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Important Compliance Considerations for Equity Compensation – Federal and State Securities Laws

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Executive Summary

Company securities, including, but not limited to stock options and restrictive stock units, have become a staple and valuable component of company compensation and bonus plans. Companies that compensate employees with such equity, either directly or indirectly, must be mindful of the complex interaction between federal and state securities laws. Violations of securities laws can result in severe penalties, including civil and criminal actions. Consequently, any securities-related course of action – including equity compensation -- should encompass a thorough examination and analysis of the applicable federal and state securities laws.

FEDERAL SECURITIES LAWS AND EQUITY COMPENSATION – RULE 701

The Securities Act of 1933 (the “Securities Act”) and the Securities Exchange Act of 1934 (the “Exchange Act”) are the two primary federal securities laws that regulate the offer, purchase, and sale of securities. In several instances, both laws impose reporting and disclosure requirements on employee benefit plans and other related parties, unless the requirements for an exemption are met. The Securities Act offers several registration exemptions, such as exemptions for small public offerings under Regulation A, private and limited offerings under Regulation D, and exemptions for accredited investors. Most significant for equity compensation plan offerings, Rule 701 allows privately held companies to offer and sell securities without registration if they are issued to employees as compensation pursuant to written compensatory benefit plans and written compensation contracts.

Relevant requirements for Rule 701 include:

- The issuer is not subject to the reporting requirements of the Exchange Act.
- The issuer is not an investment company that must be registered under the 1940 Investment Act.
- The aggregate sales price or the amount of securities sold during any consecutive 12-month period must not exceed the greater of:

1. \$1 million;

2. 15% of the total assets of the issuer (or issuer's parent in cases where the issuer is a wholly owned subsidiary and the securities represent obligations that the parent fully and unconditionally guarantees), as determined on the issuer's most recent balance sheet date; or
3. 15% of the outstanding amount of securities of that class, as determined on the issuer's most recent balance sheet date.

If more than \$5 million in securities are expected to be sold in a 12-month period, financial information and risk factors together with a copy of plan-related documents must be disclosed to employees prior to sale to satisfy Regulation A disclosure requirements. Volume limitations are based on actual sales, and in the case of options, the amounts to be sold. Specific volume limitation calculations depend on the type of equity.

BLUE SKY LAWS AND EQUITY COMPENSATION

A particular securities offering that is exempt from registration under the federal securities laws will not necessarily be exempt from registration under state securities laws, commonly known as "Blue Sky Laws." Each state has its own securities laws and applicable exemptions. Thus, offerings that are exempt from the provisions of the federal securities laws may still be subject to the notice and filing requirements of various state securities laws.

Thirty-nine states have Blue Sky Laws that comply with the Uniform Securities Act, which is partly based on federal law. While some states track federal exemptions or expressly provide that securities offered under Securities Act Rule 701 are exempt; others do not. Additional requirements under applicable Blue Sky Laws may apply. For example, New York's Blue Sky Laws require an application for exemption with the New York State Department's Investors Protection Bureau be granted. Compliance with the applicable Blue Sky Laws of the state in which the recipient of the equity compensation resides must be verified before such equity compensation is provided.

Please contact [Riebana E. Sachs](#) or any member of the Corporate, Finance and Acquisition Group with any questions.

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