

New Approach for the Assumption of Options in M&A

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A Canadian SEC reporting company that looks to acquire a company with outstanding equity grants in the United States will frequently need to address the question: What alternatives are available for the assumption of the target's outstanding options or other equity-based compensatory awards?

Under U.S. law, both the grant of the equity award *and* the exercise or conversion of the equity award must be registered under the 1933 Act or satisfy an available exemption. For Canadian issuers that are SEC reporting companies, the alternative approaches available to satisfy the 1933 Act requirements for the exercise or conversion of the assumed awards were formerly restricted to (i) an S-8 registration statement (either existing or newly filed) or (ii) an alternative exemption, such as Rule 506 of Regulation D, which would typically be available only in limited circumstances.

Under recent SEC guidance, however, SEC reporting issuers may now also rely on Rule 701 for the exercise of outstanding equity awards of the target that are assumed by the issuer *if* the target relied upon Rule 701 for the original issuance.

Rule 701 is commonly used by U.S. private companies and Canadian and other foreign public companies that aren't subject to SEC reporting obligations to structure their compensatory equity programs. Greatly simplified, Rule 701 is available to issuers that do not report with the SEC in connection with offers and sales of securities pursuant to written compensatory benefit plans to employees, officers and directors, and certain limited types of consultants and other persons, subject to limits on the amount of awards and, in certain cases, the need to deliver specified disclosures.

Notwithstanding the express language in Rule 701 that the exemption is available only to an issuer that is not subject to SEC reporting requirements, an SEC reporting issuer may rely upon Rule 701 for the exercise of the assumed awards, provided that the target satisfied the requirements of 701 at the time of the original grant.

Issuers should note that this change in guidance does not provide an exemption for the

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issuance of the acquiror options or other securities in connection with the assumption or exchange of the target options. For purposes of that transaction, the acquiror must rely upon (i) another exemption (such as Rule 3(a)(10) in a typical plan of arrangement) or (ii) a “no sale” position, which would be available if the terms of the target compensatory plan, at the time of the original grant, permitted the assumption of the options without the consent of the option holders.

This new guidance will provide issuers with additional flexibility in structuring acquisitions of companies that aren't SEC reporting companies. Due to the technical nature of the 701 exemption, however, an acquiror and its advisors should carefully review the target company's compliance with Rule 701 to satisfy themselves that the exemption was available to the target at the time of original issuance.