

Legal Updates & News

Bulletins

Amendments to California Compensatory Benefit Plan Regulations Effective Immediately

July 2007

California Commissioner of Corporations Amends Compensatory Benefit Plan Regulations

On July 9, 2007, the California Commissioner of Corporations amended the regulations under the California Corporate Securities Law of 1968 ("California Securities Law") to provide greater flexibility to companies that provide stock options or other equity-based compensation in California. Private companies that issue compensatory securities in California generally either must seek qualification of the plan by the Commissioner of Corporations under Section 25110 et seq. of the California Corporations Code, or the grants must be exempt under Section 25102(o). The new rules considerably simplify the requirements for qualification as well as those under Section 25102(o), although existing plans may need to be amended to permit their administration under the more relaxed new rules. Public companies generally do not need to concern themselves with the qualification requirements under the California Securities Law as a result of exemptions that are available to public, not private, companies.

Overview of the Amendments

Eligible Persons

The old rules provided that under an option plan or purchase plan, securities could be issued only to employees, directors, managers, or consultants. The new rules expand the list of eligible persons to include any person eligible to receive securities under Rule 701 of the federal Securities Act (such as insurance agents who are considered employees for Rule 701 purposes).

Elimination of Minimum Prices

The new rules eliminate the restrictions on minimum exercise prices for options and minimum purchase prices for securities under compensatory benefit plans. Note, however, that the rules applicable to incentive stock options and the rules under Section 409A of the Internal Revenue Code still limit companies' flexibility in the option pricing area.

Elimination of Minimum Vesting Period

The old rules required that options granted under a plan to non-management employees must vest a minimum of 20% per year over 5 years from the date the option is granted. The new rules permit companies to base exercise schedules on business needs, including the use of targeted incentives and performance-based vesting for non-management employees. Performance-based vesting has become more attractive following the implementation of the FAS 123R option expensing rules, but prior to the amendment such vesting had been difficult to structure for rank-and-file employees in California.

Amendment of 12-Month Security Holder Requirement.

The old rules required that a plan be approved by the security holders within 12 months of adoption. The new rules require security holder consent within the later of (a) 12 months of adopting the plan or (b) 12 months of the granting of any options or the issuance of any compensatory securities under the plan in California. As a result, foreign corporations making option grants in California need only obtain security holder consent of the plan within 12 months after the initial grant is made in California. In addition, the new rules allow foreign private issuers to issue options or stock under plans to recipients in California without consent from their security holders so long as the total number of recipients does not exceed 35 under all plans and arrangements.

Elimination of Restrictions on Repurchase Rights for Exempted Plans

The old rules contained certain across-the-board restrictions on repurchase rights for plans (e.g., minimum repurchase price, minimum repurchase period, and right of repurchase to lapse as to at least 20% of the shares per year). The new rules remove the restrictions on repurchase rights for plans that use the exemption under Section 25102(o) but retain them for plans that are seeking qualification. It should be noted, however, that in negotiating any repurchase price with a grantee, companies are still subject to provisions requiring the disclosure of all material information to the grantee during the course of negotiating the repurchase price.

Elimination of Equal Voting Right Requirement for Exempted Plans

The old rules provided that the shares of common stock issuable under compensatory plans had to carry equal voting rights on all matters where such vote is permitted by applicable law. The new rules eliminate this requirement for compensatory plans.

Elimination of Limitation of Total Number of Shares if Rule 701 is Met

The old rules limited the total number of securities issuable under a plan to no more than 30% of the then outstanding securities of the company, unless a higher percentage was approved by holders of two-thirds of the outstanding securities entitled to vote. The new rules eliminate this requirement for plans that meet the conditions of Rule 701 of the Securities Act. Rule 701 limits the aggregate sales price or amount of securities sold in reliance on such rule within any 12-month period to the greater of \$1 million, 15% of the total assets of the company, or 15% of the outstanding number of shares of the class of securities being offered, and it requires certain additional financial and other disclosures if aggregate sales under Rule 701 exceed \$5 million in such a period.

Elimination of Financial Disclosure Requirement if Rule 701 is Met

Under the old rules, companies were required to provide the participants in compensatory plans or agreements with financial statements at least annually. The new rules eliminate this requirement for plans that meet the conditions of Rule 701. Note, however, that Rule 701 itself contains some disclosure requirements.

The Commissioner of Corporations' order adopting the amendments can be found at:

<http://www.corp.ca.gov/pol/rm/2706order.pdf>