AMERICAN BAR ASSOCIATION
Business Law Section

ABA BUSINESS LAW SECTION

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Via Electronic Submission

April 10, 2015

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Brent J. Fields, Secretary

Re: Request for Public Comment
Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act
Securities and Exchange Commission Release Nos. 33-9693; 34-73876; File No. S7-12-14

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") with respect to proposed amendments to rules promulgated by the Commission under Section 12(g) and 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended by Titles V and VI of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), as set forth in the above release (the "Release").[1]

The comments set forth in this letter represent the views of the Committee. These comments have not been approved by the ABA's House of Delegates or Board of Governors, and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the Section.

<u>Summary of Our Comments</u>

Set forth below is a summary of the comments discussed in greater detail under "Discussion" below.

[1] The Committee previously submitted comments on implementation of the JOBS Act amendments effected by Titles V and VI of the JOBS Act (as well as certain other provisions) pursuant to the Commission's invitation of pre-rule making comments on the JOBS Act. *See* Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, ABA Business Law Section, dated June 26, 2013, available at http://www.sec.gov/comments/jobs-title-iii/jobstitleiii-243.pdf.

A. Proposed Amendments relating to Exchange Act Reporting Thresholds

1. We support the Commission's determination not to propose additional relaxations of the registration and termination provisions beyond those mandated by the statute.

2. We support the Commission's determination to incorporate the definition of "accredited investor" as codified in Rule 501(a) of Regulation D under the Securities Act of 1933, as amended (the "Securities Act") into the amendments.

3. We agree that the Commission should not require issuers, as a condition to concluding that a shareholder is (or is not) an "accredited investor," to take reasonable steps to verify such status.

4. We support the Commission's proposed facts-and-circumstances approach to determination of accredited investor status, and recommend that this be underscored in the rule or adopting release. Although we do not believe that a safe harbor is necessary, we recommend that the Commission provide additional guidance on a non-exclusive basis regarding the type of information upon which issuers may rely in forming a "reasonable belief" with respect to a record holder's "accredited investor" status. Specifically, we recommend that:

    a) Although issuers should be permitted to rely, without independent investigation, on an annual affirmation from investors that their information or status as accredited investors has not changed from prior years, issuers should not be required to seek such a confirmation of continued accredited investor status so long as the issuer has a reasonable basis to believe the investor's status has not changed. The absence of a response to any such request by an issuer should not be deemed to constitute a basis for concluding that a former accredited investor does not continue to be an accredited investor.

    b) If the Commission permits registrants to determine the accredited investor status of existing shareholders by relying on previously provided information, in our view the existing fiscal year provisions for making Exchange Act registration determinations would continue to be workable.

B. Proposed Amendments relating to Employee Compensation Plan Securities Carve-Out

1. We do not believe that the Commission should create a new – and potentially different – definition of the term "employee compensation plan" for purposes of implementing the requirements of Section 502 of the JOBS Act. Instead, we believe that the Commission's proposal to refrain from defining the term "employee compensation plan" at this time and to apply Securities Act Rule 701 concepts as part of the non-exclusive safe harbor that is being established, will provide sufficient flexibility for issuers to make the necessary determinations under Exchange Act Section 12(g)(5).

2. We support the Commission’s proposal to exclude from the definition of securities “held of record” for purposes of determining an issuer’s Exchange Act Section 12(g) registration obligations, securities held by persons who received the securities pursuant to an award to employees that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act.

3. We do not believe that the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should require the issuer to prove that the equity securities were received pursuant a Securities Act exemption. The non-exclusive safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should simply require an issuer to demonstrate compliance with the conditions of Securities Act Rule 701(c).

4. We believe that the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should encompass the full range of compensatory arrangements and security holders described in Securities Act Rule 701(c). Accordingly, we encourage the Commission to retain the category of consultants, advisors and permitted transferees as persons who may receive equity securities pursuant to an employee compensation plan proposal under the safe harbor, assuming that the conditions of Securities Act Rule 701(c) have been met.

5. We believe that, given the scope of the safe harbor in proposed Exchange Act Rule 12g5-1(a)(7)(ii), the exemption for non-reporting issuers contained in Exchange Act Rule 12h-1(f) will no longer be necessary. We believe that the exemption contained in Exchange Act Rule 12h-1(g) for reporting issuers, however, may have continuing application.

6. While we support the Commission’s proposal to extend the statutory carve-out to securities issued in certain business combinations and similar transactions that replace securities previously issued pursuant to an employee compensation plan, we recommend certain revisions to proposed Exchange Act Rule 12g5-1(a)(7)(i)(B) that we believe will help to clarify the application of this carve-out; we also recommend expanding the scope of the proposed rule in certain respects.

7. We agree with the Commission’s proposal to permit foreign private issuers to exclude securities received pursuant to an employee compensation plan in transactions exempt from, or not subject to, the registration requirements of the Securities Act from being considered in connection with the “300 holders resident in the United States” threshold specified in Exchange Act Rule 12g3-2(a). We do not believe that such an exclusion is necessary, however, for purposes of determining foreign private issuer status.

8. We urge the Commission to clarify that the requirement for a written compensatory benefit plan will be satisfied by resolutions adopted by the issuer’s board of directors or other granting authority (for example, board committee or designated executive), as well as by less formal writings, such as memoranda or emails.

C. Need for Additional Rulemaking Beyond That Required by JOBS Act.

1. We encourage the Commission to explore the feasibility of additional regulatory reforms to ensure that investors have access to public availability of reasonably current information regarding securities of companies that are exempt from reporting under the Exchange Act and that trade in active over-the-counter and broker-dealer sponsored trading markets. Those reforms should not, however, undermine the goal of the JOBS Act by imposing undue burdens on non-reporting issuers that are comparable to the burdens imposed on registrants pursuant to Exchange Act registration.

2. We concur with the Commission's determination not to propose changes to thresholds for terminating and suspending Exchange Act reporting obligations beyond those required by the JOBS Act, except in the case of savings and loan holding companies. Specifically, we concur with the Commission's determination not to raise the threshold number of holders of record for terminating or suspending Exchange Act reporting obligations and with its determination not to incorporate the exclusion of accredited investor employee compensation plan securities from the exit threshold calculation.

Discussion

A. Proposed Amendments relating to Exchange Act Reporting Thresholds

Implementation of Title V (Request for Comment 1). We support, in general, the Commission's proposed rule amendments relating to the thresholds for registration under Exchange Act Section 12(g) and the termination of registration and suspension of reporting obligations under Exchange Act Sections 12(g) and 15(d). In particular, we support the proposed amendments to Rules 12g-4 and 12h-3 under the Exchange Act, which will permit banks, bank holding companies, and savings and loan holding companies to immediately suspend reporting under Section 13(a) of the Exchange Act rather than requiring them to wait 90 days after filing to suspend their reporting obligations or to delay suspension until the beginning of their next fiscal year. The amendments to Rules 12g-2 and 12g-3 would enable these depositary issuers to avoid incurring a reporting obligation upon delisting or upon an acquisition when they would otherwise be entitled to terminate or suspend their reporting obligations. We agree with the Commission's determination not to propose amendments that extend substantially beyond the changes contemplated by the JOBS Act.

Trading in Unregistered Securities (Request for Comment 2). The Commission requested comment on the very important question of whether

> [t]he higher registration and reporting thresholds could result in issuers having a significant number of shareholders with freely tradable shares who lack current disclosure information about the issuer. How would investors get the information they need in connection with purchases and sales? What investor protection issues are raised when these security holders engage in secondary market transactions and how might they be addressed?

We encourage the Commission to explore these issues through further outreach and through coordination with the Advisory Committee on Small and Emerging Companies, the Investor Advisory Committee, and the Small Business Forum, leading to a concept release prior to proposed rulemaking. Such a release also could draw upon experience gained by the Commission's Division of Corporation Finance in administering the new continuing disclosure requirements for otherwise non-reporting issuers that have engaged in Tier 2 offerings, which were imposed by the Commission pursuant to its recent adoption of JOBS Act-mandated amendments to Regulation A, along with related amendments to Exchange Act Rule 15c2-11.[2] As the Commission is aware, the securities of a large number of companies are currently traded in markets where the only available issuer information is that obtained by registered broker-dealers pursuant to Rule 15c2-11, which does not require that the information be disseminated to the investing public. Such issuers are also subject to civil and criminal liability associated with material misstatements or omissions. It is not clear to us that the current level of information provided to shareholders of many such issuers is inadequate, but we believe that an inquiry into this question is appropriate now that the Commission has recognized the need for some level of ongoing financial and non-financial disclosure by private companies able to raise up to $50 million in capital under amended Regulation A. Moving beyond this tier of disclosure, there is currently a patchwork quilt of disclosure obligations and liabilities that we do not believe is as well harmonized as would be the case in a more efficient capital market. We encourage the Commission to formulate as reasonable and as seamless a disclosure regime as possible, both to assure the protection of investors, but also to avoid the irrational result that the information made available to security holders is based upon a capital-raising mechanism that an issuer may have utilized years earlier.

We also believe that, either as part of the above project or as a separate project, the Commission should review and reconsider its current rules that depend upon the number of "holders of record" of an issuer's securities. As the Commission is aware, concerns have been expressed that the holder of record definition in Rule 12g-5 has essentially rendered continued reporting by non-exchange listed companies (or by companies whose securities trade in markets that do not require reporting) voluntary given the prevalence of street-name ownership. And it has been noted that many companies, with thousands of beneficial holders of securities, have "gone dark" pursuant to the current rule.[3] Addressing such concerns would be consistent with the needs of our capital markets and would help to provide the important investor protections that are being brought into even sharper focus because of the JOBS Act reforms.

We therefore agree with the Commission's determination not to adjust the holder of record exit thresholds under Rule 12g-4 or 12h-3, except in the case of bank and savings and loan holding companies, as well as the determination not to apply the accredited investor and employee benefit plan securities exclusion to those thresholds. Investors that purchase private company securities do not have their expectations disrupted when the issuer is able to maintain

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[2] *See* Amendments to Regulation A, Commission Release No. 33-9741 (March 26, 2015), available at http://www.sec.gov/rules/final/2015/33-9741.pdf.

[3] See, for example, http://www.sec.gov/rules/petitions/petn4-483.htm.

its non-reporting status under the higher registration thresholds established by the JOBS Act. In contrast, investors who purchase the securities of a public company that trades and is priced based on the availability of SEC mandated disclosures are likely to suffer a valuation loss once the issuer "goes dark." Once an issuer has undertaken the cost to implement reporting procedures, maintenance of those procedures does not impose the type of drag on capital formation and job creation that Congress was concerned about with the JOBS Act.

We recognize that requiring issuers that have previously registered a class of equity securities to continue to report under the Exchange Act may give rise to legitimate fairness objections when issuers with similar shareholder bases are not required to register under the new heightened thresholds. However, on balance we believe that the investor protection concerns with reporting issuers going dark normally outweigh such legitimate fairness issues.

One area the Commission could address is the reporting obligations of distressed issuers. Under the current regulatory regime, new issuers generally are able to delay registration, despite a relatively active trading market in their equity securities, until they are prepared to undertake a registrant's significant financial and other disclosure obligations. In contrast, these obligations often become unsustainable for bankrupt registrants and other registrants confronting a serious business crisis. Many registrants facing financial crisis cease making any disclosures to investors, ultimately resulting in deregistration under Section 12(j) of the Exchange Act. We believe the Commission should consider adopting a less onerous reporting burden, perhaps along the lines of the Commission's recently adopted reporting requirements for Tier 2 issuers under Regulation A, that would encourage distressed issuers to continue providing important disclosures to investors.

<u>Savings and Loan Holding Companies</u> (Requests for Comment 3-5). We support the Commission's proposal to extend the relief set forth in Title VI of the JOBS Act, relating to banks and bank holding companies, to savings and loan holding companies.[4] Because savings and loan holding companies engage in similar lines of business to bank holding companies, and are subject to similar regulation, we agree that savings and loan holding companies should be treated in a consistent fashion to bank holding companies for purposes of the Exchange Act registration requirements. While, as discussed below, we do not support raising the exit thresholds under Exchange Act Sections 12(g) and 15(d) for all issuers, we do not see a basis for differentiating exit thresholds for savings and loan holding companies, banks, and bank holding companies.[5]

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[4] As noted in footnote 34 of the Release, savings and loans are already covered by the JOBS Act provisions, inasmuch as "Exchange Act Section 3(a)(6) defines a 'bank' to include Federal savings associations and any other banking institution or savings association, as defined in the Home Owners' Loan Act. We read this definition to include savings and loan associations and other similar entities."

[5] As the Commission notes in footnote 40 of the Release, the Board of Governors of the Federal Reserve System has exempted commercial savings and loan holding companies from the obligation to file the same reports as other banking entities, and that six such exchange-listed entities are obligated to file, and would continue to be obligated to file, Exchange Act reports pursuant to Section 12(b). We concur with the Commission's determination not to

Determination of Accredited Investor Status (Requests for Comment 6-8). We agree with the Commission's determination to apply the definition of accredited investor in Rule 501(a) of Regulation D to the new Section 12(g) registration thresholds.[6] We look forward to the results of the Commission's analysis of whether updating the definition is necessary with respect to natural persons, as contemplated by Section 413(b) of the Dodd Frank Act of 2010. In connection with that effort, we urge the Commission to keep in mind the now dual purpose of the definition and ensure that any new criteria for accredited investor status be manageable in the context of an annual assessment of an issuer's investor base to determine whether the Section 12(g) registration threshold has been crossed.

We agree that "[a]pplying the familiar concepts of the accredited investor definition in Rule 501(a) to the registration threshold in Section 12(g)(1) would facilitate compliance by issuers," and therefore support the Commission's determination not to import the verification requirements of Securities Act Rule 506(c) into the Section 12(g) annual assessment of accredited investor status. In our view, any such verification requirements would impose an unreasonable burden on issuers and undermine the Congressional intent to raise the record holder threshold under the JOBS Act.

The Commission is clearly aware that, although issuers and placement agents will regularly obtain information regarding accredited investor status in connection with Rule 506 offerings, issuers have never before had any reason to inquire as to such status following the completion of the offering. As issuers are aware, shareholders who readily provided information regarding their accredited investor status in order to purchase securities in an offering may be unwilling to provide such information on a going-forward basis.[7] Because of these considerations, we believe that significantly greater latitude should be given to issuers with regard to the means they use to determine annually the number of shareholders of record who are not accredited.

We are therefore encouraged by the Commission's willingness to explore a different approach in the context of an accredited investor determination under Section 12(g). We request that the Commission state explicitly in the final rule or in the adopting release that a registrant may rely on information previously provided by investors as indicative of their current accredited investor status, when there is a reasonable basis for doing so. Although registrants could request an annual confirmation from each previously qualified accredited investor confirming that the

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differentiate between commercial savings and loan holding companies and other savings and loan holding companies for the purposes of the rulemaking.

[6] Although foreign private issuers will benefit from the increase in the registration thresholds under the JOBS Act, application of the Rule 501(a) accredited investor definition may present some difficulties for these issuers, since they do not necessarily screen their investors under those standards when raising capital in their home countries. Nevertheless, since foreign private issuers can claim an exemption from registration under Rules 12g3-2(a) and (b) even if they exceed the Section 12(g) thresholds, we do not believe these concerns justify a different approach.

[7] The reasons for their reluctance may be many, including no perceived benefit from providing the information, and concerns about disclosing what is ordinarily deemed private and confidential information. Shareholders may also decide not to provide such information in order to prevent a registrant from determining that it is permitted to suspend or terminate its Exchange Act reporting obligations, and possibly affecting the liquidity of the its shares.

investor remains an accredited investor, the issuer should not be required to undertake this effort absent information that an investor's accredited investor status may have changed, and the absence of a response should not be deemed to constitute any basis for concluding that a former accredited investor does not continue to be such. Moreover, were the definition of accredited investor to change in the future, we would propose that there be a presumption that a person who previously met the accredited investor definition continues to be an accredited investor, even under the new definition.[8]

We generally support the Commission's flexible facts-and-circumstances approach to the determination of accredited investor status discussed in the Release. We do not believe that it would be desirable for the Commission to adopt a formal safe harbor provision relating to continued accredited investor status. We are concerned that a safe harbor provision could become a *de facto* minimum standard. Instead, we encourage the Commission to make clear in the rule or adopting release that a registrant may rely on any reasonable basis for concluding that a shareholder is an accredited investor – including certifications from broker-dealers, lawyers and accountants – and that the issuer will not be subject to enforcement action if such basis was reasonable at the time the conclusion was reached, even if it were later determined that the investor was not in fact an accredited investor.[9]

Lastly, we do not believe that there should be any bright-line test of "staleness" regarding a shareholder's accredited investor information. Information once provided should be entitled to be relied upon regardless of age, in the absence of direct information indicating that a person is no longer an accredited investor.

If reliance on previously provided investor certifications and information is accepted as a reasonable basis for an issuer's belief that the investor is accredited, we no longer believe, as suggested in the Committee's prior comment letter, that flexibility as to the date for the determination is necessary. In our view, existing fiscal year provisions for making registration determinations would continue to be workable.

B. Proposed Amendments relating to Employee Compensation Plan Securities Carve-Out

Section 502 of the JOBS Act amended Section 12(g)(5) of the Exchange Act to provide that, for purposes of determining whether an issuer is required to register a class of equity securities

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[8] Because the definition of "accredited investor" currently contains a reasonable belief standard, we believe our suggestion is consistent with the definition. We also note that the presumptions of continued accredited investor status should apply to corporations and other entities as well as to natural persons.

[9] Although the Commission has stated that "check the box" self-certifications without additional information is inadequate to enable an issuer to form a reasonable belief that an investor is accredited for purposes of Regulation D under the Securities Act, we believe that different standards should apply in the context of an annual determination under Exchange Act Section 12(g). We believe that it should be reasonable for an issuer to rely upon investor self-certifications in the latter circumstances. Also, if an issuer seeks updated certifications and some investors do not reply, the issuer should be able to rely on past certifications and any other information provided by, or available about, the investor.

under Section 12(g), the definition of the term "held of record" is not to include "securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of section 5 of the Securities Act of 1933." Further, Section 503 of the JOBS Act directs the Commission both to:

- revise the definition of the term "held of record" to implement the amendment made by Section 502; and

- "adopt safe harbor provisions that issuers can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of section 5 of the Securities Act of 1933."

At the outset, we wish to go on record as strongly supporting the Commission's implementation of Sections 502 and 503 of the JOBS Act. We believe that the policy objectives underlying the statutory carve-out and the accompanying safe harbor reflect the clear legislative intent to exclude the equity securities issued under employee compensatory plans by smaller private issuers from the determination of when registration is required under Section 12(g) of the Exchange Act, thereby enabling such issuers to use their equity securities to compensate their employees without the risk of inadvertently triggering Exchange Act registration before they are prepared to bear the costs and other burdens associated with becoming a reporting company.

<u>Definition of "Employee Benefit Plan"</u> (Request for Comment 9). After due consideration, we do not believe that the Commission should create a new – and potentially different – definition of the term "employee compensation plan" for purposes of implementing the requirements of Section 502. While we believe that a uniform and consistent definition of the written programs that are used by issuers to award equity compensation to their employees is highly desirable, given the limited scope of the current proposals and the potentially significant challenges in developing a comprehensive definition that would harmonize the body of knowledge that has developed in connection with the term "employee benefit plan" as defined in Securities Act Rule 405 (for purposes of Securities Act Form S-8 registration), the concept of a "compensatory benefit plan" as covered by Securities Act Rule 701, and Congress' objectives under Section 502 is a project for another day.

Instead, we believe that the Commission's preliminary determination to refrain from defining the term "employee compensation plan" at this time, and to apply Securities Act Rule 701 concepts as part of the non-exclusive safe harbor that is being established, provides sufficient flexibility for issuers to make the necessary determinations under Exchange Act Section 12(g)(5). As we have previously noted, from the perspective of the type of non-reporting issuers that are most often confronted with the possibility of Section 12(g) registration – that is, "start-up" companies which make extensive use of equity compensation – application in a Section 12(g) context of the familiar concepts applied by these companies in connection with the exempt issuance of compensatory equity securities under Securities Act Rule 701 will facilitate compliance by streamlining such issuers' learning curve and simplifying recordkeeping. This result is entirely consistent with Congress' clear intent to make it easier for smaller companies to remain non-reporting issuers for an extended period, if they so choose, while using their equity securities to compensate employees.

<u>No-Sale Transactions</u> (Request for Comment 10). We agree with the Commission's proposal to exclude securities held by persons who received the securities pursuant to an award to employees that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act from the definition of securities "held of record" for purposes of determining an issuer's Exchange Act Section 12(g) registration obligations. (See proposed Exchange Act Rule 12g5-1(a)(7)(i)(A)(2)). In our experience, the "no-sale" theory continues to be a frequently-used means for issuing securities in a compensatory context to employees where no consideration is tendered to the issuer in connection with the issuance. Further, such exclusion is consistent with our request that the statutory carve-out be drafted to be as broad as possible, consistent with Congress' mandate.

<u>Scope of Safe Harbor</u> (Request for Comment 11). We do not believe that the scope of the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should be limited to equity securities received pursuant to an exempt transaction that meets all of the requirements of a Securities Act exemption (such as Securities Act Rule 701 or one of the exemptions contained in Regulation D). In our view, the clear policy objectives underlying Sections 502 and 503 reflect a legislative understanding that equity securities issued under the employee compensatory plans of smaller issuers should be treated differently for purposes of the registration requirements of Exchange Act Section 12(g), and that the benefits of such transactions should not be unduly curtailed for fear of having to shoulder the costs and other burdens associated with becoming a reporting company.

We are concerned that conditioning an issuer's reliance on the safe harbor on that issuer's ability to demonstrate, perhaps years after the fact, compliance with all of the express requirements of one of various enumerated Securities Act exemptions would unnecessarily place undue emphasis on technical aspects of the selected exemption that should not serve as the basis for determining whether registration under Exchange Act Section 12(g) is necessary.

We read the language of Section 503 of the JOBS Act as mandating that the safe harbor adopted by the Commission provide certainty with respect to the exempt offering condition of Section 502, not just the "employee compensation plan" condition:

> The Commission shall also adopt safe harbor provisions that issuers can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of section 5 of the Securities Act of 1933.

Requiring an issuer that desires to rely on the compensatory plan securities safe harbor from registration under Section 12(g) to establish annually that each issuance of equity securities under a compensatory plan, which may have occurred several years earlier, satisfied an available Securities Act exemption at the time of issuance would impose a significant ongoing burden. Instead, if the safe harbor were to deem *solely for purposes of Section 12(g) of the Exchange Act* that the original issuance qualified for a Securities Act exemption if the conditions of Rule 701(c) are satisfied as of the end of the fiscal year, the safe harbor would further the Congressional purpose of excluding employee compensation plan securities from the definition of "holder of record".

Reliance on Rule 701(c) (Request for Comment 12). We support the Commission's decision to structure the non-exclusive safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) so as simply to require compliance with the conditions of Securities Act Rule 701(c). Securities Act Rule 701 has been in effect since 1988 and, based on our experience, represents the primary exemption relied upon by smaller and other non-reporting issuers to exempt the issuance of equity securities to their employees through an employee compensation plan in a transaction that is exempt from the registration requirements of the Securities Act. Accordingly, we do not believe that additional guidance is necessary at this time since a significant body of knowledge has developed over the years from which these issuers and their legal counsel can draw.

Consultants and Advisers (Request for Comment 13). We believe that the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should encompass the full range of compensatory arrangements and security holders described in Securities Act Rule 701(c). Accordingly, we encourage the Commission to retain the category of consultants and advisors as persons who may receive equity securities pursuant to an employee compensation plan under the safe harbor, assuming that the conditions of Securities Act Rule 701(c) have been met. Since such persons qualify for inclusion under Securities Act Rule 701 and, typically, are providing services to an issuer comparable to those that may be provided by an employee, we see no reason to exclude them from the safe harbor since their receipt of such securities occurs in essentially the same circumstances as an issuer's employees. As is widely-understood, smaller non-reporting issuers often use their equity securities to compensate consultants and advisors providing services as a means of both securing the receipt of such services and to conserve cash.

Since the Commission has determined that, given the nature of these relationships, it is appropriate to permit the issuance of such securities to these persons without registration under the Securities Act, we see no reason that such recipients should be considered "holders of record" for purposes of determining whether Exchange Act registration is required. We further believe that, for purposes of the determination of "holders of record," no meaningful distinction can be made between consultants or advisors who are natural persons and those which are not. Again, here we believe that the relevant consideration is the compensatory nature of the transaction and not the status of the recipient.

Former Employees and Permitted Transferees (Request for Comment 14). As noted above in our response to the Commission's Request for Comment No. 13, we believe that the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) should encompass the full range of compensatory arrangements and security holders described in Securities Act Rule 701(c). In particular, we believe the safe harbor should cover equity securities in the hands of the full range of participants and permitted transferees enumerated in Securities Act Rule 701(c) – including not only employees, officers, directors, consultants and other direct service providers, but also former employees and family members (as defined in Securities Act Rule 701(c)(3)) who acquired the securities from employees (and former employees) through gifts or domestic relations orders.

Although we believe that Securities Act Rule 701(c) extends to family members who acquire equity securities initially issued pursuant to a compensatory benefit plan from an employee (or former employee) by gift or domestic relations order, or upon an employee's (or former employee's) death (or disability), as well as to the executor or guardian of the employee, former employee, or family member who acquires the securities upon such person's death or disability, we recommend that the Commission explicitly import this interpretation of Rule 701(c) into the proposed safe harbor to avoid any confusion.

We believe that including as permitted transferees family members who receive the equity securities by virtue of the employee's (or former employee's) gift, domestic relations order, death, or disability is necessary to avoid inadvertent loss of the benefits of the carve-out as a result of such transfers. Since such transfers are outside the control of the issuer, the possible loss of the carve-out over time due to the challenges associated with maintaining visibility into such transfers would create substantial uncertainty for issuers in determining whether and when the registration requirements of Section 12(g) would be triggered. Such uncertainty may lead an issuer to limit its use of equity compensation, a result that appears to be contrary to Congress's intent.

Moreover, we believe that family members who receive equity securities initially issued pursuant to a compensatory benefit plan in a transaction not involving a sale upon an employee's (or former employee's) death or disability should not be treated differently from those who receive them as a gift during the employee's (or former employee's) lifetime. Similarly, the status of a donee for purposes of the statutory carve-out should not be affected by whether the gift or other non-sale transfer of equity securities initially issued pursuant to a compensatory benefit plan occurred during or after the employee's employment by the issuer, so long as the donor/transferor originally received the securities when employed by or otherwise serving the issuer in a capacity covered by Securities Act Rule 701(c).

<u>Rule 12h-1 Exemptions</u> (Request for Comment 15). We believe that, given the scope of the safe harbor in proposed Exchange Act Rule 12g5-1(a)(7)(ii), the exemption for non-reporting issuers contained in Exchange Act Rule 12h-1(f) will no longer be necessary. We believe that the exemption contained in Exchange Act Rule 12h-1(g) for reporting issuers, however, may have continuing application.

Note that this position is predicated on our assumption that the safe harbor contained in proposed Exchange Act Rule 12g5-1(a)(7)(ii) will continue to cover equity securities in the hands of the full range of participants and permitted transferees enumerated in Securities Act Rule 701(c). In particular, the safe harbor would need to be broad enough to cover securities held by the persons identified in the definition of family member under Securities Act Rule 701(c) who acquire the securities from the employee by gift, domestic relations order, or death, as well as executors and guardians of any such persons, and would need to cover securities issued under any exemption from registration under Section 5 of the Securities Act. Given these circumstances, we believe the proposed safe harbor will exempt all classes of securities currently exempted by Exchange Act Rule 12h-1(f).

On the other hand, with respect to an issuer that is subject to the reporting requirements of the Exchange Act, there may be instances in which securities of a class that is not registered under the Exchange Act are issued to employees for compensatory purposes under circumstances in which Securities Act registration is required, in which case the proposed safe harbor would not be available. Since new compensation vehicles develop over time, we would recommend retaining Exchange Act Rule 12h-1(g) for such situations.

Business Combinations (Request for Comment 16). We commend the Commission for recognizing that securities issued in certain business combinations and similar transactions that replace securities previously issued pursuant to an employee compensation plan should be subject to the statutory carve-out. While we support the Commission's proposal, we recommend a few revisions to proposed Exchange Act Rule 12g5-1(a)(7)(i)(B) that we believe will clarify the application of this carve-out, and we also recommend its expansion in certain respects.

Proposed Exchange Act Rule 12g5-1(a)(7)(i)(B) requires that to be excluded, the equity securities must be held by persons eligible to receive securities from the issuer pursuant to Securities Act Rule 701(c). We assume that this simply refers to the categories of persons identified in Rule 701(c), and that its application is not dependent upon an offer or sale being made under a written compensatory benefit plan or contract. We also assume that these persons can be employed by or providing services to the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parent, as contemplated by Rule 701(c).

As pointed out in the Commission's Request for Comment No. 16, this exclusion would be limited to securities issued to persons eligible to receive securities from the issuer, such as former employees who were employed by or providing services to the surviving issuer at the time the securities were offered, which is currently a requirement of Rule 701(c). And, as further pointed out, the exclusion would not apply to former employees because they would not be employed by or providing services to the surviving issuer. It is possible that denying the exclusion to these former employees could inhibit issuers that have been essentially employee-owned for a number of years from entering into business combinations or similar transactions. Consequently, we recommend that it be made clear that the carve-out applies to former employees, directors, general partners, trustees, officers, or consultants and advisors who were employed by or providing services to a predecessor or a company acquired in a business combination.

Proposed Exchange Act Rule 12g5-1(a)(7)(i)(B) further requires, consistent with the language of 502 of the JOBS Act, that the securities be received in "a transaction exempt from the registration requirements of Section 5 of the Securities Act." While we believe that this was not what Congress intended, the language literally would appear to apply only to exempted transactions under Section 4 of the Securities Act. This would include, for example, securities issued pursuant to the transactional exemptions contained in Section 4(a)(2), Section 4(a)(5), and Rule 506 of Regulation D. Arguably, it would not apply to exempted securities under Section 3 of the Securities Act, which would include securities issued under Section 3(a)(9) (in connection with exchange offers), Section 3(a)(10) (issued after a fairness hearing by court, or state banking or insurance commission or other governmental authority), Section 3(a)(11) (intrastate offerings), or Rules 504 and 505 of Regulation D. To address this problem, we recommend that the pertinent language of the safe harbor be revised to read: "exempt from, or not subject to, the registration requirements of section 5 of the Securities Act . . . ."

Further, to be excluded under proposed Exchange Act Rule 12g5-1(a)(7)(i)(B), the securities must be received "in exchange" for securities excludable under proposed Exchange Act Rule 12g5-1(a)(7). Generally, the term "exchange" is defined as giving or receiving one thing in place of another. This implies a voluntary act and may not cover all the types of transactions that should be covered by this provision. In mergers, for example, shares are generally converted into other shares and in a reverse triangular merger shares may be converted into the right to receive other shares. Although these events are typically subject to a vote of security holders, they are not necessarily voluntary. See, for example, the definition of "mergers or consolidations" in Securities Act Rule 145(a)(2), which refers to securities held by security holders that "will become or be exchanged for another security." To address this potential ambiguity, we recommend that the reference be to securities received "in substitution or exchange for or conversion of securities . . . ."

To reflect these various comments, we recommend that proposed Exchange Act Rule 12g5-1(a)(7)(i)(B) be revised to read as follows:

> (B) Held by persons eligible to receive securities from the issuer pursuant to § 230.701 of this chapter who received the securities in a transaction that was exempt from, or not subject to, the registration requirements of section 5 of the Securities Act (15 U.S.C. 77e) in substitution or exchange for or upon conversion or exercise of securities that would have been excluded under paragraph (a)(7) when initially issued, provided that such persons upon consummation of such transaction are employed by or providing services to the issuer or had been employed by or providing services to a predecessor of the issuer or acquired company in a business combination at the time of the initial issuance.

Foreign Private Issuers (Request for Comment 17). We agree with the Commission's proposal to permit foreign private issuers to exclude securities received pursuant to an employee compensation plan in transactions exempt from, or not subject to, the registration requirements of the Securities Act from the "300 holders resident in the United States" threshold specified in Exchange Act Rule 12g3-2(a). As set forth in Section 502 of the JOBS Act, securities received pursuant to an employee compensation plan are to be excluded from the count of securities "held of record" for purposes of the registration threshold under Section 12(g)(5) of the Exchange Act. The clear purpose of this provision, as noted in the Release, is to permit issuers to postpone

Exchange Act registration until they have developed a sufficiently large shareholder base to justify the costs and other burdens associated with registration and the accompanying ongoing reporting obligations. As noted previously, the provision also gives issuers flexibility to grant equity awards to their employees without undue concern about inadvertently crossing the Exchange Act registration threshold. The ability to receive equity in their employer is inherently beneficial to an issuer's employees, a goal that the Commission has long promoted through its rules.

These objectives are equally applicable to foreign private issuers. The exclusion of securities received pursuant an employee compensation plan from the 300 holders resident in the United States threshold in Exchange Act Rule 12g3-2(a) will enable foreign private issuers to grant equity awards to their U.S. employees without the disincentive of having to worry about Exchange Act registration thresholds. This flexibility will benefit the issuer's U.S.-based employees, putting them on par with their counterparts at domestic private companies, and give smaller foreign private issuers more room to engage in capital raising transactions in the U.S. private markets before they are required to register under the Exchange Act. To us, this result is consistent with the overall objectives of the JOBS Act.

In summary, foreign private issuers should be no more required to register a class of securities under the Exchange Act while they are held by a relatively small number of holders resident in the United States than their domestic counterparts. Extending the exclusion to cover this situation helps to ensure that Exchange Act registration is not required of these issuers until they have developed a sufficiently large shareholder base of United States residents with whom they do not have a direct employment relationship.

We also support the Commission's proposal to count securities received pursuant to an employee compensation plan for purposes of determining whether an issuer qualifies as a foreign private issuer under Securities Act Rule 405 and Exchange Act Rule 3b-4. Consistent with the Commission's proposed approach, we do not believe that that the exclusion of employee compensation securities is necessary for purposes of determining foreign private issuer status under Exchange Act Rule 3b-4. Excluding securities received pursuant to an employee compensation plan in this situation is not consistent with the objectives of Securities Act Rule 405 and Exchange Act Rule 3b-4, where the question is whether an issuer qualifies for the special reporting treatment afforded to foreign private issuers. In our view, this threshold determination of whether the issuer qualifies for such treatment should continue to be made entirely on the basis of the relative size of the issuer's U.S. shareholder base as compared to its overall shareholder base. The JOBS Act did not have as one of its goals the relaxation of the conditions necessary for treatment as a foreign private issuer, and therefore does not provide a basis for doing so at this time. We recognize that excluding securities received pursuant to an employee compensation plan from the count under Securities Act Rule 405 and Exchange Act Rule 3b-4 may arguably provide an incentive to foreign issuers to award equity securities to their U.S. employees, which if not an express purpose of the JOBS Act, would be fully consistent with its goals. We do not believe, however, that Congress intended the JOBS Act to change the standards for determining whether an issuer is a foreign private issuer. Thus, we do not believe that it is necessary for the Commission to take this additional step to faithfully implement Congress's intent with respect to the revisions to Section 12(g)(5) of the Exchange Act.

Other Comments

1. Written Document. We note that Securities Act Rule 701(c) calls for a written compensatory benefit plan (or written compensation contract). We believe that the requirement of a written arrangement is reasonable in the Exchange Act Section 12(g)(5) context, as well as for purposes of Securities Act Rule 701, since state corporate law will generally require some documentation of the authorized issuance of equity securities. However, we urge the Commission to clarify that this requirement will be satisfied by resolutions adopted by the issuer's board of directors or other granting authority (for example, board committee or designated executive), as well as by less formal writings, such as memoranda or emails, since in our experience the equity-grant process of smaller non-reporting issuers (particularly start-up companies) is often informal.

2. Technical Matter. We note that the semicolon at the end of the introductory clause of proposed Exchange Act Rule 12g5-1(a)(7)(i)(A) should be a colon.

* * *

The Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with the Commission and its staff and to respond to any questions.

Very truly yours,

/s/ Catherine T. Dixon

Catherine T. Dixon, Chair, Federal Regulation of Securities Committee

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