

March 30, 1998

**SEC PROPOSES EXTENDING FORM S-8
REGISTRATION TO TRANSFERRED STOCK OPTIONS**

The Securities and Exchange Commission (SEC) recently issued proposed changes to Form S-8 registration that include extending its scope to certain transferred stock options.¹ This is particularly relevant in the wake of the earlier changes to SEC Rule 16b-3 that opened the door for companies to grant stock options to their employees that were transferable.² Previously, Rule 16b-3 had required that all options be non-transferable except in the case of death. Since that change, many companies have considered adopting this feature which can provide a meaningful estate tax benefit to executives. Despite some uncertainty, a few companies have permitted stock options held by high-level executives to be transferred. This SEC proposal, if adopted, will allow family members of optionees to whom stock options have been transferred to rely on the company's Form S-8.

The Registration Issue

When companies grant stock options, they are making an offer to sell shares of company stock to the optionees. Typically, such an offering requires registration under federal securities laws and SEC rules. Registration clears the way not only for the exercise of the option but also for the subsequent sale of the underlying shares. Form S-8 is a simplified registration form crafted by the SEC specifically for shares offered by public companies to employees in a compensatory or incentive context (rather than for capital-raising purposes). Currently, Form S-8 is not available once an employee transfers a stock option.³ The SEC's proposal would change this for certain transfers.

The Proposal

A proposed amendment to Form S-8 and related rule changes would extend the availability of Form S-8 to options transferred as (a) a gift to immediate family members, trusts for the exclusive benefit of family members and any other entity owned solely by family members, or (b) as part of a divorce settlement under a "domestic relations order." As proposed, Form S-8 would not cover an employee stock option that is transferred for "consideration," e.g., sold to a third party or even a family member.

¹ Securities and Exchange Commission Release No. 33-7506, February 17, 1998.

² See our letter dated October 7, 1996, for a discussion of this change.

³ Form S-3 registration or reliance on the one-year holding period under Rule 144 has been available for transferred options.

Immediate Family Members

The proposal defines “family member” in the same way in which Exchange Act Rule 16a-1(e) does. It includes any child, step-child, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law, including adoptive relationships. In addition, for Form S-8 purposes, “family member” would also include the trusts or other entities referenced above.

In making this proposal, the SEC has asked for comments on several ancillary issues, including:

- Should Form S-8 be extended to options transferred for consideration?
- Does the extension of the Form to trusts for family members and “any other entity owned solely by these persons” sufficiently cover the estate tax saving vehicles to which a stock option could be transferred? What about subsequent transfers among family members to a trust?
- Should Form S-8 registration also cover a “reload” option granted *directly* to a family member?

The proposal also reaffirms a prior SEC staff position that Form S-8 registration may occur anytime before a stock option is exercised, not necessarily before it is granted or even vested.

Proxy Statement Disclosure

Reaffirming oral statements made by SEC staff members at conferences and other public sessions, the proposing release includes changes in the executive compensation disclosure requirements. These would require that transferred stock options be shown in both the summary compensation table and option/SAR grant table.

Interestingly, the proposal does *not* provide for including transferred options in the second stock option table required under the disclosure rules. This table shows the gains realized from stock options exercised during the reporting year by named executive officers as well as gains on stock options held by those individuals as of year-end. For example, under the proposal, a stock option granted in 1995 and transferred during a company’s 1998 reporting year would not appear in the issuer’s 1999 proxy statement regardless of whether it had been subsequently exercised or was still outstanding as of year-end.

The proposing release does, however, ask for comment as to whether such continued disclosure of transferred and outstanding stock options is appropriate and whether there should be footnote or accompanying text disclosure providing more detail. However, the proposal is silent on the issue of disclosing the value received by a named executive officer who sells a stock option or otherwise receives consideration for transferring a stock option.

Consultants/Advisors

The SEC's proposing release also includes reforms aimed at curtailing abuse in the form of using "consultants and advisors" as conduits for capital raising through the issuance of stock options under Form S-8. Form S-8 is available not only for stock options and other stock-based awards granted to employees but also for consultants and advisors. The proposal would specifically eliminate Form S-8 coverage for offerings to persons who promote or maintain a market for the company's securities. The Form, however, as proposed, would still be available for compensatory stock issued to bona fide consultants and other advisors or service providers to a company, but with greater disclosure of such participation as part of the Form S-8 filing. As proposed, the Form would also cover stock options transferred by consultants or advisors as gifts to their family members or pursuant to a domestic relations order.

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In general, this proposal appropriately addresses one of the open issues regarding registration and disclosure of transferable options. Implementation of this proposal will enhance the attractiveness of transferable options for estate planning purposes.

General questions regarding this letter may be addressed to Larry Bickford (212-986-6330) in our New York Office or Mike Thompson in our Chicago Office (312-332-0910 or email MATHOMPSON@FWCOOK.COM). Specific technical questions or questions relating to the applicability to this area to specific company situations should be addressed to the appropriate professional counsel.

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