WILMERHALE

Option Repricings Face New SEC Hurdles

2001-03-30

Companies thinking about issuing new, lower-priced options or restricted stock in exchange for underwater options now face a new regulatory hurdle – compliance with the SEC's tender offer rules.

Last week, the SEC's Division of Corporation Finance issued written guidance on the topic. The guidance is available by clicking here. The SEC confirmed its regulatory concern about programs under which employees may elect to surrender existing out-of-the-money options for new, lower exercise price options or restricted stock containing different vesting or exercise terms or a reduced number of shares. The SEC's view is that these programs are subject to:

- Rule 13e-4, the SEC's issuer self tender offer rule, which requires the filing with the SEC of a Schedule TO and the dissemination to the option holders of disclosure documents; and
- Regulation 14E, a set of rules prohibiting certain practices in connection with tender offers and requiring, among other things, that tender offers remain open for at least 20 business days.

Rule 13e-4 applies only to public companies, but Regulation 14E applies to all tender offers, regardless of whether the company is public or private. The SEC's position will add cost (including SEC filing fees and the cost of preparing Schedule TO and its exhibits) and time delays (including the 20 business day requirement of Regulation 14E) to the process of undertaking these programs.

In partial recognition of the fact that its position is akin to placing a square peg in a regulatory round hole, the SEC also issued a blanket order which exempts option exchange offers from two of the most fundamental tender offer rules:

- the "all holders" rule, which requires that tender offers be open to all holders of the class of securities that is the subject of the tender offer; and
- the "best price" rule, which requires payment of the same consideration to all holders

tendering securities in a tender offer.

In granting this blanket relief, the SEC acknowledged that these programs do not present the same discriminatory concerns these rules were intended to address and that companies often desire flexibility to treat option holders differently in order to accomplish legitimate compensation objectives. For example, for corporate governance reasons, companies often exclude executive officers and directors from option repricing programs. To take advantage of the blanket exemption, the program must be conducted for compensatory purposes, the company must be eligible to register securities on Form S-8, the old and new options or shares of restricted stock must be issued under an employee benefit plan, and the company must disclose to option holders the essential features and risks of the exchange offer.

Companies considering adopting these programs should also keep in mind corporate governance concerns and other applicable regulatory requirements. Many stockholders, particularly institutional investors, despise the practice of option repricing, unless stockholder approval is obtained. Regardless of whether stockholder approval is sought, the SEC's rules require proxy statement disclosure of option repricings if any executive officer is eligible to participate. Moreover, the recent adoption of FASB Interpretation No. 44 (FIN 44), an interpretation of the accounting rules relating to stock compensation, has imposed adverse variable accounting treatment for options or restricted stock issued in a repricing, except in limited and carefully designed programs.

Jay Bothwick
jay.bothwick@haledorr.com

Jonathan Wolfman
jonathan.wolfman@haledorr.com

Authors

Jonathan Wolfman

PARTNER

Co-Chair, Corporate Governance and Disclosure Group

jonathan.wolfman@wilmerhale.com

+1 617 526 6833