



Securities Law Institute

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On May 23, 2007, the Commission voted to propose a series of six measures to modernize and improve its capital raising and reporting requirements, with an emphasis on smaller companies. Today, the Division of Corporation Finance recommended that the Commission adopt three of the six measures that it proposed in May. The smaller reporting company regulatory simplification and Section 12(g) measures recommended by the Division today address key recommendations made by the SEC's Advisory Committee on Smaller Public Companies in its final report of April 23, 2006.

The first release contains amendments to disclosure requirements under the Securities Act and the Exchange Act to increase the number of companies eligible for the Commission's scaled disclosure and reporting requirements for smaller reporting companies. The Commission's current regulatory scheme for small businesses, adopted in 1992, provided small business issuers with modified disclosure requirements and separate forms for their use. The rule amendments approved by the Commission streamline and simplify regulation by moving the Commission's scaled disclosure requirements into one location, Regulation S-K. The new requirements available to smaller reporting companies are scaled to meet the characteristics of smaller companies, to assure that the burdens of regulation are commensurate with the benefits, and not lower standards.

The amendments expand the number of companies that qualify for the scaled disclosure requirements available to smaller reporting companies. Companies that have less than \$75 million in public equity float will qualify for the scaled disclosure requirements under the amendments. Companies without a calculable public equity float will qualify if their revenues were below \$50 million in the previous year. The rule amendments also combine for most purposes the "small business issuer" and "non-accelerated filer" categories of smaller companies in the Commission's current rules into a new category of "smaller reporting companies." In addition, the proposals simplify the regulations by moving the non-financial disclosure requirements for smaller reporting companies, which currently are contained in Regulation S-B, into Regulation S-K and the financial statement requirements into Regulation S-X. The five specific "SB" forms would be rescinded. Smaller reporting companies, which would file registration statements and Exchange Act reports on the Commission's regular forms, would be able to choose on an item-by-item basis whether to take advantage of the scaled financial and non-financial disclosure requirements or provide the same disclosure as larger companies. These companies would be able to begin using the new rules immediately after the effective date, which would be 30 days after publication in the Federal Register. The current "SB" filers would have the option to continue using the "SB" forms for periodic reports until they file their next annual report on Form 10-KSB or Form 10-K.



Securities Law Institute

The next release that was presented contains amendments to Securities Act Rules 144 and 145. Among other things, the revisions will shorten the Rule 144(d) holding period applicable to restricted securities from one year to **six** months, where the issuer of the securities has been subject to Exchange Act reporting obligations for at least 90 days before the sale of the securities. The current one-year holding period for restricted securities of non-reporting companies will remain in place.

Although the Commission proposed to reintroduce a tolling provision that would suspend the Rule 144 holding period for the length of time that a security holder owning restricted securities of a reporting company engages in hedging activities, staff did not recommend the adoption. The Commission Staff was persuaded by the public commenters that a reintroduction of the tolling provision would unduly complicate Rule 144 and require security holders and intermediaries to incur significant costs to monitoring hedging activities to comply with the provision in the absence of strong evidence that hedging activity has resulted in abuses in the context of Rule 144.

The Commission also adopted amendments to substantially simplify Rule 144 compliance for a shareholder who is not an affiliate of the issuer and has not been an affiliate for at least three months before the sale of the securities. Specifically, the amendment permits a non-affiliate of a reporting company to freely resell his or her securities after holding them for six months, subject only to the Rule 144(c) public information requirement. Also approved was the ability of non-affiliates of both reporting and non-reporting companies to freely resell their restricted securities without having to comply with any other Rule 144 condition after satisfying a one-year holding period.

In addition, the Commission eliminated the manner of sale requirements with respect to debt securities. Although not proposed, at the suggestion of commenters, staff recommended that the Commission relax the current Rule 144(e) volume limitations for debt securities by adding a new alternative test that will permit the resale of up to 10% of a tranche in any three-month period. In response to comments, the Commission also raised the Form 144 filing thresholds to trigger a filing requirement only when the Rule 144 sale exceeds 5,000 shares or \$50,000. The Commission proposed increasing the filing thresholds to 1,000 shares or \$50,000 from the existing 500 shares or \$10,000 thresholds. The combined effect of eliminating the Form 144 notice requirement for non-affiliates and raising the Form 144 filing thresholds will significantly decrease the number of Form 144 filings that are required to be filed annually with the Commission.

The adopting release also codifies several interpretive positions relating to Rule 144.

Additionally, the Commission also approved the elimination of the presumptive underwriter provision in Rule 145, except with regard to transactions involving shell companies. Under the amendments, only a party to a Rule 145(a) transaction involving shell companies, other than business combination related shell companies, or an affiliate of the party, will be deemed a presumed underwriter of the transaction. Those deemed underwriters will be permitted to resell their securities under revised provisions in Rule 145(d).



Securities Law Institute

The Commission also approved two new exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options.

Compensatory employee stock options provide a method to use non-cash compensation to attract, retain, and motivate company employees, directors, and consultants. Under Section 12(g) of the Exchange Act, an issuer with 500 holders of record of a class of equity security and assets in excess of \$10 million at the end of its most recently ended fiscal year must register that class of equity security, unless there is an available exemption from registration. Stock options, including stock options issued to employees under stock option plans, are a separate class of equity security under the Exchange Act. Thus, an issuer with 500 or more optionholders and more than \$10 million in assets is required to register that class of options under the Exchange Act because currently there is no exemption for compensatory employee stock options.

The Commission adopted two new exemptions from the registration provisions of Exchange Act Section 12(g) for compensatory employee stock options. Given the differences with regard to, among other things, the nature of the trading markets and the amount of publicly available information between issuers that are required to file reports under the Exchange Act and those issuers that do not have such an obligation, the Commission adopted separate exemptions for these different types of issuers. The exemptions apply only to an issuer's compensatory employee stock options and would not extend to the class of securities underlying those options.

The Commission adopted an exemption from Exchange Act Section 12(g) registration for compensatory employee stock options issued under written compensatory stock option plans of a private, non-reporting issuer if:

- Eligible optionholders are limited to employees, directors, consultants, and advisors (to the extent permitted under Rule 701) of an issuer, its parents, and majority-owned subsidiaries of the issuer or its parents and certain transferees;
- Transferability by optionholders of compensatory employee stock options, and prior to exercise, shares to be received on exercise of those options is restricted; and
- Risk and financial information is provided to optionholders that is of the type that would be required under Rule 701 if securities sold in reliance on Rule 701 exceeded \$5 million in a 12-month period.

Second, the Commission adopted an exemption for compensatory employee stock options of issuers that are required to file reports under the Exchange Act pursuant to Exchange Act Section 13 or Section 15(d). Optionholders of these issuers would have access to the issuer's publicly filed Exchange Act reports.



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