

# Good News Relating to Private Company Stock Plans

Insights

July 24, 2018

As required under the Economic Growth, Regulatory Relief, and Consumer Protection Act enacted in May 2018 (the “2018 Act”), the Securities and Exchange Commission (the “SEC”) issued final rules on July 18<sup>th</sup> to increase the disclosure threshold from \$5 million to \$10 million for issuances of securities in reliance on Rule 701 under the Securities Act of 1933.

Rule 701 is an exemption from federal securities law registration requirements available to private (non-reporting) companies with respect to equity compensation awards. Under the general rule, a private company can issue securities to employees and certain other service providers as long as the awards are made pursuant to a written plan or agreement provided to participants and the aggregate sales price or amount of securities sold during certain periods does not exceed specified limits. These limits are calculated with respect to a consecutive 12-month period, which may be measured consistently on either a fixed annual basis or on a rolling 12-month basis. Stock options granted in reliance on Rule 701 are deemed “sold” on the applicable grant date and are valued based upon the option exercise price.

Rule 701 additionally imposes a disclosure obligation where the aggregate sales price or amount of securities sold by the issuer during the applicable 12-month period exceeds a specified limit. For many years, this limit has been \$5 million. Effective with the publication of this rule change in the Federal Register, this limit increases to \$10 million.\* The disclosure required includes:

- A summary of the material terms of the plan or agreement;

- Risk factors associated with the risk of investing in the issuer's securities; and
- The issuer's financial statements in the manner specified in the rule, with such statements required to be dated not more than 180 days before the date of sale.

The disclosure must be provided to investors a reasonable period of time prior to the sale of the securities. For stock options, this means the disclosure must be provided to the option holder prior to the date of exercise; for most other types of awards, it must be provided prior to the date of grant. Other than the increase to the disclosure threshold, Rule 701 continues to operate as before.

The SEC release helpfully provides that issuers that have commenced an offering of securities under Rule 701 in the current 12-month period may apply the new \$10 million disclosure threshold immediately upon effectiveness of this amendment, which we expect to be published in the Federal Register in the next few days.

In the meantime, private companies issuing compensatory awards where the aggregate value or amount of securities issued in a 12-month period has exceeded \$5 million, or is expected in the current period to exceed \$5 million, will want to review with counsel how this change to Rule 701 will impact their equity compensation programs, including to determine what relief it might offer with respect to the disclosure requirement.

As a companion piece to the release of the Rule 701 final rules, the SEC also issued a "concept release" requesting public comment on various other aspects of Rule 701 and Form S-8, the registration statement form used by public companies to register securities issued pursuant to their stock plans.

The final rule release for Rule 701 can be viewed here:

<https://www.sec.gov/rules/final/2018/33-10520.pdf>

The concept release for Rule 701 and Form S-8 can be viewed here:

<https://www.sec.gov/rules/concept/2018/33-10521.pdf>

Please do not hesitate to contact one of your Gunderson Dettmer attorneys if you have questions about this alert.

\*This limit is now required to be indexed for inflation every five years.

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