

SEC's Proposed Amendments of Rule 701 and Form S-8

December 11, 2020

In 2018, the Securities and Exchange Commission (the “SEC”) solicited comment on ways to modernize Securities Act Rule 701 (“Rule 701”), the registration statement on Form S-8 (“Form S-8”), and the relationship between the two regulations.¹ Following up on this effort, the SEC recently published several amendments to Rule 701 and Form S-8 to simplify and redesign the manner in which issuers grant securities to employees in compensatory transactions.² Separately, the SEC issued proposed temporary rules (the “Proposed Temporary Rules”) that would apply Rule 701 and Form S-8 to persons providing services in the “gig economy” on a temporary, trial basis.³ The principal proposed amendments to Rule 701 and Form S-8, and the Proposed Temporary Rules, are each summarized in turn below.

If you have any questions concerning this memorandum, please reach out to your regular firm contacts in the [Executive Compensation and ERISA](#) group.

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¹ Available at <https://www.federalregister.gov/documents/2018/07/24/2018-15731/concept-release-on-compensatory-securities-offerings-and-sales>

² Available at <https://www.sec.gov/rules/proposed/2020/33-10891.pdf>

³ Available at <https://www.sec.gov/rules/proposed/2020/33-10892.pdf>



PROPOSED AMENDMENTS TO RULE 701

The SEC has proposed the following changes to Rule 701:

- **Increased Offering Cap.** Currently, Rule 701(d) imposes a cap on sales that can be made in reliance on Rule 701 in a consecutive 12-month period equal to the greatest of (i) 15% of the total assets of the issuer, (ii) 15% of the total outstanding amount of the class of securities offered and sold under Rule 701 or (iii) \$1 million. Proposed changes to Rule 701(d) would raise prong (i) from 15% of the total assets of the issuer to 25% and the \$1 million limit in prong (iii) to \$2 million. The second prong of the test remains unchanged. In the context of an acquisition, the acquiring issuer would not be required to include the aggregate sales price and amount of securities issued by the acquired entity in reliance on Rule 701 for the same 12-month period.
- **Disclosure for Sales above Threshold.** Under the existing version of Rule 701, if sales by an issuer will exceed \$10 million in any consecutive 12-month period, the issuer is required to provide the additional disclosure set out in Rule 701(e) to all investors prior to sale, even sales made before the threshold is exceeded. The proposed changes to Rule 701(e) provide that, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds \$10 million, the issuer must deliver the additional disclosure required by the rule only to investors whose sales occur after the rule's \$10 million threshold has been exceeded.
- **Financial Statement Disclosure Requirements.** Under Rule 701(e), once the \$10 million threshold is crossed, issuers are required to prepare and provide financial statements. The proposed changes to Rule 701 significantly simplify the

current financial statement requirements in the following ways:

- **Age of Financial Statements.** Currently, issuers who exceed the \$10 million threshold are effectively required to prepare quarterly financial statements. As a result of the proposed changes to Rule 701(e), financial statements would only need to be made available on a semi-annual basis and completed within three months after the end of the issuer's second and fourth quarters.
- **Foreign Private Issuers.** Under the current version of Rule 701, all foreign private issuers relying on Rule 701 are required to reconcile their financial statements to US GAAP if their financial statements are not prepared in accordance with US GAAP or International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS"). The proposed changes would permit foreign private issuers eligible for the exemption from Exchange Act registration provided by Exchange Act Rule 12g3-2(b) to prepare their financial statements in accordance with home country accounting standards if the issuer does not already prepare its financial statements in accordance with US GAAP or IFRS.
- **Use of Alternative Valuation Report.** The proposed changes would allow issuers to provide an independent valuation report of their securities' fair market value as determined by an independent appraisal consistent with the rules and regulations under Internal Revenue Code Section 409A in lieu of financial statements for purposes of Rule 701(e) disclosure. Such valuation report would need to be as of a date that is no more than six months before the relevant sale of securities to which the exemption is being applied.⁴

⁴ Under the proposed amendment, Rule 12g3-2(b)-eligible foreign private issuers that have stock readily tradeable on an established securities market may provide alternative valuation disclosure prepared consistent with

Internal Revenue Code Section 409A to determine the fair market value of the stock on the most recent trading day preceding the date of sale.

- **Certain Derivative Securities.** Proposed changes to Rule 701(e)(6) clarify the time at which any required financial information must be provided to participants who receive derivative securities that do not involve a decision to exercise or convert, such as restricted stock units (RSUs). For RSUs and similar derivative securities that vest after a period of service or upon achievement of performance goals and are automatically settled, the issuer will be required to deliver disclosure a reasonable period of time before the date that such derivative security is granted. In the case of a derivative granted to a new hire in connection with the new hire's negotiation and commencement of employment, the information will be deemed to have been delivered a reasonable time before the date of sale if it is provided no later than 14 days after the new hire commences employment.
- **Disclosure Requirements Following Business Combination Transactions.** The proposed changes to Rule 701(e) clarify that after completion of a business combination transaction, in determining if the amount of securities the acquiring issuer sold during any consecutive 12-month period exceeds \$10 million, the acquiring issuer would consider only securities sold in reliance of Rule 701 during that period and would not be required to include any securities sold by the acquired entity pursuant to the rule during the same 12-month period.
- **Eligible Recipients.** The SEC has proposed a number of changes to those who may participate in an offering that is exempt under Rule 701.
 - **Entity Consultants and Advisors.** The proposed changes would expand Rule 701 consultant and advisor eligibility to entities meeting the following criteria: (1) substantially all of the activities of the entity involve the performance of services, and (2) substantially all of the ownership interests in the entity are held directly by: (a) no more than 25 natural persons, of whom at least 50% perform such services for the issuer through the entity; (b) the estate of such a natural person; and (c) any natural person who acquired ownership interests in the entity by reason of the death of such a natural person. According to the SEC, these requirements help to ensure that compensatory securities are only issued to entities that are owned by the actual service providers.
 - **Former Employees.** Like the amendments being approved to Form S-8 described below, the amendments to 701 would permit issuances to former employees in connection with specified post-termination grants and to former employees of acquired entities. In particular, under the proposed amendments, issuances under Rule 701 could be made to (x) persons who were employed by or providing services to the issuer, its parents, its subsidiaries or subsidiaries of the issuer's parent and who are issued securities after resignation, retirement or other termination as compensation for services rendered during a performance period that ended within 12 months preceding such termination, and (y) former employees of an entity that was acquired by the issuer if the securities are issued in substitution or exchange for securities that were issued to the former employees of the acquired entity on a compensatory basis while such persons were employed by or providing services to the acquired entity.
 - **Subsidiary Employees.** In order to align with Form S-8, the proposed amendments clarify that Rule 701 would be available to cover issuances to employees of subsidiaries of an issuer, regardless of whether the subsidiary is majority-owned.

PROPOSED AMENDMENTS TO FORM S-8

The SEC has proposed the following changes to Form S-8:

— **Addition of Plans and Securities or Classes of Securities to Form S-8.** A number of the proposed amendments facilitate the on-going administration of an issuer's registration statements on Form S-8 by clarifying and/or simplifying the process by which issuers can register offerings under multiple plans on a single Form S-8 and/or add shares or plans to an existing Form S-8.

- **Addition of Plans to Form S-8.** Issuers may add additional plans to an existing Form S-8 by filing an automatically effective post-effective amendment to a previously filed Form S-8. The SEC noted their belief that, among other things, this clarification may facilitate the use by an issuer of a single Form S-8 for all employee benefit plans, if an issuer chooses to do so.
- **Securities Allocation among Incentive Plans.** Issuers may use a single Form S-8 to register multiple incentive plans and are not required to allocate registered securities among incentive plans. Issuers would be required in the initial registration statement to list the types of securities covered by the registration statement and identify the plans pursuant to which the issuer intended to issue securities as of that date, but would not need to assign or allocate the securities registered to particular plans.⁵ Effectively, issuers would be permitted to create a pool of registered shares that could be issued interchangeably under its various incentive plans as necessary.
- **Addition of Securities or Classes of Securities to Form S-8.** Rule 413 under the Securities Act does not currently permit an issuer to register the offer and sale of additional securities by means of a post-effective amendment to a registration statement on Form S-8. Proposed amendments to Rule 413 would permit issuers to add additional securities or classes of

securities to an existing Form S-8 by filing an automatically effective post-effective amendment.

- **Fee Calculation and Fee Payments on Form S-8 for Defined Contribution Plans.** A number of the proposed amendments impacting Form S-8 are intended to ease potential challenges for issuers with respect to timing and calculation of fees for offerings of securities pursuant to defined contribution plans on Form S-8. In particular, proposed amendments to Rule 457 under the Securities Act would permit registration of an indeterminate number of securities to be sold under the issuer's defined contribution plans. Within 90 days after the end of the issuer's fiscal year, the issuer would be required to file a post-effective amendment and pay the registration fee for such fiscal year based on the aggregate offering price of all the securities sold during that year. The proposed rule would impact all newly filed registration statements on Form S-8 for offerings pursuant to defined contribution plans and would not affect the amount of fees owed by issuers for previously registered defined contribution plans.
- **Eligible Recipients.** As noted in the discussion of Rule 701 above, the proposed amendments address the use of both Rule 701 and Form S-8 for offerings to entity consultants and advisors, as well as former employees and would permit:
 - **Consultants and Advisors.** use of Form S-8 in connection with the offer and sale of securities to entity consultants and advisors that meet the same criteria under Rule 701 discussed above.
 - **Former Employees.** use of Form S-8 in connection with the offer and sale of securities to former employees under the circumstances described above.
- **ERISA Compliance.** Currently, Item 8(b) of Form S-8 specifies that in lieu of providing an

⁵ Issuers will still be required to track their offers and sales of securities to ensure that they have sufficient capacity registered in order to fulfill the needs of the various incentive plans identified on the Form S-8.

opinion of counsel regarding ERISA compliance or an Internal Revenue Service (“IRS”) determination letter, the issuer may undertake to submit a plan and any amendments to the plan to the IRS in a timely manner. The proposed amendments to Item 8(b) would eliminate this requirement and would permit an undertaking that issuers maintain the plan’s compliance with ERISA and make all changes required to maintain such compliance in a timely manner.

PROPOSED TEMPORARY RULES REGARDING “GIG” WORKERS

The SEC has proposed amendments on a temporary basis to Rule 701 and Form S-8 to permit an issuer to offer and sell securities to certain platform workers. For these purposes, platform workers are considered persons unaffiliated with the issuer who meet the following two criteria: (1) the worker provides bona fide services through or by means of the issuer’s internet-based or other widespread, technology-based marketplace platform or system, and (2) the services must be provided pursuant to a written contract or agreement between the issuer and the platform worker. The proposed amendments would automatically expire 5 years from the date of their effectiveness, thus providing the SEC with an opportunity to evaluate the appropriateness and the purpose of such issuances during a limited trial period.

The SEC has suggested that expanding the scope of Rule 701 and Form S-8 to include offers and sales of securities to platform workers could benefit an issuer and its investors, including those platform workers who become new equity holders. The SEC has, however, proposed additional requirements with which an issuer must comply in order to offer and sell securities to platform workers pursuant to Rule 701 or Form S-8.

- The issuer operates and controls the platform, as demonstrated by its ability to provide access to the platform, establish the principal terms of service for using the platform and terms and conditions by which the platform worker receives payment for the services provided through the platform, and

accept and remove platform workers participating in the platform;

- The securities issuance must be pursuant to a compensatory arrangement that is evidenced by a written compensation plan, contract, or agreement between the issuer and the platform worker;
- No more than 15% of the value of compensation received by a platform worker from the issuer for services provided during a consecutive 12-month period, and no more than \$75,000 of such compensation received from the issuer during a consecutive 36-month period, may consist of securities issued pursuant to Rule 701 or a registration statement on Form S-8;
- The amount and terms of any securities issued to a platform worker may not be subject to individual bargaining;
- With respect to issuances made pursuant to Rule 701 only, the issuer must take reasonable steps to prohibit the transferability of securities issued to platform workers except for transfers to the issuer or by operation of law.

In order to integrate the proposed amendment to offer platform workers securities with existing rules, the SEC highlighted that platform workers would be an additional class of persons temporarily eligible under Rule 701(c) to participate in the issuer’s Rule 701 offers and sales, and would be subject to the same Rule 701(d) limitations on the total amount of securities that an issuer may sell rather than creating a separate and independent ceiling on the amount of securities that could be offered or sold.

The SEC has made a general request for comments and has solicited specific comments on each proposed amendment.

All comments to the proposed amendments and Proposed Temporary Rules must be received on or before February 9, 2021⁶ and must be submitted electronically⁷ or by paper⁸.

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⁶ 60 days following publication in the Federal Register.

⁷ The SEC's internet comment form is available at <https://www.sec.gov/rules/proposed.shtml>

⁸ Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.