



ATTENTION

SEC Adopts Exemption from Section 12(g) Registration for Compensatory Employee Stock Options

The Securities and Exchange Commission (“SEC”) has adopted two new exemptions to the registration requirements of the Securities Exchange Act of 1934 (the “Exchange Act”) for compensatory employee stock options,¹ effective as of December 7, 2007. The new exemptions provide registration relief to “non-reporting companies,” which includes companies that have not registered a class of equity securities under Section 12 of the Exchange Act and are not subject to the reporting requirements of Section 15(d) of the Exchange Act. The exemption also provides relief to “reporting companies,” which includes companies that have registered the class of securities underlying the employee stock options under Section 12 of the Exchange Act and are required to file Exchange Act reports pursuant to Sections 13 and 15(d) of the Exchange Act. If an issuer qualifies for and complies with one of the new exemptions, the issuer will not be required to register a class of stock options that would otherwise be registrable under Exchange Act Section 12(g).

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SECTION 12(G) REGISTRATION BACKGROUND REQUIREMENT

Section 12(g) of the Exchange Act requires that an issuer with 500 or more holders of a class of equity securities and assets exceeding \$10 million at the end of its most recently ended fiscal year register that class of equity security, unless there is an available exemption from registration. Under the Exchange Act, stock options, including those issued to employees under a company’s stock option plan, are a separate class of equity security. Exchange Act Rule 12h-1(a) provides an exemption from registration for interests in “stock bonus, stock purchase, profit-sharing, pension, retirement, incentive, thrift, savings or similar plan[s];” however, no similar exemption applies to compensatory stock options. Thus, for a company that has 500 or more holders of record of employee stock options and assets of more than \$10 million at the end of its most recent fiscal year, Section 12(g) requires that company to register the subject class of stock options.

Historically, issuers faced with registration obligations arising under Section 12(g) as a result of cumulative issuance of compensatory stock options that exceeded the 500 holder threshold generally obtained relief by requesting and

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obtaining “no-action” letters from the SEC. These no-action letters, when provided, exempted the issuer’s issuance from 12(g) registration. Exemptive relief was generally based on the fulfillment of specific conditions, including:

- the options terminating at the same time that employment was terminated;
- the options not being exercisable by the holders until after the issuer’s initial public offering or such time at which the issuer was no longer seeking relief;
- the issuer’s provision of financial information that would have been required of the issuer if it registered the securities; and
- limited transferability of the options, the underlying stock and the pledging of subject securities.

With respect to any given issuance or transaction, there was no assurance that an exemption letter would be obtained for any particular transaction, which resulted in uncertainty for issuers and stock option plan participants. It is anticipated that the newly adopted exemptions will prove beneficial to non-reporting companies by eliminating the uncertainty of the no-action letter relief process when implementing a compensatory employee stock option plan.

The new exemptions will also significantly lower the costs incurred by issuers granting compensatory stock options to large numbers of employees and protect investors through expansion of the issuer’s required financial disclosures.

ADOPTED EXEMPTIONS FOR NON-REPORTING COMPANIES

The exemption from the registration requirements of Section 12(g) benefiting non-reporting companies

(private companies that do not have a class of securities registered under Section 12 of the Exchange Act and are subject to the requirements of Section 15(d) of the Exchange Act) permits the issuer to forego registering stock options otherwise registrable under 12(g), subject to compliance with all of the following conditions:

- The options must be issued under one or more written compensatory employee stock options plans.
- Plan participants must be limited to employees, directors, consultants, and advisors of the issuer, its parents, or majority-owned, direct or indirect subsidiaries of the company or its parents.
- The plan must restrict the transferability of the stock options and the underlying shares received upon exercise of the options.²
- The securities underlying the stock options issued under all compensatory stock option plans must be of the same class of securities of the issuer.
- Every six months, the issuer must provide risk and financial information comparable to that which would be required under Securities Act Rule 701 if securities sold in reliance on Rule 701 exceeded \$5 million in a 12-month period. The financial information provided must include financial statements that are not older than 180 days.

The conditions of the exemption must be included in the written stock option plan or within the terms of the individual written option agreements, and must apply to options outstanding at the time the issuer relies on the exemption for the exemption to be available. The exemption does not require any restrictions applicable to the timing of exercise of the options.



Please note that the exemption applies only to the compensatory employee stock options of the issuer - it does not extend to the class of securities underlying the options. The exemption would no longer be available if the issuer became subject to the reporting requirements of the Exchange Act, or if the issuer no longer meets the conditions to the exemption.

ADOPTED EXEMPTIONS FOR REPORTING ISSUERS

The second exemption amends Exchange Act Rule 12h-1 to provide an exemption for compensatory employee stock options of issuers who have registered the class of equity security underlying those options under the Exchange Act or are required to file periodic reports under Sections 13 or 15(d) of the Exchange Act. The exemption is not available to an issuer that is required to file Exchange Act reports solely pursuant to Exchange Act 15(d). The exemption requires compliance with both of the following conditions:

- The options are issued pursuant to a written compensatory stock option plan.
- Plan participants must be limited to employees, directors, consultants and advisors of the issuer, its parents or majority-owned direct or indirect subsidiaries of the issuer or its parent.

Please note that the exemption is not conditioned on the issuer being current on its SEC filings.

REGISTRATION WHEN AN ISSUER IS NO LONGER ELIGIBLE FOR EXEMPTION

A non-reporting issuer who, but for this exemption, would be obligated to register a class of compensatory stock options pursuant to 12(g), and who becomes ineligible for the exemption, will have 120 calendar days

from the date it becomes ineligible to register the stock options under Section 12(g). Similarly, a reporting issuer who, but for this exemption, would be obligated to register a class of compensatory stock options pursuant to 12(g), and who becomes ineligible for the exemption, will have 60 calendar days from the date it becomes ineligible for the exemption to register the class of security.

CONCLUSION

The exemptions adopted provide private, non-reporting companies with certainty about the availability of an Exchange Act registration exemption for their compensatory employee stock options plan. Additionally, the exemptions provide increased flexibility for companies to grant compensatory employee stock options and lower the costs of granting compensatory employee stock options.

1 Exemption of Compensatory Employee Stock Options for Registration under Section 12(g) of The Securities Exchange Act of 1934, Exchange Act Release No. 34 -56887 (December 3, 2007) (available at <http://www.sec.gov/rules/final/finalarchive/finalarchive2007.shtml>).

2 Compensatory employee stock options and the shares received or to be received on exercise of those options cannot be transferred except to (1) family members (as defined in Rule 701) by gift or pursuant to domestic relations orders; (2) on death or disability of the optionholder. In addition, the options or shares issued or issuable on the exercise of the options and shares of the same class of equity security underlying the options may not be pledged or transferred, other than to the issuer, subject to 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. Optionholders may receive compensation for their options from the issuer or arising out of a change in control or other acquisition transaction. An issuer does not have to repurchase options if an express prohibition on transfer of options is not permitted under applicable state law.

Boston

One Financial Center
Boston, MA 02111
+1.617.856.8200
+1.617.856.8201 [fax]

Hartford

City Place I
185 Asylum Street
Hartford, CT 06103
+1.860.509.6500
+1.860.509.6501 [fax]

New York

Seven Times Square
New York, NY 10036
+1.212.209.4800
+1.212.209.4801 [fax]

Providence

121 South Main Street
Providence, RI 02903
+1.401.276.2600
+1.401.276.2601 [fax]

Washington, DC

601 Thirteenth Street NW,
Suite 600
Washington, DC 20005
+1.202.347.2222
+1.202.347.4242 [fax]

London

8 Clifford Street
London, W1S 2LQ
United Kingdom
+44.20.7851.6000
+44.20.7851.6100 [fax]

Dublin

Alexandra House
The Sweepstakes
Ballsbridge, Dublin 4
Ireland
+353.1.664.1738
+353.1.664.1838 [fax]

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For further information, please contact your Brown Rudnick attorney or one of the following attorneys:

James E. Bedar

+1.617.856.8167
jbedar@brownrudnick.com

Patrick M. Cox

+1.212.209.4949
pcox@brownrudnick.com

Mark A. Dorff

+44.20.7851.6005
mdorff@brownrudnick.com

Philip J. Flink

+1.617.856.8555
pflink@brownrudnick.com

Alan N. Forman

+1.212.209.4812
aforman@brownrudnick.com

James L. Hauser

+1.617.856.8130
jhauser@brownrudnick.com

Timothy C. Maguire

+1.617.856.8377
tmaguire@brownrudnick.com

Michael J. Student

+1.212.209.4907
mstudent@brownrudnick.com

Steven F. Wasserman

+1.212.209.4999
swasserman@brownrudnick.com

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