FINAL STATEMENT OF REASONS
FOR THE ADOPTION OF RULES UNDER THE
CORPORATE SECURITIES LAW OF 1968

As required by Section 11346.9 of the Government Code, the California Corporations Commissioner ("Commissioner") sets forth below the reasons for the amendment of Sections 260.140.8, 260.140.41, 260.140.42, 260.140.45, and 260.140.46 of Title 10 of the California Code of Regulations, relating to compensatory benefit plans under of the Corporate Securities Law of 1968 (Corporations Code Section 25000 et seq., the "CSL").

BACKGROUND

The Commissioner regulates the offer and sale of securities in California under the CSL. It is unlawful for any person to offer or sell in this state any security in an issuer transaction unless such sale has been qualified by the Commissioner or unless such security or transaction is exempt or not subject to qualification. (See Corporations Code Section 25110.)

Under Corporations Code Section 25140, the Commissioner may refuse to qualify an issuance of securities unless the Commissioner finds that the proposed issuance of securities is “fair, just, and equitable.” The Commissioner has adopted qualification guidelines for various types of offerings of securities, including securities issued pursuant to compensatory benefit plans. (See 10 C.C.R. 260.140.41-42 and 260.140.45-46, hereinafter referred to as the “Compensatory Plan Regulations.”) The guidelines are general in nature and such standards are not intended to preclude the application of more liberal or more stringent standards if justified by the circumstances. (See 10 C.C.R. 260.140.)

In addition to providing guidance for applications submitted to the Commissioner for qualification, the Compensatory Plan Regulations play a separate role with respect to an exemption from qualification. Under Corporations Code Section 25102(o), the offer or sale of any security issued by a corporation or limited liability company pursuant to a compensatory benefit plan is exempt provided the issuance is exempt from federal registration pursuant to Rule 701 (“Rule 701”) of the Securities Act of 1933, as amended (17 C.F.R. 230.701), the terms of such plan comply with the Compensatory Plan Regulations, and a notice filing and fee is provided to the Department of Corporations (the “Department”). Offers and sales exempt under Corporations Code Section 25102(o) are deemed to be part of a single, discrete offering and not subject to integration with any other offer or sales, whether qualified, exempt from qualification, or not subject to qualification.

In 1999, the Commissioner proposed amendments to Sections 260.140.41, 260.140.42 and 260.140.45 (published in California Regulatory Law Bulletin 99, No. 01, p. 26, hereinafter referred to as the “1999 Rulemaking Project”). The 1999 Rulemaking

Project proposed to repeal certain provisions of the Compensatory Plan Regulations, including conditions related to the exercise price, vesting schedule, and repurchase rights. Final regulations under the 1999 Rulemaking Project, however, were never adopted.

In 2001, the Commissioner proposed amendments to the Compensatory Plan Regulations to implement the statutory change enacted by SB 1837 (Chap. 705, Stats. 2000) (hereinafter referred to as the "2001 Rulemaking Project"). SB 1837 extended the exemption in Corporations Code Section 25012(o) to include securities issued by limited liability companies. During the comment period for the 2001 Rulemaking Project, the Commissioner received requests that the Compensatory Plan Regulations be amended in the manner previously proposed in the 1999 Rulemaking Project. Since such suggestions were outside the scope of the 2001 Rulemaking Project, they were not acted upon.

Nonetheless, in February 2002, the Commissioner issued an invitation to comment on the Compensatory Plan Regulations ("2002 Invitation for Comment") in light of the continuing interest of stakeholders in the 1999 Rulemaking Project. The Department received a number of comments as result of its invitation, but has taken no action since with respect to the Compensatory Plan Regulations.

The Compensatory Plan Regulations are generally not applicable to compensatory plans offered by publicly-traded companies listed on the major exchanges. Corporations Code Section 25100(o) exempts from qualification with the Commissioner any warrant or right to subscribe to securities listed on the New York Stock Exchange, the American Stock Exchange, the Nasdaq Global Market, and the Nasdaq Global Select Market. (See also Commissioner's Release 27-C (rev. Mar. 9, 1992) and Release 87-C (Oct. 8, 1993).)

The Commissioner believes that compensatory benefit plans play an important and positive role in the development of businesses, especially newer and emerging businesses that seek to utilize capital to grow rather than for individual compensation. These plans can provide the opportunity for employees, officers, directors, consultants and others to participate in the potential future growth of the company where they work. Options, when awarded and exercised in a lawful and proper manner, can serve as a powerful incentive for employees to enhance business growth and create shareholder value.

The Commissioner is unaware of any other state that imposes requirements similar to the Compensatory Plan Regulations. The Commissioner has concerns that the Compensatory Plan Regulations are inconsistent with the regulatory approach taken by the other states and the federal securities laws, can impose a burden on businesses seeking to create jobs and expand operations in California, and restrict the opportunity for California residents to participate in compensatory benefit plans without providing commensurate investor protection in return. See Corporations Code Section 25612.5(b)(1) (prescribing rules with a view to achieving maximum uniformity of registration statements, applications, and reports wherever practicable).

Accordingly, the Commissioner has determined that the standards adopted in Sections 260.140.8, 260.140.41, 260.140.42, 260.140.45 and 260.140.46 should be amended.

Section 260.140.8

Section 260.140.8 provides guidelines on restrictions on transfer, including rights of first refusal and the option of the issuer or other holders to repurchase securities. Section 260.140.8 amendments include the former provisions of Sections 260.140.41(k) and 260.140.42(h). As a result, Rule 701 plans or agreements that intend to utilize the exemption in Corporations Code Section 25102(o) will no longer be subject to restrictions on repurchase rights. By removing this requirement for Rule 701 plans and agreements, the Commissioner believes that this will result in more uniform regulation of such plans and agreements on a national basis. However, compensatory benefit plans or agreements submitted to the Commissioner for qualification under the fair, just and equitable standard remain subject to the guidelines. The guidelines have been revised to provide an issuer with a longer period to repurchase securities after the termination of employment, and to require the repurchase price to be not less than the fair value of the securities on the date of termination, rather than the fair market value on the date of termination. These changes were made to account for the lack of a market for some securities, and to provide an issuer greater flexibility in structuring and exercising repurchase rights.

Section 260.140.41

Section 260.140.41 provides that the issuance of securities to employees, directors, managers or consultants under an option plan must meet specified conditions. The section heading has been renamed because it is no longer limited only to employees, directors, managers and consultants.

The introductory clause of Section 260.140.41 is amended to be consistent with the scope of eligible persons in Rule 701. The introductory clause also clarifies that this section only applies to those offerings made for compensatory purposes (as opposed to capital raising purposes).

Subsection (a) is amended to delete the reference to a percentage calculation found in Section 260.140.45. (Section 260.140.45 is amended in this rulemaking project not to apply to any offering that complies with all conditions of Rule 701.) As amended, the total number of securities that may be issued by a plan may be expressed as a specific number or as a percentage. This will allow companies greater flexibility in setting the total number of securities that may be issued under the plan.

Subsection (b) is repealed. This subsection requires that the exercise price of the securities may generally not be less than 85% of the fair value of at the time the option is granted. By repealing subsection (b), a company and its option grantees will have flexibility to determine the appropriate exercise price of the securities. The

Commissioner observes that all option grants remain subject to the exercise of fiduciary duties by the directors or managers and that, as part of such duties, the directors or managers would have to consider any adverse tax or accounting consequences of issuing below-market grants. In addition, the adopted changes would not prohibit a company from including a minimum price limitation if it so desires.

Subsection (d) is amended to allow options granted under a compensatory benefit plan to be transferred to a revocable trust. This change allows for option grants to be transferred to a revocable trust, for estate planning purposes.

Subsection (f) is repealed. This subsection requires that a vesting rate of at least 20% per year over five years from the option grant date. By repealing this subsection, a company and its option grantee will be able to determine an exercise schedule that meets the needs of all parties. The strict linear approach currently set forth in subsection (f) would not permit the use of targeted incentives and performance-based vesting for non-management employees. In the absence of such flexibility, it is possible that such non-management employees may be excluded from sharing in any option grants with senior management.

Subsection (g) is amended to clarify that the regulation does not require the extension of the exercise period past the option exercise date. For example, if an option grantee held an option with an exercise period of 10 years and died one month prior to the expiration date, the option must be exercised within one month.

Subsection (h) is amended to clarify that the authority to grant any options under a plan or agreement expires within 10 years from the date the plan or agreement is adopted or approved by the issuer's security holders, whichever is earlier. The plan itself does not need to terminate after 10 years. For example, since an option granted in the ninth year of a plan's existence can have an exercise period of up to ten years, the plan would need to exist until at least the nineteenth year. Furthermore, confidentiality or arbitration or vesting schedules may need to remain in place past the end of the 10-year period.

Subsection (i) is amended to clarify that the guideline may be satisfied by receiving security holder approval prior to or within 12 months after the grant of any options or issuance of any security in this state. Under the existing guidelines, a plan or agreement must be approved within 12 months of adoption of the plan or entering into the agreement. This requirement has created some issues for out-of-state companies seeking the exemption provided by Corporations Code Section 25102(o), especially where such a company has an existing plan and has expanded (through acquisition or otherwise) to hire persons in California. The amendments provide flexibility as a company may now obtain security holder approval more than 12 months after adoption of a plan or entering into an agreement, but only if such approval is received within 12 months after the granting of any options or issuance of any security thereunder in California.

Subsection (i) is further amended to permit foreign private issuers, as defined by

Rule 3b-4 of the Securities Exchange Act of 1934, as amended (17 C.F.R. 240.3b-4), to utilize the exemption set forth in Corporations Code Section 25102(o). Obtaining approval of security holders can be a costly and burdensome effort, especially for foreign companies that may have been organized under laws very different from U.S. corporate laws. The adopted amendment would permit foreign private issuers to grant options and issue securities to a minimal amount of persons in this state without having to obtain approval of their security holders. The Commissioner has selected 35 persons based on similar requirements found in subdivisions (f) and (h) of Corporations Code Section 25102 as well as Rule 506 under the Securities Act of 1933, as amended (17 C.F.R. 230.506); however, unlike the other provisions, there will be no exclusion of any person (e.g., accredited investors) from the total number.

Subsection (k) is moved to Section 260.140.8. As a result, plans or agreements that intend to utilize the exemption in Corporations Code Section 25102(o) will no longer be subject to restrictions on repurchase rights. By placing such restrictions in Section 260.140.8, plans or agreements submitted to the Commissioner for qualification under the fair, just and equitable standard remain subject to the guidelines. By removing this requirement for Rule 701 plans and agreements, the Commissioner believes that this will result in more uniform regulation of such plans and agreements on a national basis. Since the restrictions in current subsection (h) excludes officers, directors, managers and consultants, the unintended consequence may be that subsection (h) prevents non-management employees from sharing in any potential equity gains if companies were to avoid issuing options to non-management employees due to regulatory limitations.

In determining any repurchase price, the issuer may have a bargaining advantage due to superior information. The Commissioner reiterates that Corporations Code Section 25401 requires the disclosure of all material information to the grantee during the course of negotiating the repurchase price (i.e., disclose or refrain from engaging in the transaction) and the failure to disclose can result in administrative, civil, and criminal liability.

Subsection (l) is repealed. Current subsection (l) requires that voting stock and similar equity securities comply with Section 260.140.1. Because Section 260.140.1 will continue to apply to any application for qualification of any compensatory benefit plan, repeal of subsection (l) will only affect Rule 701 offerings. By removing this requirement for Rule 701 plans and agreements, the Commissioner believes that this will result in more uniform regulation of such plans and agreements on a national basis.

Section 260.140.42

Section 260.140.42 provides that securities sold to employees, directors, managers or consultants under a purchase plan must be issued pursuant to specified conditions. The section heading has been renamed because it is no longer limited only to employees, directors, managers and consultants and bonus plans (where recipients receive securities without any cash payment) are also covered by the section.

The introductory clause of Section 260.140.42 is amended to be consistent with the scope of eligible persons in Rule 701. The introductory clause also clarifies that this section only applies to those offerings made for compensatory purposes (as opposed to capital raising purposes).

Subsection (a) is amended to delete the reference to a percentage calculation found in Section 260.140.45. (Section 260.140.45 is amendment in this rulemaking project to not apply to any offering that complies will all conditions of Rule 701.) As amended, the total number of securities that may be issued by a plan may be expressed as a specific number or as a percentage. This will allow companies greater flexibility in setting the total number of securities that may be issued under the plan.

Subsection (b) is repealed. This subsection requires that the securities have a specified purchase price as set forth in the rule. By repealing subsection (b), a company and its eligible recipients will have flexibility to determine the appropriate purchase price of the securities. The Commissioner notes that the minimum purchase price requirement in current subsection (b) created some confusion as to whether a company could issue bonuses in the form of securities. The Commissioner observes that all purchase plans and bonus plans remain subject to the exercise of fiduciary duties by the directors or managers. In addition, the proposed changes would not prohibit a company from including a minimum price limitation if it so desires.

Subsections (c) and (d) are amended to conform to the types of persons now eligible to purchase securities under this section. In addition, subsection (c) is amended to allow rights to acquire securities under the plan to be transferred to a revocable trust. This change allows the rights to acquire securities under the plan to be transferred to a revocable trust, for estate planning purposes.

Subsection (e) is amended to clarify that the authority to issue securities under a plan or agreement expires within 10 years from the date the plan or agreement is adopted or approved by the issuer's security holders, whichever is earlier. The plan itself does not need to terminate after 10 years. For example, confidentiality or arbitration or vesting schedules may need to remain in place after past the end of the 10-year period.

Subsection (f) is amended to clarify that the guideline may be satisfied by receiving security holder approval prior to the issuance of any securities in this state. Under the existing guidelines, a plan or agreement must be approved within 12 months of adoption of the plan or entering into the agreement. This requirement has created some issues for out-of-state companies seeking the exemption provided by Corporations Code Section 25102(o), especially where it has an existing plan and has expanded (through acquisition or otherwise) to hire persons in California. The amendments provide flexibility as a company may now obtain security holder approval more than 12 months after adoption of a plan or entering into an agreement, but only if such approval is received prior to the issuance of any securities thereunder in California.

Subsection (i) is further amended to permit foreign private issuers, as defined by

Rule 3b-4 of the Securities Exchange Act of 1934, as amended (17 C.F.R. 240.3b-4), to utilize the exemption set forth in Corporations Code Section 25102(o). Obtaining approval of security holders can be a costly and burdensome effort, especially for foreign companies that may have been organized under laws very different from U.S. corporate laws. The amendment permits foreign private issuers to grant options and issue securities to a minimal amount of persons in this state without having to obtain approval of their security holders. The Commissioner has selected 35 persons based on similar requirements found in subdivisions (f) and (h) of Corporations Code Section 25102 as well as Rule 506 under the Securities Act of 1933, as amended (17 C.F.R. 230.506); however, unlike the other provisions, there is no exclusion of any person (e.g., accredited investors) from the total number.

Subsection (h) is being moved to Section 260.140.8. As a result, plans or agreements that intend to utilize the exemption in Corporations Code Section 25102(o) will no longer be subject to restrictions on repurchase rights. By placing such restrictions in Section 260.140.8, plans or agreements submitted to the Commissioner for qualification under the fair, just and equitable standard remain subject to the guidelines. By removing this requirement for Rule 701 plans and agreements, the Commissioner believes that this will result in more uniform regulation of such plans and agreements on a national basis. Since the restrictions in current subsection (h) excludes officers, directors, managers and consultants, the unintended consequence may be that subsection (h) prevents non-management employees from sharing in any potential equity gains if companies were to avoid issuing securities to non-management employees due to regulatory limitations.

In determining any repurchase price, the issuer may have a bargaining advantage due to superior information. The Commissioner reiterates that Corporations Code Section 25401 requires the disclosure of all material information to the grantee during the course of negotiating the repurchase price (i.e., disclose or refrain from engaging in the transaction) and the failure to disclose can result in administrative, civil, and criminal liability.

Subsection (i) is repealed. Current subsection (i) requires that voting stock and similar equity securities comply with Section 260.140.1. Because Section 260.140.1 will continue to apply to any application for qualification of any compensatory benefit plan, repeal of subsection (i) will only affect Rule 701 offerings. By removing this requirement for Rule 701 plans and agreements, the Commissioner believes that this will result in more uniform regulation of such plans and agreements on a national basis.

Section 260.140.45

Section 260.140.45 is amended to exclude plans that comply with all conditions of Rule 701. Rule 701(d) limits on the aggregate sales price or amount of securities sold in reliance of such rule within any 12-month period to the greater of $1 million, 15% of the total assets of the issuer, or 15% of the outstanding amount of the class of securities being offered. The Commissioner concludes that the sufficiency of federal regulation, as well as the interest in uniform regulation of national offerings, justifies exempting Rule 701 offerings from Section 260.140.45.

Section 260.140.46

Section 260.140.46 is amended to exclude plans that comply with all conditions of Rule 701. Rule 701(e) requires disclosure, including financial statement disclosure under certain circumstances. The Commissioner concludes that the sufficiency of federal regulation, as well as the interest in uniform regulation of national offerings, justifies exempting Rule 701 offerings from Section 260.140.46.

DETERMINATIONS

The Commissioner has determined that the adoption of the regulation does not impose a mandate on local agencies or school districts.

ALTERNATIVES CONSIDERED

No alternative considered by the Department would be more effective in carrying out the purpose for which the regulation is proposed, would be as effective and less burdensome to affected private persons, or would lessen any adverse impact on small businesses.

ADDENDUM, REGARDING PUBLIC COMMENTS

No request for hearing was received during the 45-day public comment period, which ended on December 18, 2006. Accordingly, no hearing was scheduled or held.

COMMENTS RECEIVED DURING THE 45-DAY COMMENT PERIOD

COMMENTOR: E-mail dated October 19, 2006, from Edward M. Alterman, Fried, Frank, Harris, Shriver & Jacobson LLP.

COMMENT 1: Commentor suggests that the Department amend all of the compensatory benefit plan rules to make them inapplicable to Rule 701 plans in order to benefit California employees without compromising investor protection.

RESPONSE: The Department believes that the rules provide benefits to employees and investors, and that the proposed changes achieve a balance among the interests of all interested parties.

COMMENTOR: Letter and e-mail dated November 9, 2006, from Ellen Lieberman, Debevoise & Plimpton LLP.

COMMENT 1: Commentor states that in many instances the grant of bonus stock by an employer does not constitute a "sale" within the meaning of Section 2(a)(3) of the Securities Act of 1933. The Commentor requests that the Commissioner clarify that California will treat bonus stock granted to an employee without individual bargaining in the same manner as the SEC.

RESPONSE: The Department considers the grant of bonus stock a “sale” under Corporations Code Section 25017, where an employee has provided services as consideration for the stock.

COMMENT 2: Commentor states that Sections 260.140.41 and 260.140.42 provide that options granted and securities sold pursuant to a plan or agreement must provide for all of the provisions thereafter enumerated. Commentor suggests that the enumerated provisions and any other California requirements for compensatory benefit plans under California blue sky law be limited in application to securities granted or sold to employees or other eligible participants who are offered or purchase securities in this state.

RESPONSE: The provisions of Sections 260.140.41 and 260.140.42 are only applicable to offers or sales made in this state, as defined in Section 25008 of the Corporations Code. However, for offers or sales made pursuant to a compensatory benefit plan, the plan must be consistent with any minimum requirements set forth in the rules. Issuers that do not want all employees to be within the minimum requirements of the rules may structure their transactions accordingly, such as having a plan in compliance with the California requirements for securities offered in California.

COMMENT 3: Commentor states that with respect to repurchase rights in Section 260.140.8(b)(4)(ii), the provisions should include all of the entities named in Rule 701 (i.e., "an officer, director, manager, advisor or consultant of the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parents").

RESPONSE: The Department concurs, and this change has been incorporated into the regulations.

COMMENT 4: Commentor states that the Corporations Commissioner might consider whether references to general partners and trustees might be helpful for inclusion into Sections 260.140.41 and 260.140.42, in the context of qualification of securities.

RESPONSE: The Department concurs, and this change has been incorporated into the regulations.

COMMENT 5: Commentor suggests that the scope of eligible persons in Sections 260.140.41 and 260.140.42 be further modified to clarify that it includes former employees, directors, officers, consultants and advisors, consistent with Rule 701. Commentor further suggests the language specify that the term “employee” includes insurance agents who are exclusive agents of the issuer, its subsidiaries or parents, or derive more than 50% of their annual income from those entities.

RESPONSE: The Department does not believe it is necessary to include former employees, et al., in the scope of eligible persons under the California rules, since Rule 701 requires that these persons be employed at the time of the offer of the securities. Since California considers all transactions after the grant of options and/or purchase rights to be included within the exemption or qualification of the options or purchase rights, the subsequent employment status of the grantee will not impact the applicability of the rules. The Department does not believe it is necessary to further define the term “employee” because the additional language added by this rulemaking action includes insurance agents who are “employees” for purposes of Rule 701, and Rule 701 provides that the term “employee” includes insurance agents who are exclusive agents of the issuer, its subsidiaries or parents, or derive more than 50% of their annual income from those entities.

COMMENT 6: Commentor suggests that subdivision (e) of Section 260.104.41 may be unnecessary. This subdivision provides that options for terminated employees will terminate on the earlier of the option expiration date, 30 days from the date of termination, or 6 months from the date of termination if caused by death or disability. Commentor suggests that the investor benefits from California’s micromanaging option exercise periods for terminated employees are questionable, and there is not a sufficient rationale or justification to retain the provision. Commentor further suggests that compliance may result in unfavorable tax results to participants of incentive stock option plans. Under Section 423 of the Internal Revenue Code, options must be exercised within 3 months of termination of employment to receive favorable tax treatment. The California six-month requirement will result in exercise after three months, and thus less favorable tax treatment for employees. Certain other options granted at a discount to market value may be subject to federal tax penalties if their terms extend for more than 2 ½ months after the end of the year of termination, a distinct issue if the termination occurs towards the end of the year.

RESPONSE: The Department believes that the rule provides flexibility for plan participants, who may exercise sooner to achieve more favorable tax treatment. There may be circumstances where an optionee is unable to exercise within 3 months, and is willing to take the resulting tax consequences.

COMMENT 7: Commentor states that the approval requirements in subdivision (g) of Section 260.104.41 and subdivision (e) of Section 260.140.42 are not justified on investor protection grounds and should be eliminated. If not eliminated, Commentor suggests that the provision be modified to permit approval prior to or within 12 months after grant of an option or issuance of a security in California,. Commentor further suggests that approval not be required at all for foreign private issuers, since the requirement is often not in line with the requirements in their home jurisdiction. Alternatively for foreign private issuers, Commentor suggests that the number of participating persons be determined with respect to any single plan or agreement, and increased from 35 to 100. Commentor suggests that the approval requirement is still a deterrent to companies that might otherwise establish their operations or expand their operations in this state, and creates an uneven playing field and disadvantage for the California workforce in that California employees may not be offered the same benefits as employees in other states.

RESPONSE: The Department believes that the provisions regarding shareholder approval are justified on investor protection grounds. The changes proposed by this rulemaking action eliminate the 15% maximum discount limitation for options or purchase rights granted to employees, and shareholders should be able to decide the extent to which they will have their shares diluted by the exercise of potentially bargain basement options.

However, the Department concurs with Commentor's suggestion that the rule allow for approval to be obtained within 12 months after the grant of an option, and the rule has been revised to reflect this change. While the Department has considered the suggestion to extend the foreign issuer approval requirement to more than 35 persons, the Department believes that this suggestion requires further study. A limitation of 35 persons has precedence in the small and limited offering exemptions, whereas an increase to 100 persons has no similar justification. In addition, blanket exclusion for foreign issuers may unjustifiably provide a benefit to foreign issuers not shared by all issuers.

COMMENTOR: Letter dated November 14, 2006, from Suzanne S. Graeser, Morrison & Foerster LLP.

COMMENT 1: Commentor suggests that the proposed text in Section 260.140.8(b)(4) should be removed in light of certain tax and accounting issues. Section 260.140.8(b)(4) sets forth provisions for repurchase rights that are presumptively reasonable upon termination of employment. Commentor indicates that the rule may result in less favorable tax treatment under Financial Accounting Statement 123(R) as a result of the failure of an employee to be subject to the risks and rewards of equity ownership. As an alternative to removing the section, Commentor recommends the time period for the repurchase right be extended to more than 6 months, such as 9 months.

RESPONSE: While the Department has considered the interplay between FAS 123(R) and its rule, the Department believes that the protections afforded by the rule outweigh burden of the potential for adverse tax treatment, and the issuer may avoid this tax treatment through the terms of the plan. The Department has extended the repurchase right to 6 months to provide an issuer greater flexibility in structuring a plan. However, the protections on the repurchase price afforded by the rule does not allow an employee to be subject to the risks and rewards of equity ownership for purposes of FAS 123(R), and therefore changing the time period to more than 6 months won't achieve a different tax treatment. Nevertheless, the Department will review the impact of this rule on permit applications to determine whether additional changes are warranted in the future.

COMMENT 2: Commentor suggests that the proposed text in Section 260.140.8(b)(4)(ii) be deleted, because it would be inconsistent to free options and restricted stock pursuant to Corporations Code Section 25102(o) plans from a minimum vesting schedule but to continue to impose a minimum vesting schedule for restricted stock outside of Section 25102(o).

RESPONSE: While the Department has considered whether different treatment is appropriate and warranted, the Department believes that the different treatment is consistent with the SEC. In particular, securities offered pursuant to compensatory benefit plans meeting the requirements of Rule 701 are exempt from registration, but reporting companies may not rely upon the exemption. Similarly, securities offerings meeting the requirements of Rule 701 may rely on the exemption in Corporations Code Section 25102(o), but reporting companies may not. Nevertheless, the Department will review the impact of this rule on permit applications to determine whether additional changes are warranted in the future.

COMMENTOR: Letter via e-mail dated December 7, 2006, from Andrew D. Brooks on behalf of the State Regulation of Securities Committee of the Section of Business Law of the American Bar Association.

COMMENT 1: Commentor suggests that the Commissioner should consider clarifying that California will treat bonus stock in the same manner as it is treated by the SEC. The SEC provides that where bonus stock is granted to a broad class of employees without individual bargaining, it is not a "sale."

RESPONSE: A similar comment has been addressed above. The Department does not believe that securities issued under a bonus plan should be excluded from the protections set forth in the compensatory benefit plan rules.

COMMENT 2: Commentor requests that the Department clarify that the compensatory benefit plan rules are limited in application to offers or sales of securities issued only to California participants.

RESPONSE: A similar comment has been addressed above.

COMMENT 3: Commentor suggests that Section 260.140.8(b)(4)(ii) be amended to allow an issuer to place additional restrictions on repurchase rights for certain eligible persons specified in Rule 701, and include general partners and trustees (where the issuer is a business trust).

RESPONSE: A similar comment has been addressed above.

COMMENT 4: Commentor suggests that the proposed changes to Sections 260.140.41 and 260.140.42 be further modified to clarify that the eligible persons include insurance agents as set forth in Rule 701.

RESPONSE: As discussed above, the Department believes this has been accomplished by the language incorporating the insurance agents who are employees for purposes of Rule 701.

COMMENT 5: Commentor further suggests that the Department consider whether references to general partners and trustees might be helpful in the context of qualification of securities.

RESPONSE: As discussed above, this change has been incorporated.

COMMENT 6: Commentor suggests that subdivision (e) of Section 260.140.41 may be unnecessary, and may result in unfavorable tax results to plan participants.

RESPONSE: A similar comment has been addressed above.

COMMENT 7: Commentor suggests that the approval requirements in subdivision

(g) of Section 260.140.41 and subdivision (e) of Section 260.140.42 should be permitted both prior to and within 12 months after grant of an option or issuance of a security in California.

RESPONSE: As discussed above, this change has been incorporated into the rule.

COMMENT 8: Commentor suggests that the approval requirement in Sections 260.140.41 and 260.140.42 should not be required at all for foreign private issuers, because such requirements are often in conflict with requirements in their home jurisdictions. Commentor further suggests that the number of participating persons should be determined with respect to any single plan or agreement, and the number of California participants increased from 35 to 100.

RESPONSE: A similar comment has been addressed above.

COMMENTOR: E-mail dated December 13, 2006, from Tahir J. Naim, Fenwick & West LLP

COMMENT 1: Commentor suggests that under Internal Revenue Code Section 409A, one way to avoid treatment of a stock option as a form of deferred compensation is to set the exercise price no less than the fair market value on the date of grant. In practice this should eliminate the grant of discounted stock options.

RESPONSE: No response necessary.

COMMENT 2: Commentor suggests further amending Section 260.140.46 to assist publicly-traded companies that become subject to the compensatory benefit plan regulations as a result of being delisted from a national securities exchange. In particular, Commentor suggests allowing the ability to suspend the annual delivery requirement where companies are delayed in preparing federally-required financial filings due to accounting imbroglios.

RESPONSE: The Department's experience with filings by delisted publicly-traded companies does not indicate that this is a problem. Section 260.140.46 requires annual financial statements, but does not require audited financial statements. Nevertheless, the Department will study this issue further to determine whether a change is necessary in the future.

COMMENT 3: Commentor suggests that the Department clarify that public companies with S-8s on file may transfer options or purchase rights in the same manner as permitted by Rule 701.

RESPONSE: The Department confirms that options or purchase rights may be transferred as permitted by Rule 701, regardless of whether the compensatory benefit plan is in compliance with Rule 701.

COMMENTOR: Letter dated December 15, 2006, from Ann M. Coons, on behalf of the Business and Corporations Law Section of the Los Angeles County Bar Association.

COMMENT 1: Commentor states that the Executive Committee of the Business and Corporations Law Section of the Los Angeles County Bar Association is in agreement with the Commissioner that the proposed amendments would achieve a greater degree of uniformity and consistency between California regulations related to compensatory benefit plans and the regulations of other states and the federal securities law.

RESPONSE: No response necessary.

COMMENTOR: E-mailed letter dated December 18, 2006, from Michael A. Occhiolini on behalf of the Corporations Committee, Business Law Section of the State Bar of California.

COMMENT 1: Commentor indicates that the Corporations Committee of the Business Law Section of the State Bar of California supports the proposed amendments with a suggested modification to Sections 260.140.45(c) and 260.140.46 to include registered domestic partners in the definition of "family member."

RESPONSE: The Department concurs, and this change was incorporated in the amendments.

COMMENT 2: Commentor indicates that in Section 260.140.42 the term "Bonus Plans" in the title is not defined under the proposed amendments and the term "Bonus Plans" should either be clarified or deleted.

RESPONSE: The term "bonus plan" is used within Rule 701, and the Department intends it to have the same meaning. While the Department does not believe further clarification is necessary at this time, the Department will continue to consider whether additional clarification would be beneficial.

COMMENT 3: Commentor states that in Sections 260.140.42(f) and 260.140.42(d) the ten year maximum plan requirement should be eliminated because there is no similar requirement under Rule 701, and there should not be a statutory maximum time period requirement for benefit plans.

RESPONSE: As amended, the rules require that options or purchase rights be granted within 10 years from the date of adoption or approval of the shareholders, whichever is earlier. This provision is intended to protect the interests of other shareholders, and prevent an "overhang" of potential options that could be granted forever. Therefore, the Department does not believe a change to the rule is necessary.

COMMENT 4: Commentor recommends the removal of Section 260.140.8(b)(4) because the requirement that the right to repurchase shares within 90 days is inconsistent with the requirements under Financial Accounting Statement 123(R). An issuer and an option grantee should be able to determine an appropriate exercise schedule that meets the requirements of each of the respective parties.

RESPONSE: A similar comment has been addressed above.

COMMENTOR: Letter and e-mail dated December 15, 2006, from Nelson D. Crandall, Enterprise Law Group, Inc.

COMMENT 1: Commentor states that Section 260.140.8(b)(1) states that a transfer restriction is presumptively reasonable if the provisions base the price at which the issuer or other holder may purchase the securities upon “an independent appraised value.” Appraisals can vary and many appraisers may include a substantial minority discount when preparing appraisals for estate planning purposes. Commentor suggests that the application of a minority discount is inappropriate in a compensatory plan. Commentor recommends the rule be amended to define the appraised value to be the value of the share upon sale of all assets for cash on a going-concern basis (or liquidation, if higher) less debts.

RESPONSE: While the Department recognizes the Commentor’s concern, this comment is outside the scope of this proposed rulemaking as it relates to limited offering restrictions. The Department will take this comment under consideration for future rulemaking.

COMMENT 2: Commentor states that the “fair market value” is a difficult concept when there is no market. The provisions in Section 260.140.8(b)(4) state that a repurchase right upon termination of employment is presumptively reasonable if the repurchase price is not less than the “fair market value” of the securities to be repurchased. Commentor suggests that the Department consider adding a provision to define the repurchase price when there is no active trading market for the securities being repurchased.

RESPONSE: The term “fair market value” has been amended to “fair value.” However, the Department believes it is unnecessary to define the term further at this time. Section 260.140.50 provides additional guidance with regard to valuing an offering.

COMMENT 3: Commentor states that in Section 260.140.41(b) the plan or agreement must prohibit transfer of the options except upon the death of the optionee. Commentor suggests that the Department consider adding the transfer of options to a revocable trust because a transfer to a revocable trust is not truly a transfer, since the transferor retains the right to take the asset back at any time. By allowing transfer of options to a revocable trust would make it easier for option holders to do ordinary estate planning.

RESPONSE: The Department has incorporated this change into the amendments.

COMMENTS RECEIVED DURING THE 15-DAY COMMENT PERIOD

The 15-day public comment period ended on March 9, 2007.

COMMENTOR: Facsimile transmission dated March 2, 2007, from David A. Thayer, Jackson Kelly, PLLC

COMMENT 1: Commentor states that many incentive stock option plans are written in order to ensure compliance with the incentive stock option provisions of Internal Revenue Code Section 422. Option plans complying with Section 422 are afforded favorable tax treatment for participants in these plans, as specified. Commentor suggests that many incentive stock option plans will technically not meet the requirements of proposed Section 260.140.46 due to the requirement that the options remain exercisable for a period of six months following death.

RESPONSE: Based upon the Department's review of Section 422, incentive stock options may be in compliance with both the Department's rules and the Internal Revenue Code, but participants may lose tax benefits if they exercise their options after 3 months in the case of death. Participants may avoid this consequence by exercising options within 3 months after death, without a change to the Department's rules.

COMMENTOR: E-mail dated March 8, 2007, from Peter W. Wardle on behalf of the Corporations Committee, Business Law Section of the State Bar of California.

COMMENT 1: Commentor states that the Corporations Committee of the Business Law Section of the State Bar of California supports the proposed amendments with suggested modifications to Section 260.140.45(c) to include registered domestic partners.

RESPONSE: This suggestion has been incorporated into the regulations.

COMMENT 2: Commentor recommends the elimination of the ten-year maximum plan requirement set forth in Sections 260.140.41(f) and 260.140.42(d) because there is no similar requirement under Rule 701, and there should not be a statutory maximum time period requirement for benefit plans.

RESPONSE: A similar comment has been addressed above.

COMMENT 3: Commentor suggests that, to provide for conformity with accounting requirements, Section 260.140.8(b)(4) should be removed or amended to provide for (1) a period of at least seven months with respect to presumptively reasonable repurchase rights and (2) a repurchase price based on the fair value at the time of repurchase, as opposed to the fair value at the time of the applicable employee's termination.

RESPONSE: A similar comment has been addressed above. As noted above, the Department will review the impact of this rule on permit applications to determine whether additional changes are warranted in the future.

COMMENTOR: E-mail dated March 8, 2007 from Tahir J. Naim, Fenwick & West LLP

COMMENT 1: Commentor suggested that the word “transferability” in Section 260.140.41(c) be replace with the word “transfer”.

RESPONSE: The Department has incorporated this suggestion into the regulations.

COMMENTS RECEIVED DURING THE SECOND 15-DAY COMMENT PERIOD

No public comments were received during the 15-day public comment period, which ended on April 2, 2007.

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