

# Client Alert.

February 16, 2012

## SEC Staff Issues Global No-Action Relief From Exchange Act Registration for Restricted Stock Units

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On February 13, 2012, the staff of the U.S. Securities and Exchange Commission's Division of Corporation Finance (the "Staff") issued a global no-action letter that provides relief from the requirement to register under the Securities Exchange Act of 1934, as amended (the "Exchange Act") upon reaching the holder of record threshold due to the issuance of restricted stock units ("RSUs").<sup>1</sup>

The Staff's position is limited to RSUs that meet the conditions specified in the no-action letter and does not apply to a company generally, nor does the Staff's position cover other securities that the company may issue. The Staff had previously provided no-action relief on the topic to individual companies, including Facebook, Zynga and Twitter.<sup>2</sup>

### EXCHANGE ACT REGISTRATION REQUIREMENTS

Generally, under Section 12(g) of the Exchange Act and Exchange Act Rule 12g-1, any company with assets in excess of \$10 million and a class of equity securities held of record by five hundred or more persons is required to register that class of equity securities under the Exchange Act. Absent relief from the Staff, a company that issues RSUs to five hundred holders of record or more would be required to file an Exchange Act registration statement and become subject to the Exchange Act's reporting requirements. The Securities and Exchange Commission (the "Commission") has previously indicated that the five hundred holders of record threshold correlates to companies that are presumed to have an active trading market in their securities and therefore should be required to provide mandatory disclosure to protect the company's investors.

In 2007, the Commission exempted certain compensatory stock options (but not the shares underlying such options) from the Exchange Act Section 12(g) registration requirements.<sup>3</sup> However, the Commission's exemption covered only compensatory stock options and did not exempt RSUs from the Section 12(g) registration requirements. As noted above, in recent years the Staff has granted no-action relief from Section 12(g) registration requirements relating to RSUs, but each of these no-action letters has been limited to the specific facts and circumstances of the company receiving the relief.

### CHARACTERISTICS OF RESTRICTED STOCK UNITS

Unlike a grant of restricted stock, in which shares of a company's stock are issued to an employee, an RSU represents the right to receive a number of shares of company stock in the future, subject to certain conditions. Such conditions may

<sup>1</sup> *Fenwick & West LLP* (February 13, 2012). The Staff's response and the incoming request are available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2012/fenwickwest021312-12g.htm>.

<sup>2</sup> See *Facebook, Inc.* (October 14, 2008); *Zynga Inc.* (June 17, 2011); and *Twitter, Inc.* (September 13, 2011).

<sup>3</sup> *SEC Release No. 34-56887* (December 7, 2007).

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be time-based (vesting over a period of continued service to the company), performance-based (vesting after certain performance objectives are met), or some combination of the two, or they may relate to the occurrence of an event such as an initial public offering. Depending upon the nature of the company's compensation program, the company may issue shares of the company's stock, cash or some combination of the two in settlement of the RSUs.

As noted in the no-action request, holders of RSUs do not, by virtue of such RSUs, hold shares of the company's common stock, nor are they able to vote the shares or receive dividends. In addition, these RSUs are typically issued under written compensatory equity incentive plans and are only awarded to the company's employees, directors and consultants. Such plans and the related award agreements also strictly limit the ability of an RSU holder to transfer the RSU to another holder, other than to family members by gift or domestic relations order, or to an executor or guardian upon the holders' death or disability, to the company, or in connection with a change of control or other acquisition transaction involving the company, if after such transactions the RSUs will not be outstanding and the company will no longer be relying upon the Staff's relief.

## STAFF CONSIDERATIONS FOR GRANTING RELIEF

The incoming no-action request notes a number of factors from the exemptive provisions of Exchange Act Section 12(h) in support of the Staff's grant of relief from the Exchange Act registration requirements of Section 12(g) for RSUs.

Specifically, the request notes that the issuance of RSUs does not affect the number of public investors in a company because RSU holders do not pay cash or other similar consideration in exchange for the RSU and, as noted above, there are strict limits on the transfer of RSUs to other holders. For this reason, there is also very little trading interest in the RSUs, another factor for the Staff's consideration under Section 12(h). Finally, the request also notes that any Staff relief would only be available for private companies, as Section 12(h) directs the Staff to consider the nature of the issuer in contemplating whether exemptive relief should be granted.

In its response, the Staff indicated that it will not object if a company does not comply with the registration requirements of Section 12(g) of the Exchange Act with respect to RSUs if such RSUs are granted pursuant to a written compensatory equity incentive plan and subject to certain terms and conditions described in the incoming request letter. In addition, the Staff notes that its position remains in effect until the company otherwise becomes subject to Exchange Act registration or reporting requirements with respect to any other class of its securities.

The request includes terms and conditions that RSUs must meet in order to be covered by the Staff's relief. The company must agree in the written equity incentive plan, a written agreement with the RSU holder, or in another agreement enforceable against the company to provide the RSU holder with the information specified in Exchange Act Rule 12h-1(f)(vi), which includes certain financial statements and other information, until such time as the company becomes subject to Exchange Act reporting requirements or is no longer relying on the Staff's relief. In addition, such RSUs must be:

- Issued under a written compensatory equity incentive plan established by the company, a parent or subsidiary of the company, or a majority-owned subsidiary of the company's parent;
- Held by only the persons described in Rule 701(c) under the Securities Act of 1933, as amended (the "Securities Act"), which consists of employees and directors of, and consultants to, the company and certain transferees (described below);

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- Transferable only to (i) family members (as defined in Securities Act Rule 701(c)(3)) by gift or domestic relations order or to an executor or guardian upon the holders' death or disability; (ii) the company; or (iii) in connection with a change of control or other acquisition transaction involving the company, if after such transactions the RSUs will not be outstanding and the company will no longer be relying upon the Staff's relief;
- Restricted under the written equity incentive plan, written agreement, or the company's organizational documents as to any pledge, hypothecation, or other transfer, including any short position, any put equivalent position (as defined in Exchange Act Rule 16a-1(h)) or any call equivalent position (as defined in Exchange Act Rule 16a-1(b)), by the RSU holder prior to the settlement of the RSU (except as described above); and
- Transferable by subsequent holders of the RSU only upon the death of such holder, with such restrictions on subsequent transfer included in the company's written compensatory equity incentive plan, written agreement, or the company's organizational documents, and acknowledged in writing by such transferees.

## CONCLUSION

The Staff's relief essentially expands the exemption from Section 12(g) registration that the Commission previously granted for compensatory stock options to include RSUs that meet the terms and conditions described in the no-action request. The Staff's position perhaps reflects the need for similar treatment of these two forms of compensation, particularly given the recent increase in the popularity of RSUs as an element of compensation.

Because the Staff has opted to issue a global no-action position, companies will be able to rely on the no-action letter's relief and take comfort that they will not be required to file an Exchange Act registration statement and become subject to the Exchange Act reporting requirements by virtue of issuing RSUs to five hundred or more record holders. Companies should take care, however, to ensure that such RSUs meet the terms and conditions described in the no-action request, including the absence of public investors and the lack of trading interest in the RSUs. If the terms and conditions of a company's RSUs differ from those contemplated in the no-action letter, the company should consider revisiting its RSU program to determine if changes should be made going forward that will make the Staff's relief in this letter available in the future.

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