

July 26, 2018

SEC Adopts Final Rules Raising Rule 701 Disclosure Threshold

On July 18, as mandated by the Economic Growth, Regulatory Relief and Consumer Protection Act (see our client alert [here](#)), the SEC adopted final rules (available [here](#)) to revise Securities Act Rule 701(e) to increase, from \$5 million to \$10 million, the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which an issuer is required to deliver additional disclosures to recipients of awards under Rule 701. Rule 701 is otherwise unchanged.

Rule 701 establishes an exemption from the registration requirements of the Securities Act for securities issued to officers, directors, employees and consultants pursuant to a written compensatory benefit plan by companies that are not subject to the reporting requirements of the Exchange Act. The aggregate sales price or amount of securities sold in any consecutive 12-month period in reliance on Rule 701 is limited to the greatest of: (a) \$1 million, (b) 15% of the total assets of the issuer and (c) 15% of the outstanding amount of the class of securities being offered. The exemption is available only to the issuer of the securities and does not cover resales of securities by any person.

Under Rule 701, the issuer is required to deliver to investors a copy of the compensatory benefit plan or contract. In addition, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds \$5 million (or, upon effectiveness of the amended rule, \$10 million) the following additional and potentially burdensome disclosures are required to be provided a reasonable period of time prior to the date of sale:

- a summary of the material terms of the plan;
- a risk factor analysis of the investment in the offered securities; and
- financial statements of the issuer (or, if the issuer is relying on the assets of the parent to meet the 15% asset test, the financial statements of the parent). The financial statements must include a balance sheet as of a date within 180 days, together with statements of income, cash flows and stockholder's equity for two complete fiscal years and for any interim period from the end of the last fiscal year to the balance sheet date. This last requirement can be particularly challenging for foreign private issuers, many of whom only publish annual and semi-annual financial statements (creating issues with the 180-day provision) and prepare such financial statements in accordance with International Financial Reporting Standards ("IFRS") as published by the European Union (requiring that the audit opinion then refer to both IFRS as published by the European Union and IFRS as issued by the International Accounting Standards Board).

Issuers that have commenced an offering in the current 12-month period will be able to apply the new \$10 million disclosure threshold immediately upon effectiveness of the amendment.

The final rule amendment will become effective upon publication in the *Federal Register*.

In addition to amending Rule 701, the SEC issued a concept release (available [here](#)) seeking public comment on ways to modernize compensatory securities offerings and sales pursuant to Rule 701 and Form S-8, given the significant evolution that has taken place both in the types of compensatory offerings issuers make and the composition of the workforce since the SEC last substantively amended Rule 701 in 1999. As noted in the concept release, forms of equity compensation that were not typically used at that time, particularly restricted stock units, have become common, and new types of contractual relationships between companies and individuals involving short-term, part-time or freelance work arrangements have emerged. Individuals participating in these arrangements do not enter into traditional employment relationships, and thus may not be “employees” eligible to receive securities in compensatory arrangements under Rule 701.

Among other things, the SEC is seeking comment as to whether:

- Rule 701 and Form S-8 accommodations should extend to “gig economy” relationships, and if so, under what circumstances;
- the disclosure content and timing requirements of Rule 701(e) should be revised;
- the maximum amount of securities that may be offered and sold under Rule 701 should be raised and, if so, how;
- Form S-8 should be streamlined, including by permitting a company to register all employee benefit plans on a single form, or rescinded entirely; and
- a “pay-as-you-go” fee structure should be adopted for Form S-8, whereby companies would pay filing fees on an as-needed basis rather than in connection with the original filing.

The comment period will remain open for 60 days after publication in the *Federal Register*.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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