

AMERICAN BAR ASSOCIATION

Technical Session Between the SEC Staff and the Joint Committee on Employee Benefits

Questions and Answers

May 6, 2008

The following questions and answers are based on informal discussions between private sector representatives of the JCEB and SEC staff members. The questions were submitted by ABA members and the responses were given at a meeting of JCEB and government representatives. The responses reflect the unofficial, individual views of the government representatives as of the time of the discussion, and do not necessarily represent the position of the agency. This report on the discussions was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting, and has not been reviewed by SEC staff members. The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.

JCEB Questions for SEC – 2008

Proxy Rules

- 1A. **Footnotes to Summary Compensation Table.** Various instructions to the Summary Compensation Table require footnote disclosures elaborating on the information reported in the table. Instructions 3 and 4 to the All Other Compensation column clearly state that footnotes for that column need address only the most recent (last) fiscal year. However, there is not a comparable instruction with respect to the other columns. For other columns in the SCT, when footnote disclosure is called for, is it also required only with respect to the most recent fiscal year?

Suggested Answer: Required footnote disclosures with respect to the other columns of the SCT also is required only with respect to amounts reported for the most recent fiscal year. Of course, there may be times when companies determine that it is appropriate to provide information as to prior years when doing so would assist with shareholders' understanding of the information.

SEC Response: Footnote information for years other than the most recent year are only required if necessary to an investor's understanding of the information provided for the most recent year.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 119.14 (July 3, 2008).]

- 1B. **Assumptions for Stock and Option Awards.** Assuming that the answer to the previous question is that footnote disclosure is required only with respect to amounts reported in the Summary Compensation Table for the most recent fiscal year, if a company is disclosing equity award assumptions by reference to financial statement footnotes as specified under the Instruction to S-K 402(c)(2)(v) and (vi), which financial statements should be cited - (i) only the footnote in the most recent fiscal year financials, or (ii) the footnote in each year's financial statements in which a grant occurred that was expensed during the last fiscal year.

SEC Response: You need to refer to the footnote in each year's financial statements in which a grant occurred that was expensed during the most recent fiscal year (i.e., the second alternative in the Question).

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 119.15 (July 3, 2008).]

2. **Assumptions for Stock and Option Awards.** The Instruction to the stock and option award columns of the Summary Compensation Table calls for disclosure of the assumptions made in connection with the valuation of these awards. If a company chooses to provide this information with respect to awards granted in the last fiscal year as part of the disclosure in connection with the Grants of Plan-Based Awards Table, is it

permissible to satisfy the requirements of the Summary Compensation Table with a cross-reference to such disclosure?

SEC Response: A cross-reference to the Grants of Plan-Based Awards Table would be permissible, if the assumptions are stated in connection with that table. But this would only pick up awards granted in the most recent fiscal year. You would still need to refer to the assumptions used for grants in prior years that were expensed in part during the most recent fiscal year.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 119.16 (July 3, 2008).]

3. **Bonus Payable in Stock.** Several questions have arisen regarding the proper reporting where a bonus opportunity is initially denominated in cash (such as a percent of salary) but is subsequently paid in an equity form. Please clarify the proper reporting in the following situations. In particular, is the “bonus” reportable in the Non-Equity Incentive Plan column or in the Stock Awards column of the Summary Compensation Table, and how is it reported in the Grant of Plan-Based Awards Table?

(a) A company establishes an annual bonus opportunity under a non-equity incentive plan as a dollar amount. After the year is over, the company decides to pay a portion of the bonus in fully vested stock.

Suggested Answer: By analogy to Q&A 4.03 of the Staff’s Guidance on S-K Item 402 (which deals with an election by the executive to convert a cash bonus to stock), the full amount of the bonus should be reported as Non-Equity Incentive Compensation (in both the Summary Compensation Table and the Grants of Plan-Based Award Table) since the right to receive stock was not embedded in the award at grant.

(b) After the year is over, the company decides to pay the bonus in restricted stock or RSUs which are subject to additional time-based vesting, and will ultimately be paid in stock.

(c) After the year is over, the company decides to pay the bonus in phantom stock or RSUs which are subject to additional time-based vesting, and will ultimately be paid in cash.

(d) At the time of establishing the bonus opportunity, the company determines that the dollar amount of bonus earned will be converted into fully vested stock based on the stock price on the date of payment (or last day of the fiscal year for which the bonus was earned).

(e) At the time of establishing the bonus opportunity, the company determines that the dollar amount of bonus earned will be converted into equity (restricted stock or RSUs) which will be paid in stock subject to additional time-based vesting. The number of shares subject to the award will be based on the stock price on

either the date of payment or last day of the fiscal year for which the bonus was earned, neither of which is known at the time the bonus opportunity is established.

- (f) At the time of establishing the bonus opportunity, the company determines that the dollar amount of bonus earned will be converted into phantom shares which will be paid in cash, subject to additional time-based vesting.
- (g) Is the answer to any of the above questions different if the bonus is purely discretionary (and thus reportable in the Bonus column rather than the Non-Equity Incentive Plan column)?

Suggested Answer: No.

- (h) Does the Staff guidance in Q&A 4.03 of the Staff's Guidance on S-K Item 402 (dealing with an executive's discretion to take a portion of salary or bonus in stock) also apply to non-equity incentive compensation?

Suggested Answer: Yes.

SEC Response: The response to items (d), (e), (f), and (g) are straight-forward. All of (d), (e), and (f) [*i.e. where at the time of establishing the bonus opportunity the company determines that the amount of bonus earned will be determined as a dollar amount but converted into a form of equity*], are equity incentive plan awards since they are covered by FAS 123R. They should be reported as stock awards in the Summary Compensation Table and as equity incentive plan awards in the Grants of Plan-Based Awards Table. Although the Grants of Plan-Based Awards Table normally calls for reporting a number of shares that could be earned at each level of performance, in this case where the potential bonus is stated in dollars, it would be permissible to change the column heading and report the potential payouts in dollars.

With respect to (g), a discretionary bonus payable in stock should be reported in the Stock Awards column of the Summary Compensation Table, and reported as a stock grant in the Grants of Plan-Based Awards Table.

The treatment in items (a), (b), and (c) is uncertain. It was noted by ABA representatives that having the proxy reporting follow the accounting treatment was problematic since the accounting treatment is often unpredictable. It was also noted that the situation described in these items may occur where at the time of grant a company intends to pay cash, but at year-end has insufficient cash and decides to pay in equity. Treating such awards as equity awards creates a disconnect because the equity award would typically be granted in the subsequent year.

4. **Retention Bonus.** In 2008 a company enters into retention agreements with certain executives under which it agrees to pay a cash retention bonus if the executive remains in employment until a specified date in 2010. What, if anything, is reportable in the proxy statement for 2008 with respect to this arrangement? Is the analysis different if the retention bonus will be credited with earnings during the retention period?

Suggested Answer: The agreement should be described in the CD&A, but is not required to be reported in the Summary Compensation Table for 2008. The payment would be reported in the Bonus column of the SCT for 2010. The same reporting would apply if the bonus amount was increased by an earnings component.

SEC Response: The retention bonus should be reported in the Summary Compensation Table only when the employment or performance necessary to earn the bonus has been completed – that is when the bonus is deemed “earned.” If the employment condition for payment of the bonus is not satisfied until 2010, the bonus would be reported for 2010. However, if the executive became entitled to a portion of the bonus by virtue of employment through 2009, that portion of the bonus would be reportable in the Summary Compensation Table for 2009. If there was an earnings component to the bonus (for example, if the bonus amount would also be credited with earnings at the “prime rate”) the earnings would be reportable when the performance necessary to earn them was complete. Thus the earnings would be reportable at the same time as the related bonus, assuming the earnings are not payable unless the bonus is paid. However if the executive will be entitled to keep the earnings whether or not he/she earns the bonus, then the earnings should be reported each year as they are earned. A retention bonus that requires future service as a condition of payment (and that is not deferred after such service has been completed) would not be reported in the Deferred Compensation Table.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 119.17 (July 3, 2008).]

5. **Role of Compensation Consultant.** Item 407(e)(3)(iii) of Reg S-K, dealing with information required to be provided about the compensation committee, requires companies to provide specific information about the role of any compensation consultant that is involved in determining or recommending the amount or form of executive or director compensation. In its comment letters the SEC Staff has suggested that this disclosure is required as part of the Compensation Discussion and Analysis. Is this information required to be provided twice and, if not, on what basis is a registrant to differentiate between the requirements of Item 407(e)(iii) and Item 402(b)?

Suggested Answer: Detailed disclosure about the role of the compensation consultant may be provided in either the committee description section or the CD&A.

SEC Response: Information about the role of the compensation consultant should go with the other Rule 407 information. The information about committee “process” should not be part of the CD&A unless it’s relevant to the discussion of a particular compensation decision.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 118.06 (July 3, 2008).]

6. **Outstanding Equity Awards Table.** Instruction 2 to this Table calls for footnote disclosure of the vesting dates of the awards listed. If the table includes a column

showing the grant date of each award, is it permissible to have a general statement of the vesting schedule for such awards (e.g. all awards vest 25% per year beginning on the first anniversary of the date of grant)?

Suggested Answer: Yes. This shortens the disclosure and is easier for most readers to understand than a long list of vesting dates. It also provides information with respect to the portion of outstanding awards that has already vested. If any awards have a vesting schedule that differs from the standard schedule, separate disclosure of the applicable vesting schedule should be provided.

SEC Response: In order to use this approach, you must include a column showing the grant date of the award. The Staff agrees that this approach is more easily understood.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 122.02 (July 3, 2008).]

7. **Nonqualified Deferred Compensation Table.** Is a company required to provide the disclosure required by the Nonqualified Deferred Compensation Table on a plan-by-plan basis, or is aggregated disclosure sufficient?

SEC Response: The information should be provided on a plan-by-plan basis. This is consistent with the treatment in the Pension Plan Table. The overall thrust of the rules is to provide more information. There may be questions about what is “a plan” for these purposes.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 125.03 (July 3, 2008).]

8. **Nonqualified Deferred Compensation Table.** A company credited an amount of deferred compensation under an excess plan in January 2008 that related to amounts credited to a qualified plan with respect to 2007 earnings. The company’s contribution would be reported in the Summary Compensation Table for 2007 since it was “earned” in 2007. Should the contribution be reported in the Nonqualified Deferred Compensation Table for 2007 or 2008? The Item for that Table calls for contributions “during” the last fiscal year, and here the contribution is actually being made in the subsequent year.

SEC Response: The Staff’s initial response was that the disclosure is more meaningful if in sync with the Summary Compensation Table; the act of crediting the excess plan “contribution” can be viewed as purely a ministerial act, and so the fact that the bookkeeping happens in the subsequent year is immaterial and should be disregarded. In follow-up discussion it was noted that there may be problems with this approach in certain circumstances, for example where a bonus that is being deferred was “earned” for the prior year, but the amount of the bonus was not determined until the subsequent year. Also, treating the deferred compensation as if it were credited during the most recent year may create a disconnect between the year-end account balance reported in the proxy statement and the plan’s actual

year-end account balance. The ABA representatives offered to refine the question in the context of various types of plans.

[Update: See Division of Corporation Finance Compliance and Disclosure Interpretations, Regulation S-K, Question 125.04 (July 3, 2008).]

Form S-8

9. **S-8 Prospectus.** A plan permits participants to elect the investment of their account among several investment funds. One of such funds has been “frozen” so that no new money can be transferred into that fund, but existing amounts can remain in it or be transferred out to another fund. Item 1(g) of Part I of Form S-8 requires disclosure of investment performance “[i]f participating employees may direct all or any part of the assets under the plan to two or more investment media...” Must the prospectus for this plan provide financial data for the frozen fund as well as for the funds into which participants can direct new investment?

SEC Response: The S-8 prospectus must continue to provide the investment performance information about the frozen fund.

10. **Securities Act Rule 428(b)(5) and E-Proxy.** The “e-proxy” rules permit registrants to deliver proxy materials through a “notice and access” model whereby registrants can send paper notices to shareholders informing them of the availability of proxy materials on a website. Prior consent of shareholders to electronic delivery of proxy materials need not be obtained (although shareholders may request traditional hardcopy delivery). Securities Act Rule 428(b)(5) requires a registrant to deliver shareholder communications, including proxy materials, to its employee stock plan participants generally no later than the time such materials are sent to security holders. Release No. 33-7288 (May 9, 1996) provides guidance on electronic deliveries to employees. The guidance is generally similar to e-proxy, but is limited to employees who have access to computers in the normal course at work. Can a company that adopts e-proxy satisfy its delivery obligations under Securities Act Rule 428(b)(5) to all plan participants by utilizing e-proxy’s notice and access model?

Suggested Answer: Registrants can satisfy their obligations under Securities Act Rule 428(b)(5) using either the e-proxy rules or the 1996 guidance. If a registrant uses e-proxy’s notice and access model to effect deliveries to employee stock plan participants, the registrant may deliver the Notice of Internet Availability of Proxy Materials by the means that is customarily uses to deliver important employment-related information to the employee.

SEC Response: The “e-proxy” rules were subject to the full rule proposal notice and comment process. The Staff guidance regarding Rule 428 was not subject to a similar process. This is an area that the Staff would want to consider in the context of a general review of S-8 [which an ABA subcommittee is working on]. The Staff also noted a growing concern about S-8 abuses, such as using S-8 for capital-raising purposes.

Regulation S

11. **Employees on “Temporary Assignment.”** Reg S provides an exemption from Securities Act registration for shares issued under employee benefit plans to employees who reside outside the US or who are “on temporary assignment” in the US. Assume a non-US company granted a stock option to a non-US employee and then transferred the employee to the US for a two-year assignment, with the expectation that he would be reassigned to his home country at the end of such assignment. Would such an employee be considered “on temporary assignment” in the US during the two-year period so as to be able to exercise his stock option under Reg S?

SEC Response: Whether an employee is on “temporary assignment” is a matter of facts and circumstances. There is no bright line test. A “temporary assignment” could last 2 years, or perhaps 3, but is not likely to include a 6-year assignment. It depends on the nature of the assignment, the understanding between the employee and employer, and indicia that the employee will return to the home country. A written agreement helps establish the understanding regarding the nature of the assignment.

Rule 701

12. **Applicability of \$5 Million Limit on Conversion from S-8 to Rule 701.** A foreign issuer that had been registered under the Exchange Act deregistered, and in that connection terminated a registration statement on Form S-8 covering outstanding stock options. We understand that the Staff has taken the position that these stock options can now be covered by Rule 701. How do these options affect the Rule 701 \$5 million limit on annual grants (or other sales) beyond which the company must deliver the financial statement and other specified disclosure?

Suggested Answer: Options that were granted while the company was registered under the Exchange Act and that were initially covered by an S-8 registration statement can be exercised under Rule 701 after the company’s deregistration without regard for the \$5 million limit. The limit was intended to apply in the year of grant, so that a company that wanted to stay below the limit could plan accordingly. No such limit was applicable at the time the options were granted. An after the fact application of the limit seems unfair and a trap for the unwary.

SEC Response: Rule 701 does not deal with this. The Staff would consider granting no-action relief in individual circumstances. If the company had been granting below \$5 million of options per year while it was registered under the Exchange Act, the enhanced disclosure would not be required. But if the company had been granting significant numbers of options, some additional disclosure would be required. The Staff might be willing to consider relief if the company had granted large numbers of options in a few years while public, but in subsequent years granted below the \$5 million limit and only a few of the earlier options were still outstanding. The same situation could arise with a domestic company that went private, in which case additional disclosure is likely to be required in order to satisfy

the Section 12(g) exemption from registration of the options. The Staff would be receptive to receiving more information from the ABA about the circumstances in which this problem has arisen, what issuers are doing about it, and suggested approaches for dealing with the issue.

13. **Date of Foreign Issuer Financial Information.** Rule 701 requires the applicable financial information to be as of a date no more than 180 days before the date of option exercise or other sale of a security, which effectively requires an issuer to prepare quarterly financial statements. Many foreign issuers provide only semi-annual financial statements under their home country rules (and would not be required to prepare quarterly financial statements if they were registered under the Exchange Act). Can foreign issuers satisfy Rule 701 by providing only their most recent semi-annual financial statements?

SEC Response: The Staff is sympathetic to the problem, but the Rule says 180 days and the Staff has no authority to grant exemptions from the requirement. The Staff would be willing to consider a rule amendment or a global no-action letter in response to an ABA submission.

14. **Reconciliation of Foreign Financial Statements.** Rule 701, as amended in late 2007, permits a foreign issuer to avoid the need to reconcile its financial statements to U.S. GAAP if the financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

- (a) If a foreign issuer's home country financial statements are prepared using a version of IFRS other than the version issued by the IASB, can the company satisfy Rule 701 by providing a reconciliation to IFRS as issued by the IASB?

SEC Response: No. However, the audit report need not be based on IFRS as issued by the IASB, so long as the financial statements are.

- (b) Can a foreign issuer reconcile its financial statements to U.S. GAAP only on an annual basis, and provide reconciled annual financial statements together with its most recent unreconciled interim financial statements?

Suggested Answer: Yes. Annual reconciliation is all that is required of foreign issuers that are registered under the Exchange Act, and unregistered issuers should not have a more onerous burden, particularly with respect to information provided to employees.

SEC Response: This is an area where the Rule is silent, so the Staff may have authority to provide interpretive relief. The Staff wants to give this more consideration.

Form 8-K

15. **Termination of Officer.** Item 5.02(b) of Form 8-K requires disclosure if one of the specified principal officers or a named executive officer “retires, resigns, or is terminated from that position.” Is a Form 8-K required when one of such officers is moved to a different executive officer position?

Suggested Answer: Disclosure is not required for an executive officer’s change of title unless he or she is moving into or out of one of the specified “principal officer” positions or is being demoted to a non-executive officer position. So, for example, no Form 8-K is required when a Senior Vice President is promoted to Executive Vice President, but a filing would be required if the Chief Financial Officer was transferred to a non-CFO Executive Vice President position.

SEC Response: The Staff agreed with the Suggested Answer.

16. **Director Resignation.** Item 502(b) of Form 8-K states that a reporting obligation is triggered when a director provides notice of a decision to resign, retire or refuse to stand for re-election. Q&A 117.01 of the Staff’s Guidance clarified that a report is triggered “regardless of whether the resignation, retirement or refusal to stand for re-election is conditional or subject to acceptance.” A company’s corporate governance policies require a director to offer to resign upon any material change in their position, including their resignation or retirement from their primary employment, so that the company’s board can consider whether the director’s continued service on the board is appropriate under the circumstances. Is a Form 8-K required to be filed when a director offers to resign under such a policy, even if such offer is not accepted by the board and the director thus continues to serve on the board?

Suggested Answer: A Form 8-K is not required in these circumstances. An offer to resign should not be treated the same as a notice of resignation, at least when the offer is not accepted and the director continues to serve.

SEC Response: The Staff disagrees. An 8-K is required in this situation. An offer to resign is the same as a notice of resignation. There would need to be a second 8-K filed to report the board’s response to the offer if the response cannot be reported in the 8-K reporting the offer to resign. This is an area where shareholders would likely want to know that the resignation policy was triggered and what the board’s response was.

Follow-up Question: What 8-K reporting is required where a company requires each director to sign a conditional resignation at the time of election, to be effective upon both (i) failure to be reelected by a majority vote and (ii) the board’s acceptance of the conditional resignation?

SEC Response: The company can explain in a single 8-K, or in its proxy statement, that all directors have signed such a resignation. In this case, there would be no need to file a separate 8-K to report a director’s failure to get a majority vote. But

there would be a requirement to file an 8-K to report whether the board accepted or rejected the conditional resignation.

[Update: The Staff position reflected in these responses has been modified. See Division of Corporation Finance Compliance and Disclosure Interpretations, Form 8-K, Question 117.15 (June 26, 2008).]

17. **Disclosure of Option Grant.** A company has adopted and filed an omnibus equity plan under which the compensation committee has broad discretion to grant stock options, and a variety of other equity awards subject to specific limitations contained in the plan. The compensation committee grants stock options to the named executive officers under the plan. Is Form 8-K disclosure of the grant required? Does it matter whether the company has previously filed a form of grant letter for this type of award?

Suggested Answer: No 8-K is required, whether or not a form of grant letter for the award has been filed. An instruction to Item 5.02(e) of Form 8-K provides that grants or awards need not be disclosed if they are made under a plan or contract that has previously been disclosed and are “materially consistent” with such plan or contract. Any grant made under a plan that is within the discretion permitted under the plan should be treated as “materially consistent” with the plan.

SEC Response: Under old FAQs, the need to file a Form 8-K for an equity grant depended on whether there was a previously-filed form of grant agreement. This is no longer part of the current Staff interpretations. Compliance and Disclosure Interpretations 117.09 – 117.11 deal with a cash plan, but should be used as an analogy with respect to an equity plan.

18. **Appointment of Principal Officer.** Item 5.02(c) of Form 8-K provides that when certain officers are appointed, the company must file an 8-K that, among other things, contains a description of “any material plan, contract, or arrangement” covering the officer that is entered into or materially amended in connection with his appointment, and “any grant or award” to such person in connection with such event. Does this Item require disclosure of even a non-material, routine equity grant made to an individual at the time of his appointment to a “principal officer” position?

SEC Response: Yes.

Section 16

19. **Performance Vesting Based on Total Shareholder Return.** A company granted stock options that will vest only upon achievement of a specified level of total shareholder return (TSR). TSR is measured by reference to both the increase in market price of the company stock and the amount of dividends paid during the period. Is an option that vests based on TSR a derivative security that must be reported at grant or an instrument that is not a derivative security and thus must be reported at vesting?

SEC Response: Under *Certilman*, if vesting is based on anything other than market price, the option is not a derivative security. But the real question is what role

dividends play in the TSR of a particular company. If the company pays no dividends or the dividends are de minimis, the option would be a derivative security. However, if dividends are a real factor, an option that vests on TSR would generally not be a derivative security. What's not clear is where you draw the line.

20. **Reporting Forfeiture of RSUs.** An executive chose to report a grant of RSUs payable in stock on Table I of Form 4 (rather than reporting it as a derivative security on Table II). The RSUs are subsequently forfeited. If they had been reported on Table II, the forfeiture would not need to be reported if the executive received no value from the forfeiture. Is the forfeiture required to be reported because the RSUs were reported on Table I?

Suggested Answer: The forfeiture is not required to be reported. Choosing to report the RSU grant on Table I does not change its nature as a derivative security.

SEC Response. The Staff agrees with the suggested answer. The rules regarding reporting of the forfeiture are the same regardless of whether the RSU grant was reported in Table I or II.

Sections 12(g) Exemptions for Compensatory Options

21. **Rule 12h-1(f) Exemption for Non-reporting Companies.** Prior to the adoption of new Rule 12h-1(f), a non-reporting company failed to file a Form 10 to register its compensatory stock options under Section 12(g) of the Exchange Act within 120 days after a fiscal year end when the company had 500 or more holders of compensatory options and total assets in excess of \$10 million. The company has less than 500 holders of any class of stock. If, following the effective date of Rule 12h-1(f), the company meets all of the requirements set forth therein, can it rely on the new exemption from registration under Section 12(g) going forward?

Suggested Answer: Yes, if all of the conditions of Rule 12h-1(f) are currently met. However, the company will still have potential issues regarding past violations of Section 12(g), which are not retroactively cured by the subsequent availability of the exemption.

SEC Response: The exemption is self-executing and looks at whether the company meets the conditions for the exemption today. Failure to register previously does not affect the availability of the exemption going forward. Availability of the exemption going forward does not cure any prior violations.

22. **Companies with Exchange Act-Registered Stock Options.** Prior to the adoption of new Rules 12h-1(f) and 12h-1(g), a private company crossed the Section 12(g) thresholds with respect to its compensatory options at a fiscal year end (the "FYE"), filed a timely Form 10 with respect to such options and registered them under Section 12. The issuer has less than 500 holders of any class of stock, but it has more than \$10 million in total assets. If the issuer would have met the conditions of the Rule 12h-1(f) private company exemption at FYE had it then been available, is there any way for the issuer simply to deregister the options and return to being a private company? We note that under Rule

12g-4, deregistration is normally not available unless the number of holders of the class goes below 300.

Suggested Answer: It doesn't make sense to put the issuer in this "Catch 22" situation. If the issuer had failed to register the options in the first place, it would be permitted to remain a private company. But this issuer "did the right thing" and registered its options. It should not be penalized for having done that. The SEC staff should interpret the rules to permit deregistration of compensatory options by a reporting company in this position if it would have met the conditions of Rule 12h-1(f) at FYE (had it been available) and continues to meet the conditions of Rule 12h-1(f) other than the fact that it is a reporting company.

SEC Response: A company in this situation would need to submit a letter to the Staff seeking relief, and the Staff would consider the particular circumstances. The Staff granted such relief to ViewSonic Corporation in March 2008.

23. **Compensatory Options that Don't Meet the Rule 12h-1(g) Exemption.** Prior to the adoption of new Rule 12h-1(g), the technical requirement for reporting companies to register compensatory options under Section 12 was honored in the breach. Companies simply did not register such options (assuming that they had registered the underlying class of stock under Section 12) and the SEC did not object. However, now that this technical violation has been pointed out by the SEC in the proposing and adopting releases, reporting companies must review their compensatory options carefully to see if they meet the conditions of Rule 12h-1(g). Assume that, upon performing such review, the issuer determines that it does not meet all of the conditions of the new exemption. This could be due to the fact that the issuer has a transferable stock option program where optionees are permitted to sell their options to participating institutions (such as is the case with Google), which institutions are clearly not Rule 701 qualified option recipients. What is the proper course of action for such companies?

Discussion: The new exemption contained in Rule 12h-1(g) expressly states that, if the exemption ceases to be available, the issuer "must file a registration statement to register the class of stock options *or a class of security* under Section 12 of the Act within 60 calendar days."

- (a) If we ignore the italicized words, it would seem that such an issuer would have had 60 days following the effectiveness of the exemption to file a Form 8-A for the options. The rule was effective upon publication of the adopting release in the Federal Register on December 7, 2007, and 60 days thereafter would have been February 5, 2008. In fact, Google did file a Form 8-A to register its options under Section 12 on February 5, 2008.
- (b) But what is the meaning of the italicized phrase "or a class of security"? Does it mean that, since the issuer already has a class of securities registered under Section 12 (namely the underlying common stock), it does not need to register the options even though it does not meet the conditions of the exemption? Surely this

cannot have been the intent, as this interpretation would obliterate the other conditions of the exemptive rule.

Suggested Answer:

- (a) The interpretation in (a) above is correct.
- (b) The identified phrase “or a class of security” is intended to address a situation where the issuer has been a reporting company by virtue of Section 15(d) (but does not have a class of securities registered under Section 12) and meets all of the conditions of Rule 12h-1(g), but then ceases to be required to file periodic reports under Section 15(d). Such an issuer can then choose to:
 - (1) comply with Rule 12h-1(f), as it is now no longer a reporting company, or
 - (2) get back into compliance with Rule 12h-1(g) by registering “a class of security” (other than the options) under Section 12, or
 - (3) cease relying on any exemption for the compensatory options and register them under Section 12.

SEC Response: If the options don’t meet all the requirements of the exemption (such as where the options are transferable to persons other than permitted holders as described in the exemption), the exemption is not available and the options must be registered. However, if the issuer fails to satisfy the requirements of the exemption because its Exchange Act reporting obligations arose under Section 15(d) and those obligations have been suspended, the exemption will be available if the issuer registers a class of securities under Section 12 of the Exchange Act.

Rule 144

24. **Treatment of Pledged Shares.** Interpretation 209.01 of the Staff’s Guidance on Rule 144 deals with an affiliate’s pledge of unrestricted stock to a non-affiliate pledgee. We understand that the recent amendments to Rule 144 have not changed the Staff’s previous position (as set forth in Interpretation 209.01) that a new holding period for the pledgee is not triggered where the stock is acquired upon the affiliate-pledgor’s default solely by operation of the pledge agreement. However, the revised aggregation provision of Rule 144(e) that now applies to an affiliate-pledgor for up to six months after the date of default (in the case of a reporting company; one year in the case of a non-reporting company) indirectly may have affected this interpretive position to the extent that it has been read by practitioners to suggest that once the non-affiliate pledgee is free to re-sell without restriction under Rule 144(k) (now Rule 144(b)), the affiliate-pledgor also could sell securities of the same class under the Rule without the need to aggregate the pledgee’s sales (even though the pledgor still would be subject to all other conditions of Rule 144 applicable to affiliate sales, including the volume limitations set forth in Rule 144(e)).

Please clarify how amended Rule 144 would apply, under the fact pattern outlined in Interpretation 209.01, to each of the affiliate pledgor and non-affiliate pledgee in a situation where the pledgee is able to sell the unrestricted securities received upon default under Rule 144(b), assuming the six-month (or one year) post-default period had not yet expired. Does the answer change depending on whether the issuer of the securities is a reporting vs. a non-reporting company?

Suggested Answer: The pledgor would be required to aggregate the pledgee's sales only during the shorter of (i) six months after the default or (ii) completion of a one-year combined holding period. This treatment would apply regardless of whether the issuer of the pledged securities is reporting or non-reporting.

SEC Response: See response to Question 25.

25. **Treatment of Gifted Shares.** Assume the same basic fact pattern as presented in Interpretation 209.01, but substitute an affiliate gift of unrestricted securities to a non-affiliate donee. These are the basic facts outlined in Interpretation 225.02 of the Staff's Guidance on Rule 144, and we have assumed that the Staff would continue to take the position expressed there that the gift of unrestricted securities is not a "sale" triggering a new holding period. Please explain how amended Rule 144 would apply here to each of the affiliate donor and non-affiliate donee in situations where the non-affiliate donee is free to re-sell under Rule 144(b) but the six-month (or one-year) post-gift period for donor affiliate aggregation had not yet run. Would this answer be affected by the reporting status of the issuer?

Suggested Answer: The donor would be required to aggregate with the donee only during the shorter of (i) six months after the date of the gift or (ii) completion of a combined holding period of one year. This treatment would apply for both reporting and non-reporting issues.

SEC Response: The Staff confirmed the views stated in prior no-action letters that the act of a pledge or a gift does not start a new holding period. The aggregation issue is more difficult. The goal is to provide for consistent treatment under the prior and current Rule 144. The Staff asked for the basis of the position stated in the Question that the pledgor or donor does not have to aggregate his sales with those of the pledgee or donee if the pledgee or donee can freely resell the shares. An ABA representative stated that this is a position that had previously been taken by the Staff under old Rule 144(k), but that a footnote in the Release adopting the amendments to Rule 144 raised a question as to whether this interpretation continued to apply under the amended Rule 144. The Staff will give further consideration to this issue. The amendment was not intended to put pledgors and donors in a worse position than under the old rules.

26. **Presumptive Underwriter Doctrine.** Please confirm that the elimination of the presumptive underwriter doctrine under amended Rule 145 now extends to Section 3(a)(10)-exempt transactions.

SEC Response: Confirmed, provided the company is not a shell company. The presumptive underwriter doctrine applies if you're dealing with a shell company.

27. **Removal of Legends.** Does the Staff have any view with respect to the removal of legends in the case of a non-affiliate's sale of restricted securities of a reporting company under Rule 144 after the six-month holding period has run, but before expiration of the remaining six-month period during which the current informational requirements of Rule 144(c) continue to apply? If so, please elaborate.

Suggested Answer: Footnote 65 to the Adopting Release means what it says -- the Staff would not object to the removal of restrictive legends from shares held by non-affiliates after ALL applicable conditions in Rule 144 are satisfied. Rule 144(c) is one of those conditions.

SEC Response: The footnote speaks for itself, and the Staff won't express a view beyond what the footnote says. Removal of legends is a state law issue and thus outside the Staff's normal purview. However, the Staff agreed with the suggested answer.