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# SEC Proposes Changes to Rule 701 and Form S-8

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On November 24, 2020, the U.S. Securities and Exchange Commission (SEC) proposed changes to Rule 701 and Form S-8 under the Securities Act of 1933. While most of the initial attention has focused on the revisions that would allow equity compensation to be granted to "gig economy" workers, certain other revisions are broader in scope and apply to all private and public companies relying on Rule 701 or Form S-8 to grant equity compensation to service providers.

## What are Rule 701 and Form S-8?

For a company to issue securities in the US, it must comply with complex securities registration requirements or have an exemption available. Rule 701 under the Securities Act provides the most-often used exemption to permit private companies to offer securities (such as stock options and restricted stock units) to service providers (e.g., employees, consultants and directors). For public companies, the SEC provides a simplified form of registration statement (Form S-8) covering compensatory equity awards.

## How has the SEC proposed to modernize Rule 701 and Form S-8 generally?

The SEC has proposed amendments to Rule 701 and Form S-8 addressing concerns raised by companies and practitioners for many years, including:

- **Allowing entity eligibility** – For Rule 701 and Form S-8, the proposed rule would extend consultant and advisor eligibility to entities meeting specified criteria, including the entity's ownership interests being held by no more than 25 natural persons, at least 50% of whom perform services for the company issuing the securities. This change would enable advisors and consultants to avail themselves of the benefits of providing services through an entity while still being eligible to receive an equity award.
- **Permitting former employee eligibility** – For Rule 701 and Form S-8, the proposed rule would expand eligibility to former employees, enabling companies to issue awards following resignation, retirement or other termination as compensation for services rendered during a performance period that ended within 12 months preceding the termination. This change would permit granting stock-based compensation with respect to past services in connection with a post-termination separation or settlement agreement as well as potentially permitting repricing of equity awards held by former employees.
- **Providing relief for awards held by former employees in an acquisition** – For Rule 701 and Form S-8, the proposed rule would expand eligibility to former employees of an acquired entity with respect to awards issued in substitution or exchange for awards granted by the acquired entity prior to the acquisition. This change would permit, for example, the assumption of options and other awards without regard to whether the award holder remains in service post-closing, avoiding the need to "cash-out" such former service providers in a transaction where consideration is all stock.
- **Relaxing additional disclosure delivery requirements under Rule 701** – The proposed rule would relax additional disclosure requirements under Rule 701, specifically requiring disclosure only with respect to sales after the $10 million threshold is exceeded and not on a look-back basis to other sales during the 12-month period in which the threshold was exceeded.
- **Simplifying content and reducing frequency of Rule 701 disclosure** – The proposed rule would reduce the frequency of the required financial disclosure under Rule 701 from quarterly to semiannually and, notably, generally permit issuers to provide an independent third-party valuation report prepared under Section 409A of the Internal Revenue Code in lieu of financial statements. These changes would reduce the burden of generating frequent financial statements and permit an alternative that is more often readily available to companies, providing greater flexibility and potentially reducing expenses.

- **Relaxing deadline for Rule 701 disclosure for new hires** – The proposed rule would revise the timeframe during which disclosures must be provided to new hires under Rule 701 in the context of granting them restricted stock units and other awards that do not involve a further decision to exercise or convert. For newly hired service providers, the proposed rule would allow the required disclosures to be provided within 14 days after the individual commences service with the company (rather than before the award is granted, as in the current rule). The proposed rules would continue to require companies to deliver such disclosures a reasonable time prior to the grant of restricted stock units and similar awards granted outside the new hire context. As to new hires, this change would permit grants of restricted stock units and similar awards to new hires as of their start date without requiring that confidential information be provided to the individual while only a prospective employee. This change does not apply to options or other awards where a subsequent investment decision is required. For such options and other awards, Rule 701 will continue to require disclosure to be delivered a reasonable period of time before the date of exercise or conversion.
- **Clarifying the use of a single Form S-8 for multiple incentive plans** – The proposed rule would clarify the ability to add multiple plans to, and allocate shares among multiple incentive plans on, a single Form S-8 and permit the addition of shares by an automatically effective post-effective amendment. This change would provide greater certainty, simplicity and flexibility for companies with multiple plans.
- **Raising the ceiling for Rule 701 transactions** – Currently, issuances made in reliance on Rule 701 during a 12-month period are capped at the greatest of (1) $1 million, (2) 15% of the issuer's total assets and (3) 15% of the outstanding class of securities offered. The proposed changes would raise this ceiling and increase the dollar limit and percent of the issuer's total assets caps to $2 million and 25% of the issuer's total assets, respectively. The 15% of the outstanding class of securities cap would, however, remain the same.
- **Announcing consideration of further improvements for employee stock purchase plans** – For Form S-8, the SEC is soliciting comments as to potential improvements in the securities registration aspects of the implementation of an employee stock purchase plan in connection with an initial public offering (IPO). Currently, companies seeking to start an offering period immediately at IPO generally enroll all employees as of the IPO and then provide for an opt-out period following the IPO, which can be administratively burdensome. The SEC is inviting comments as to whether providing for a pre-IPO exemption for enrollment under 701, permitting additional pre-IPO communications with potential participants or some other strategy would be useful. Depending on how any ultimate amendment is structured, this change could permit companies to enroll employees prior to the IPO in an ESPP offering period that commences upon the IPO.

# What are the proposed revisions to Rule 701 and Form S-8 affecting "gig economy" workers?

**Overview** – The proposed amendments would expand the coverage of Rule 701 and Form S-8 on a temporary, trial basis to include workers (platform workers) who provide services pursuant to a written compensatory agreement, which services are available through an internet-based platform or through another widespread, technology-based marketplace platform or system. The proposed amendments would expire, absent further action by the SEC, five years from the date of their effectiveness.

**Eligible issuers** – The five-year pilot program applies to companies that operate and control an internet-based platform or other widespread, technology-based marketplace platform or system, as demonstrated by the company's ability to:

- provide access to the platform;
- establish the principal terms of service for using the platform and terms and conditions by which the platform worker receives payment for the services provided through the platform; and
- accept and remove platform workers participating in the platform.

**Requirements to grant awards to platform workers** – The proposed amendments allow these companies to issue equity compensation to platform workers, subject to the following conditions:

- the equity compensation must be granted pursuant to a written compensatory arrangement;
- the equity compensation may not be granted for services that are in connection with the offer or sale of securities in a capital-raising transaction or for services that directly or indirectly promote or maintain a market for the company's securities;

- the value of the equity compensation at the time of issuance may not exceed 15% of the platform worker's compensation from the issuer for services provided by means of the platform over a 12-month period;
- the value of the equity compensation at the time of issuance with respect to any platform worker may not exceed $75,000 over a 36-month period;
- the amount and terms of the equity compensation may not be subject to individual bargaining or the platform worker's ability to elect between payment in securities or cash; and

- if relying on Rule 701, the company must take reasonable steps to prohibit the transfer of the securities issued pursuant to the proposed amendment, other than a transfer to the company or by operation of law.

**Requirements to furnish certain information to the SEC** – Under the proposed amendments, private and public companies that choose to grant equity compensation to platform workers in reliance on this pilot program would also be required to furnish the following information to the SEC at six-month intervals:

- the criteria used to determine eligibility for awards, whether those criteria are the same as for other compensatory transactions, and whether those criteria, including any revisions to the criteria, are communicated to platform workers in advance as an incentive;
- the type and terms of securities issued, and whether the same securities are issued for other compensatory transactions during that interval;
- if pursuant to Rule 701, the reasonable steps taken to prohibit the transfer of the securities sold pursuant to the new rule;
- the percentage of overall outstanding securities that the amount issued to platform workers cumulatively represents;
- during the interval, the number of platform workers, the number of non-platform workers, the number of platform workers who received securities pursuant to the new rule, and the number of non-platform workers who received securities pursuant the company's Rule 701 or Form S-8 issuances; and
- both in absolute amounts and as a percentage of the company's total Rule 701 or Form S-8 issuances during the interval: the aggregate number of securities issued to platform workers, and the aggregate dollar amount of securities issued to platform workers.

# What is the process for public comment and eventual effectiveness of the proposed amendments to Rule 701 and Form S-8?

The public comment period for each of the proposed amendments will be open for 60 days following publication in the Federal Register. The SEC will consider the public's input on the proposed amendments as it drafts final rules. If the SEC adopts final rules, they will establish the effective date of any changes and become part of the official rules that govern the securities industry.

It should be noted that SEC Chairman Jay Clayton will depart prior to the end of the 60-day comment period, and his successor will be appointed by the administration of President-Elect Joe Biden, potentially raising additional uncertainty as to whether these rules will be adopted in their current form, particularly with respect to the proposed amendments relating to platform workers.

# Key Contacts

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