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September 24, 2018

Via E-mail: rule-comments@sec.gov

Securities and Exchange Commission,
100 F Street, N.E.,
Washington, D.C. 20549-1090.

Attention: Brent J. Fields, Secretary

Re: Concept Release on Compensatory Securities Offerings and Sales-
File No. S7-18-18

Ladies and Gentlemen:

We appreciate the opportunity to respond to the United States Securities and Exchange Commission's (the "Commission") concept release and request for comment on the exemption from registration under the Securities Act of 1933 (the "Securities Act") for securities issued by non-reporting companies pursuant to compensatory arrangements under Rule 701¹ and on Form S-8,² the registration statement for compensatory offerings by reporting companies.³

We support the Commission's efforts to update the requirements and applicability of Rule 701 and Form S-8 to reflect the evolving nature of compensation and alternate work relationships. We believe that Rule 701 and Form S-8 continue to be valuable tools that promote the use of equity-based awards for employee compensation

¹ 17 C.F.R. § 230.701 ("Rule 701").

² 17 C.F.R. § 239.16b ("Form S-8").

³ Concept Release on Compensatory Securities Offerings and Sales, Securities Act Release No. 33-10521, 83 Fed. Reg. 34958 (July 24, 2018) (the "Release").

and help align the interests of employees with those of the issuer's other equityholders. We have set forth our comments on some of the issues raised in the Release below in the order of their presentation in the Release.

I. Rule 701

A. Rule 701(c) Eligible Plan Participants

The Commission solicited comment as to whether the new types of contractual relationships arising between companies and individuals in the labor markets and the workplace economy should be eligible to participate in exempt compensatory offerings.⁴ Currently, individuals participating in these new types of arrangements do not enter into what may be considered traditional employment relationships and thus may not qualify as employees, consultants, advisors, or de facto employees eligible to receive securities in compensatory arrangements under current Rule 701.⁵

We are supportive of the Commission expanding the definition of "employee" under Rule 701 (and, as discussed below, Form S-8) to encompass a multitude of working relationships. Workplace relationships have changed dramatically in the last decade and continue to develop. Rule 701 generally covers securities offered or sold under a non-reporting company's (and certain of its affiliates') plan or agreement to the company's "employees, directors, general partners, trustees (where the issuer is a business trust), officers, or consultants and advisors,"⁶ including individuals in a "de

⁴ Release at 34961, Question 1.

⁵ Release at 34961.

⁶ Rule 701(c).

facto” employment relationship with the company.⁷ Securities offered or sold to consultants and advisors are potentially eligible under the exemption if the consultant or advisor is a natural person providing “bona fide” services to the issuer or certain of its affiliates and the services are not provided in connection with capital-raising transactions or in order to promote or maintain a market for the securities.⁸ Neither the current definitions of “consultants” or “advisors,” nor the inclusion of individuals in a de facto employment relationship with the issuer are sufficient to cover the types of non-traditional labor relationships that arise from online marketplaces that seek to put customers in direct contact with a broad range of non-employee individuals who actually provide the end services or products. We recommend that the Commission expand the coverage of Rule 701 by focusing on the persons who provide services or products on behalf of the issuer or its affiliates. Use of titles or legal relationships are simply inadequate in today’s workforce. In our view, to encompass the new types of alternative work arrangements, Rule 701 (and Form S-8) should encompass those individuals providing services to or on behalf of the Company or making or distributing the products sold or provided to the Company’s consumers.

Likewise, we would delete the requirement that insurance agents need to be exclusive agents of the issuer, its subsidiaries or parent, or derive more than 50% of their annual income from those entities.⁹ In our view, insurance and other agents selling an issuer’s products and services should be treated no differently than an “employee” and

⁷ Rule 701 – Exempt Offerings Pursuant to Compensatory Arrangements, Securities Act Release No. 33-7645, 64 Fed. Reg. 11095, at Section II.D (Mar. 8, 1999); Release at 34960.

⁸ Rule 701(c)(1). For ease of reference, we refer herein to the types of individuals to whom securities may be offered under Rule 701 as “employees.”

⁹ Rule 701(c); Form S-8, General Instructions, A.1(a)(1).

should be covered by both Rule 701 and Form S-8. Rule 701's current focus on "exclusive" relationships and income generation ignore the reality of today's current workforce.

We do not see the potential for abuse of such an expanded definition. Securities issued under Rule 701 are deemed to be "restricted securities"¹⁰ and cannot be widely distributed upon issuance, and issuances under Rule 701 are compensatory in nature and not meant for capital raising purposes. As such, and as a matter of policy, we think it is preferable to broadly structure Rule 701 so that more issuers—and an expanded definition of "employees"—may benefit from it. We believe the general conditions under the current rule are adequate to protect investors regardless of the new forms of employee-employer relationships it may be expanded to encompass, and that some conditions, including the means of disclosure and the substance of financial information of the issuer provided to investors and the limits on the size of eligible offerings under Rule 701, among other items, may be further updated as discussed in this letter.

The Commission also solicited comment as to whether a potential eligibility test should consider "the individual[employee]'s level of dependence on the issuer, or, conversely, the issuer's degree of dependence on the individuals," and specifically considered an eligibility test that depends on the percentage of the individual's earned income derived from using the issuer's platform to reach consumers.¹¹ As with our proposal to delete the income test for determining if an insurance agent is an employee, we would not support any type of income-based test. Such a test would be administratively cumbersome to administer, would artificially draw

¹⁰ Securities issued under Rule 701 are deemed to be "restricted securities" as defined in 17 C.F.R. § 230.144. Rule 701(g); Release at 34960.

¹¹ Release at 34961, Question 7.

a line that may not be fully reflective of the importance of an individual to the issuer, and could change from year to year despite the fact that services provided to the issuer did not change at all.

Consistent with our views above, we would recommend that the Commission not adopt a separate set of rules for those individuals participating in the “gig economy.”¹² As a matter of fairness, additional burdens should not be placed on employees and employers solely because their alternative working relationship differs from those more traditionally used by employers.

B. Rule 701(e) Disclosure Requirements

The Commission’s adopted amendment to Rule 701(e) increased 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 the issuer is required to deliver additional disclosures to investors.¹³ If this disclosure is not provided to all investors before the initial sale of the securities, the issuer could lose the exemption for the entire offering when sales exceed the \$10 million threshold during the 12-month period.¹⁴ We

¹² For example, the Commission asked: “Should the amount of securities issuable pursuant to Rule 701 to individuals participating in the ‘gig economy’ in a 12-month period be subject to a separate ceiling rather than the current Rule 701(d) ceilings? If so, how should that ceiling be designed and measured?” Release at 34962, Question 15.

¹³ Release at 34962.

¹⁴ Release at 34962 (“In circumstances where the required disclosure is inadvertently not provided to all investors before the \$5 million threshold is crossed, issuers may not rely on the exemption.”); *see also* U.S. SEC Advisory Committee on Small and Emerging Companies, Recommendations Regarding Securities Act Rule 701, Appendix A, at 19 (Sept. 21, 2017) (the “Advisory Committee Recommendation”), *available at* <https://www.sec.gov/info/smallbus/acsec/acsec-rule-701-recommendation-2017->

agree with the Commission's amendment to increase the threshold in recognition of the impact of inflation since 1999.¹⁵ The threshold increase is also warranted in that companies are tending to stay private longer, receive higher levels of valuation and outside investor capital before going public, and their labor forces are commensurately larger at the time they seek to go public than was the case at the time of the Commission's last substantive amendments to Rule 701.¹⁶ Moreover, evidence suggests that non-reporting companies, particularly in the technology sector, rely on compensatory equity grants not just for senior management, but to compensate employees across a larger spectrum of seniority levels.¹⁷ In light of these fundamental changes in the nature

09-21.pdf ("Since the \$5 million limit could be exceeded at the end of a 12 month period, but the rule requires disclosure to be provided for any sales under Rule 701 during the 12 month period (or, for options, anyone who exercises options during this time), companies must generally 'guess' as to whether the \$5 million limit will be exceeded and begin providing disclosure before the disclosure threshold is exceeded in order to ensure compliance." (emphasis omitted)).

¹⁵ Release at 34962, n.51.

¹⁶ See, e.g., Advisory Committee Recommendation at 1; National Venture Capital Association, 2018 Yearbook, at 30 (reporting total venture capital funding prior to IPO and median/average time from first venture capital investment to exit), available at <https://nvca.org/research/research-resources/>; Lauren Gensler, *The IPO Class of 2018*, Forbes (January 12, 2018), available at <https://www.forbes.com/sites/laurengensler/2018/01/12/ipo-class-of-2018-dropbox-spotify-lyft/#45f345215cc9> (noting, "[m]any technology companies that remain on the sidelines are putting off an IPO in large part because they're flush with money from private investors and can afford to do so.").

¹⁷ See Stephanie Strom, *At Chobani, Now It's Not Just the Yogurt That's Rich*, N.Y. Times (Apr. 26, 2016), available at <https://www.nytimes.com/2016/04/27/business/a-windfall-for-chobani-employees-stakes-in-the-company.html> ("Technology start-ups often pay employees partly in shares to help recruit them or to compete in a company's early days for in-demand workers."); compare with WorldatWork & Vivent Consulting, 2018 Incentive Pay Practices: Privately Held Companies, at 23, 25 (2018), available at

of private companies, we believe that it is critical for the Commission to increase the threshold to \$25 million.

However, even with the increased threshold, the current structure of Rule 701 still results in issuers needing to anticipate, by up to a full year, the possibility that they may exceed the threshold and will result in companies making decisions about granting equity compensation solely because of Rule 701 limits.¹⁸ Under the current amended rule, when the total sales of securities exceed the \$10 million threshold, the issuer must disclose a reasonable time before the sale to each recipient of securities within a 12-month period (i) a summary of the applicable equity incentive plan's material terms, (ii) an explanation of the risk factors associated with investment in the securities, and (iii) financial statements of the issuer in accordance with generally accepted accounting principles ("GAAP").¹⁹ Failure to provide the requisite disclosure in a timely manner, even when the failure is inadvertent (for example, where the issuer did not accurately estimate the value of its stock over a future 12-month period) would invalidate the use of the exemption for the entire 12-month offering period and potentially result in a violation of Section 5 of the Securities Act (absent another available exemption), fines

https://www.worldatwork.org/docs/surveys/Survey%20Brief%20-%202017%20Incentive%20Pay%20Practices-%20Privately%20Held%20Compaies.pdf?language_id=1 (reporting that in 2017, 54% of responding companies across a broad range of industries grant compensatory equity to employees, with 50% of respondents granting equity to employees at the vice president level and above, 2% to all managers and above, 18% to all key employees and above and 9% to all employees; a percentage of companies make awards to employees based on factors other than seniority, including base salary levels and market driven practices).

¹⁸ Release at 34962.

¹⁹ Rule 701(e); Release at 34959–60.

to the issuer and even the issuer being required to conduct a rescission offer with respect to the offered securities.

We propose that Rule 701 be revised such that failure to provide disclosure for a particular offering would not impact the applicability of the exemption for prior issuances during the applicable 12-month offering period. Instead, a crossing of the threshold should only impact the applicability of the exemption for (1) the equity issued in the offering which caused the \$10 million threshold to be breached and for which disclosure was not provided and (2) any subsequent offerings in the 12-month period for which sufficient disclosure was not provided. We do not think retroactive disclosure to participants in earlier issuances would be warranted given that the applicable sale and investment election would have already occurred.²⁰ After-the-fact disclosure would not further the Commission's goals of informed investment decisions and would not affect the participant's decision to receive the securities.

The utility of the exemption has been reduced for many private issuers out of concern that the current \$10 million threshold could be surpassed, particularly in companies that are experiencing significant growth. The changes we propose would provide companies a measure of comfort that Rule 701 would continue to be applicable even where future events are uncertain and difficult to predict. Additionally, treating sales over the \$10 million limit separately and not integrating them with the earlier sales for disclosure purposes would be consistent with the current operation of Rule 504 of Regulation D²¹ with respect to restricted securities.

²⁰ Release at 34963–64 (“[B]ecause instruments such as RSUs settle by their terms without the recipient taking such an action, the relevant investment decision for the RSU, if there is one, likely takes place at the date of grant”).

²¹ 17 C.F.R. § 230.504, Instruction to Paragraph (b)(2) (“If a transaction under § 230.504 fails to meet the limitation on the aggregate offering price, it does not

We also note that many non-reporting companies, including early stage investment companies, do not timely prepare audited financial disclosures, meaning they may not readily be able to take advantage of Rule 701's authority to issue securities above the threshold. The preparation of GAAP financial statements is a time-intensive and costly process, and a strong deterrent to small companies taking full advantage of Rule 701.

We believe the Commission should permit companies to provide Internal Revenue Code Section 409A²² valuation information regarding the securities in lieu of GAAP financial statements.²³ In our experience, valuation information is more useful for an employee to evaluate his or her equity award grant than early-stage financial information. 409A valuation information is also subject to an existing regulatory scheme and has independent economic significance. It is therefore a suitable alternative to providing the more time-intensive GAAP financial statements. Moreover, many issuers of equity awards already conduct 409A valuations to determine, for example, exercise prices (in the case of option awards) and tax withholding (in the case of restricted stock and RSUs). Thus 409A valuations can be readily disseminated instead of forcing issuers to take on the more time-intensive process of creating new GAAP-compliant financial reports that are of limited use to employees.

affect the availability of this § 230.504 for the other transactions considered in applying such limitation. For example, if an issuer sold \$5,000,000 of its securities on January 1, 2014 under this § 230.504 and an additional \$500,000 of its securities on July 1, 2014, this § 230.504 would not be available for the later sale, but would still be applicable to the January 1, 2014 sale.”).

²² 26 U.S.C. § 409A.

²³ Release at 34963.

Our proposed approach will particularly benefit start-up companies—who are the most likely to not have GAAP financial reports available. We also believe that many private issuers would be more willing to disclose valuation information to employees than GAAP financial statements, and as such, would be more amenable to relying on Rule 701. Some private issuers face competitive risks if forced to disclose financial statement information and thus choose not to rely on Rule 701. This is particularly true in the case of a former employee being entitled to receive information regarding the issuer's financial condition and results of operations when employed by a competitor of the issuer. Section 409A valuation information, on the other hand, tends to be less competitively sensitive.

If the Commission determines not to allow 409A valuation information to replace the GAAP financial statements disclosure requirement, the Commission should consider allowing issuers to provide 409A valuation information in lieu of GAAP financial information where issuances are below a threshold, above which GAAP financials would be required to be disclosed. This alternative would allow a company that is unexpectedly approaching the disclosure threshold (*e.g.*, due to an unanticipated increase in valuation or growth of the business) to continue its planned issuances by disseminating the readily available 409A valuation information, allowing minimal disruption to the company's planned business and compensation practices. If the company then anticipates the need to issue equity awards above the second threshold, it can rely on this buffer to continue issuing while working through the process of preparing GAAP financial statements. The thresholds could be set to align with the additional cost of first developing GAAP financial information.

C. Rule 701(d) Exemptive Conditions

Under the current rule, the aggregate amount of securities issued in reliance on Rule 701 within any 12-month period must not exceed the greatest of the

following: (i) \$1 million, (ii) 15 percent of total assets of the issuer (the “15% asset cap”), or (iii) 15 percent of all outstanding securities of the same class being offered.²⁴ The Commission solicited comment as to whether there is a continuing need for any annual regulatory ceiling for Rule 701 transactions, or alternatively, if a ceiling is retained, whether it should be raised.²⁵

We propose that the \$1 million aggregate issuance limit (the “\$1 million cap”) be increased to \$2 million. As noted in the Release, \$5 million in 1999 dollars would be approximately \$7.5 million in 2018, a 50% increase.²⁶ Although inflation was discussed only in the context of justifying the \$5 million disclosure threshold increase, the same concerns would apply equally to the \$1 million cap. Similarly, the arguments raised by the Commission’s Advisory Committee on Small and Emerging Companies regarding the increased prevalence of companies remaining private longer and growing to higher valuations as justification for the disclosure threshold increase would also justify an increase in the \$1 million cap.²⁷

The \$1 million cap is a particularly important prong for start-up companies to rely on the exemption. Newly formed companies often have few assets and may look to issue a large percentage of their current equity to first-round employees.²⁸

²⁴ Rule 701(d)(i)–(iii).

²⁵ Release at 34964, Questions 40–41.

²⁶ Release at 34962, n.51.

²⁷ See Advisory Committee Recommendation at 1.

²⁸ See Christopher Geczy, Jessica S. Jeffers, David K. Musto, and Anne M. Tucker, *In Pursuit of Good & Gold: Data Observations of Employee Ownership & Impact Investment*, 40 Seattle U. L. Rev. 555, at 572 (2017) (“[E]mpirical evidence suggests equity-based compensation plans are particularly popular with firms facing financial needs and constraints.”); see also Strom, *supra* note 17

Such an offering would likely fail to satisfy the second or third prongs of the limit test, and so increasing the first prong will ensure these fledgling companies continue to benefit from Rule 701. The \$1 million cap is also useful to start-up companies for its simplistic application, as it doesn't require reference to a balance sheet or capitalization table.

We also propose that the Commission increase the 15% asset cap to 25%. Under the current structure of Rule 701, the second prong tends to be less advantageous to modern companies. In contrast to the structure of businesses around the time Rule 701 was last substantively updated, modern companies rely much more heavily on human capital and are less asset-intensive.²⁹ This may hold particularly true for service-based firms operating in the "gig economy." Moreover, many companies operate largely as a starting concern with little cash, and thus are not easily able to rely on the 15% asset cap. In order to increase the efficacy of this prong and reflect the changing nature of many private businesses, the 15% asset cap should be increased.

(describing how technology start-ups compensate employees through equity to compete in a company's early days for in-demand workers).

²⁹ Larry Jacob, *3 Trends that Prevent Entrepreneurs from Accessing Capital*, Ewing Marion Kauffman Foundation (July 25, 2018), <https://www.kauffman.org/currents/2018/07/3-trends-that-prevent-entrepreneurs-from-accessing-capital> ("[T]he majority of new businesses are service businesses that do not have significant assets or collateral, but instead are based on cash flow.... Traditional lending models no longer fit today's startups: only 18 percent of businesses ever access a bank loan." (citing Alicia Robb & Arnobio Morelix, *Startup Financing Trends by Race: How Access to Capital Impacts Profitability*, Annual Survey of Entrepreneurs Data Briefing Series at 2 (Oct. 2016), available at https://www.kauffman.org/-/media/kauffman_org/research-reports-and-covers/2016/ase_brief_startup_financing_by_race.pdf)).

II. Form S-8

A. Form S-8 Eligible Plan Participants Consistency with Rule 701

The Commission has solicited comment regarding the continued harmonization of the scope of “consultants and advisors” between Form S-8 and Rule 701, and more broadly whether the scope of eligible individuals should be the same under both the form and the exemption.³⁰ We recommend that, to the extent the Commission revises the application of Rule 701 by expanding the scope of individuals eligible for compensatory offerings as described above, corresponding changes should be made to Form S-8. Because Rule 701 and Form S-8 are designed to promote the same goals—including recognizing the difference in the relationship between the issuer and recipient of securities in a compensatory offering compared to a capital raising transaction—we believe the two regimes should be aligned to the extent practicable.³¹ The same benefits from recognizing the evolving working relationship structures discussed above under Rule 701 would equally apply to Form S-8.

Additionally, in circumstances where an issuer is transitioning from becoming a non-reporting company to becoming a reporting company (or vice versa), alignment will help to avoid foot faults for issuers transitioning from one regime to another. Setting different eligibility standards between Rule 701 and Form S-8 would cause unneeded complexity and make it harder for companies who have previously relied on Rule 701 to conduct substantially similar offerings once they become eligible for Form S-8. As such, the two regimes should be aligned to the extent practicable.

³⁰ Release at 34965, Questions 42–43.

³¹ See Release at 34959.

B. Form S-8 Eligible Prospective and Former Employees

We encourage the Commission to revisit and clarify the treatment of restricted stock units (“RSUs”) and other equity awards to prospective and former employees under Form S-8. The current form, last substantially amended in 1999,³² permits the registration of the exercise and subsequent sale of securities received in respect of stock options held by former employees, but is silent with respect to other types of equity awards held by former employees (other than with respect to certain types of intra-plan transfers).³³

Since Form S-8 was last amended in 1999, the popularity of option awards has declined relative to grants of other forms of awards,³⁴ while at the same time, reporting companies commonly award multiple types of equity awards as part of their annual equity compensation mix. In the Release, the Commission acknowledged that since Rule 701 and Form S-8 were last revised, “[f]orms of equity compensation that were not typically used at that time, particularly restricted stock units (“RSUs”), have become common[.]”³⁵ Therefore, it is particularly timely to revise Form S-8 to account for RSUs and other award types with respect to former employees given that the

³² Registration of Securities on Form S-8, Securities Act Release No. 33-7646, 64 Fed. Reg. 11103 (Mar. 8, 1999).

³³ Form S-8 General Instructions, A.1.(a)(3). Form S-8 has, for almost 30 years, provided for registration of the exercise and subsequent sale of certain securities held by former employees. Registration and Reporting Requirements for Employee Benefit Plans, Securities Act Release No. 33-6867, 55 Fed. Reg. 23909 (June 13, 1990).

³⁴ Joseph E. Bachelder III, *What Has Happened to Stock Options?*, Harv. Law School F. on Corp. Governance and Fin. Reg. (Oct. 2, 2014), <https://corpgov.law.harvard.edu/2014/10/02/what-has-happened-to-stock-options/>.

³⁵ Release at 34961.

Commission is reconsidering Rule 701 in light of such developments. We believe that alignment of the treatment of options and other forms of compensatory awards under Form S-8 would be beneficial and would eliminate a distinction that might weigh against grants of certain types of awards which would otherwise be favored for valid business purposes.

We propose three changes in this regard. First, Form S-8 should expressly cover the settlement, delivery and subsequent sale of stock in respect of RSUs and other equity awards granted to former employees and other service providers while they were employed or providing services to the issuer,³⁶ similarly to how stock options are currently treated under Form S-8.³⁷ Second, companies should be able to register new grants of equity awards to former employees under Form S-8, provided such grants are made in respect of such employee's prior service and in connection with ordinary course periodic grants under the company's incentive plans for the 12-month period following retirement or termination. Finally, the Commission should clarify that contingent offers of securities in connection with offer letters and employment agreements (or other conditional pre-employment arrangements or promises) provided to prospective employees are covered by Form S-8.

Each of these proposals recognizes the period of employee service relevant for Form S-8 should broadly capture both prior agreements conditioned on future service and retrospective grants in respect of past service. Moreover, each proposed change is consistent with the Commission's views that due to the employer/employee

³⁶ This would align with the requirement of Rule 701 that offers and sales of securities to former employees and other service providers are exempted only if such persons were employed by or providing services to the issuer at the time the securities were offered. *See* Rule 701(c).

³⁷ Form S-8 General Instructions A.1.(a)(3)(i).

relationship, “employees are more familiar with their company than most other investors”³⁸ which supports a “policy determination to treat Form S-8 issuances more liberally.”³⁹

1) *Inclusion of RSUs and other forms of awards for settlement, delivery and subsequent sale by former employees.*

Under the current Form S-8, the term “employee” includes former employees only with respect to “the exercise of employee benefit plan stock options and the subsequent sale of the securities, if these exercises and sales are permitted under the terms of the plan”, as well as certain intra-plan transfers.⁴⁰ Because Form S-8’s language specifically applies to only stock options, Form S-8 cannot be used to register the settlement, delivery and subsequent sales of other types of employee equity awards, such as RSUs, for former employees.

We do not believe there is a meaningful distinction between options and other forms of equity-based awards such as RSUs, and that the Commission is correct that Form S-8 should be revised in light of modern equity-grant practices. The current Form S-8 gives a preference to stock options as compared to other equity awards, and there is simply no basis to distinguish options from other equity awards from a Securities Act registration perspective.

³⁸ Employee Benefit Plans; Interpretations of Statute, Securities Act Release No. 33-6188, 45 Fed. Reg. 8960, at Section VII.A (Feb. 11, 1980).

³⁹ U.S. Securities and Exchange Commission, *Compliance and Disclosure Interpretations – Securities Act Sections*, Question 239.15 (Nov. 26, 2008), available at <https://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm>.

⁴⁰ Form S-8 General Instructions A.1.(a)(3).

- 2) *Extension of Form S-8 to new grants of equity to former employees in respect of prior service.*

We suggest the Commission expand Form S-8 to allow for registration of new grants of equity awards to a former employee, provided that (1) the grant is made in respect of such employee's *bona fide* prior service to the company,⁴¹ (2) the grant is made under the issuer's shareholder approved employee benefit plan and (3) the grant is made within 12 months of the former employee's termination of employment. This proposal recognizes that some companies establish year-end compensation reviews that grant equity awards on an annual basis in recognition of the service provided in the preceding year. If an individual terminates employment prior to the annual review, the company may nevertheless wish to grant equity awards to the former employee during the annual grant review, particularly in the case of retirement or a conciliatory termination of employment. Because the individual would not qualify as a "consultant" or "advisor" and the definition of "employee" does not cover former employees in this circumstance, the company may not be able to rely on Form S-8 to register such an award.

As a matter of policy, this change is consistent with the Commission's intentions to treat issuances under Form S-8 liberally.⁴² First, any such award would be compensatory in nature and clearly tied to the *bona fide* services provided to the company while the recipient was an employee. Second, our proposal recognizes the intent of issuers in having an annual period for award issuances, which causes the secondary effect of a delay between when the recipient's employment terminates and when the award is issued. Form S-8 should be structured to permit this compensation practice. Finally, the

⁴¹ This addresses a primary concern regarding misuse of Form S-8—that of disguising capital-raising activities. *See* Release at 34965, n.82.

⁴² *See supra* note 39 (citing policy determination to treat Form S-8 issuances more liberally).

proposed addition of a 12-month cut-off period is intended to ensure such grants would be made within the next annual review cycle, giving further comfort that the expansion would not be abused for delayed non-compensatory capital raising purposes.

3) *Clarification of treatment of employment negotiations contemplating grants of RSUs to prospective employees.*

We propose the Commission expand Form S-8 to allow registration of offers of equity-based awards to prospective employees. We believe that offers of equity awards to prospective employees should be registrable on Form S-8 so long as the offer is contingent on future employment. Issuers should not need to wait until the formal “employment” of an employee to offer equity-based awards. So long as the equity award is conditioned on the creation of an employment arrangement, these offers should be covered. Grants to newly hired employees are already recognized by several national securities exchanges as subject to special treatment under “inducement grant” exceptions that provide issuers with a separate, efficient route to incentivize newly hired employees outside of their shareholder-approved equity incentive plans.⁴³

C. Form S-8 Administrative Burdens

We appreciate the Commission’s goal to simplify the requirements of Form S-8 and reduce the complexity and cost of compliance to issuers while retaining appropriate investor protections.⁴⁴ We propose that the following additional changes to the way securities are registered with respect to Internal Revenue Code Section 401(k) and other types of defined contribution retirement savings plans and non-qualified deferred contribution plans (“DC Plans”) be adopted to further this goal.

⁴³ See NASDAQ Listing Rule 5635(c)(4); NYSE Listed Company Manual Rule 303A.08.

⁴⁴ Release at 34965.

The Commission rightfully asks whether, in certain circumstances, such as where employees may purchase employer securities through participation in DC Plans, Section 5 compliance issues may arise when DC Plan sales exceed the number of shares registered.⁴⁵ Unlike equity incentive plans, DC Plans do not typically provide a finite pool of securities that participants may elect to purchase from, and instead, where employer stock is offered as an investment alternative, commonly provide employer stock funds that are open-ended in the number of securities that participants may purchase. When investment elections and sales are made, the stock fund will either allocate shares purchased from other selling participants or buy shares on the open market. In each case, employers are required to keep track of the number of issuances and sales against the limited number of securities registered on Form S-8 that may be offered. Similarly, the filing fee (and the amount of securities being offered) in respect of issuer obligations under non-qualified deferred contribution plans that constitute offerings of securities is based on the amount of compensation being deferred at the election of participants.⁴⁶ Participant deferrals may provide participants the opportunity to actually or notionally participate in the growth and appreciation of employer stock through investment elections tied to its performance. Issuers must estimate the potential number of future elections, both with respect to the initial employee deferrals and subsequent investment elections, based on historical usage and future participation and election rates.

Unlike open market purchases of issuer stock by third-party investors, investments in DC Plans and non-qualified deferred contribution plans provide for a

⁴⁵ Release at 34965, Question 45.

⁴⁶ See U.S. Securities and Exchange Commission, *Compliance and Disclosure Interpretations – Securities Act Sections*, Question 239.03 (Nov. 26, 2008), available at <https://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm>.

potentially limitless number of investment elections and sales that count against the issuer's pre-registered limit. Therefore, the issuer must estimate the amount of securities to register on the original Form S-8, often balancing the costs of registering a potentially excess number of securities that may go unused against the potentiality that election deferrals could cause the issuer to inadvertently violate Section 5 if the number of securities offered exceeds the registered amount under the plan. Violations of Section 5 are expensive and time-consuming to correct. Furthermore, the estimates that issuers need to undertake in order to register securities in respect of DC Plans are difficult to make, even where the issuer has perfect historical information. Where an issuer has given due consideration and made reasonable efforts to estimate share usage, and has paid fees in respect thereof, the prospect of additional punitive fees or having to conduct a rescission offer to correct inadvertent failures acts as a disincentive to issuers from continuing to offer employer stock in DC Plans.

Rule 413 does not permit an issuer to register additional securities by means of a post-effective amendment, and therefore an issuer may not currently register additional securities by filing a post-effective amendment to Form S-8 and must instead file a new Form S-8 to register additional securities.⁴⁷ Other than filing a new Form S-8, issuers do not have an easily available option to implement an adjustment to the shares registered in respect of a DC Plan and have no option to correct an issuance of securities in excess of the amount registered on Form S-8 without violating Section 5.

We propose two changes to Form S-8 in order to help remove potential hurdles to issuer participation and provide clarity with respect to the administration of DC Plans. First, we request the Commission to continue the current practice that only

⁴⁷ See U.S. Securities and Exchange Commission, *Compliance and Disclosure Interpretations – Securities Act Forms*, Question 126.36 (Feb. 27, 2009), available at <https://www.sec.gov/divisions/corpfin/guidance/safinterp.htm>.

shares purchased in the open market (or issued by the issuer) with respect to DC Plans count against the registration requirement. Purchases or sales of securities that are offset within the DC Plan itself should not be counted against the shares registered on Form S-8 since there is no open market transaction (or issuance by the issuer). It seems appropriate that registration fees should only be paid with respect to securities acquired in the market or issued by the issuer.

Second, we propose that Form S-8 provide an alternative registration option whereby an issuer may choose, instead of registering a finite number of shares on Form S-8, to register an indeterminate number of shares in respect of DC Plans, similar to that permitted by well-known seasoned issuers. Under this alternative, within ninety days of the end of the issuer's fiscal year, the issuer would have a true-up obligation to measure the number of securities that had been issued in respect of the applicable DC Plan in the prior 12-month period and pay the requisite fee. Our proposal would allow issuers to decide whether they have the ability to accurately estimate share usage on a prospective basis, or whether they would prefer to rely on the alternative registration option to measure usage and pay fees on an ongoing annual basis, thus providing comfort that the issuer may continue to issue employer stock through the DC Plan in the normal course. Removing this potential hurdle will help to incentivize issuers to continue to offer employer stock in DC Plans as an easy way for employees to participate in the growth of the issuer, which is both consistent and in furtherance of the original purposes of Form S-8.

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If you would like to discuss our letter, please feel free to contact Robert
W. Reeder at [REDACTED] or Marc Trevino at [REDACTED].

Yours truly,

Sullivan & Cromwell LLP