security underlying the stock options does not have a class of security registered under section 12 of the Act and is not required to file reports pursuant to section 15(d) of the Act;

(ii) The stock options have been issued pursuant to one or more written compensatory stock option plans established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents;

**Note to paragraph (f)(1)(ii):** All stock options issued under all written compensatory stock option plans on the same class of equity security of the issuer will be considered part of the same class of equity

security for purposes of the provisions of paragraph (f) of this section.

(iii) The stock options are held only by those persons described in Rule 701(c) under the Securities Act (17 CFR 230.701(c)) or their permitted transferees as provided in paragraph (f)(1)(iv) of this section;

(iv) The stock options and, prior to exercise, the shares to be issued on exercise of the stock options are restricted as to transfer by the optionholder other than to persons who are family members (as defined in Rule 701(c)(3) under the Securities Act (17 CFR 230.701(c)(3)) through gifts or domestic relations orders, or to an executor or guardian of the optionholder upon the death or disability of the optionholder until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act or is no longer relying on the exemption pursuant to this section; provided that the optionholder may transfer the stock options to the issuer, or in connection with a change of control or other acquisition transaction involving the issuer, if after such transaction the stock options no longer will be outstanding and the issuer no longer will be relying on the exemption pursuant to this section;

**Note to paragraph (f)(1)(iv):** For purposes of this section, optionholders may include any permitted transferee under paragraph (f)(1)(iv) of this section; provided that such permitted transferees may not further transfer the stock options..

(v) The stock options and the shares issuable upon exercise of such stock options are restricted as to any pledge, hypothecation, or other transfer, including any short position, any “put equivalent position” (as defined in § 240.16a-1(h) of this chapter), or any “call equivalent position” (as defined in § 240.16a-1(b) of this chapter) by the optionholder prior to exercise of an option, except in the circumstances permitted in paragraph (f)(1)(iv) of this section, until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act or is no longer relying on the exemption pursuant paragraph (f)(1) of this section; and

**Note to paragraphs (f)(1)(iv) and (f)(1)(v):** The transferability restrictions in paragraphs (f)(1)(iv) and (f)(1)(v) of this section must be contained in a written compensatory stock option plan, individual written compensatory stock option agreement, other stock purchase or stockholder agreement to which the issuer and the optionholder are a signatory or party, other enforceable agreement by or against the issuer and the optionholder, or in the issuer's by-laws or certificate or articles of incorporation.

(vi) The issuer has agreed in the written compensatory stock option plan, the individual written compensatory stock option agreement, or another agreement enforceable against the issuer to provide the following information to optionholders once the issuer is relying on the exemption pursuant to paragraph (f)(1) of this section until the issuer becomes subject to the reporting requirements of section 13 or 15(d) of the Act or is no longer relying on the exemption pursuant paragraph (f)(1) of this section:

The information described in Rules 701(e)(3), (4), and (5) under the Securities Act (17 CFR 230.701(e)(3), (4), and (5)), every six months with the financial statements being not more than 180 days old and with such information provided either by physical or electronic delivery to the optionholders or by written notice to the optionholders of the availability of the information on an Internet site that may be password-protected and of any password needed to access the information.

**Note to paragraph (f)(1)(vi):** The issuer may request that the optionholder agree to keep the information to be provided pursuant to this section confidential. If an optionholder does not agree to keep the information to be provided pursuant to this section confidential, then the issuer is not required to provide the information.

(2) If the exemption provided by paragraph (f)(1) of this section ceases to be available, the issuer of the stock options that is relying on the exemption provided by this section must file a registration statement to register the class of stock options under section 12 of the Act within 120 calendar days after the exemption provided by paragraph (f)(1) of this section ceases to be available; and

(g)(1) Stock options issued under written compensatory stock option plans under the following conditions:

(i) The issuer of the equity security underlying the stock options has registered a class of security under section 12 of the Act or is required to file periodic reports pursuant to section 15(d) of the Act;

(ii) The stock options have been issued pursuant to one or more written compensatory stock option plans established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents;

**Note to paragraph (g)(1)(ii):** All stock options issued under all of the written compensatory stock option plans on the same class of equity security of the issuer will be considered part of the same class of equity

security of the issuer for purposes of the provisions of paragraph (g) of this section.

(iii) The stock options are held only by those persons described in Rule 701(c) under the Securities Act (17 CFR 230.701(c)) or those persons specified in General Instruction A.1(a) of Form S-8 (17 CFR 239.16b); provided that an issuer can still rely on this exemption if there is an insignificant deviation from satisfaction of the condition in this paragraph (g)(1)(iii) and after December 7, 2007 the issuer has made a good faith

and reasonable attempt to comply with the conditions of this paragraph (g)(1)(iii). For purposes of this paragraph (g)(1)(iii), an insignificant deviation exists if the number of optionholders that do not meet the condition in this paragraph (g)(1)(iii) are insignificant both as to the aggregate number of optionholders and number of outstanding stock options.

(2) If the exemption provided by paragraph (g)(1) of this section ceases to be available, the issuer of the stock options that is relying on the exemption

provided by this section must file a registration statement to register the class of stock options or a class of security under section 12 of the Act within 60 calendar days after the exemption provided in paragraph (g)(1) of this section ceases to be available.

By the Commission.

Dated: December 3, 2007.

**Nancy M. Morris,**

*Secretary.*

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