114TH CONGRESS
2d Session
HOUSE OF REPRESENTATIVES
REPORT
114–398

ENCOURAGING EMPLOYEE OWNERSHIP ACT OF 2015

JANUARY 28, 2016.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

R E P O R T

together with

MINORITY VIEWS

[To accompany H.R. 1675]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 1675) to direct the Securities and Exchange Commission to revise its rules so as to increase the threshold amount for requiring issuers to provide certain disclosures relating to compensatory benefit plans, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

Introduced by Representative Hultgren on March 26, 2015, H.R. 1675, the Encouraging Employee Ownership Act of 2015, amend Securities and Exchange Commission (SEC) Rule 701, originally adopted in 1988 under Section 3(b) of the Securities Act of 1933 (Securities Act) and last updated in 1999. Under current law, if an issuer sells, in the aggregate, more than $5 million of securities in any consecutive 12-month period, the issuer is required to provide additional disclosures to investors, such as risk factors, the plans under which offerings are made, and certain financial statements. H.R. 1675 requires the SEC to increase that threshold from $5 million to $10 million and index the amount for inflation every five years. Identical legislation has been introduced by Senators Pat Toomey and Mark Warner, and support for this effort to update Rule 701 can be found in the SEC's Government-Business Forum

on Small Business Capital Formation Final Reports for 2001, 2004, 2005, and 2013.

BACKGROUND AND NEED FOR LEGISLATION

In 1988, exercising its authority to grant exemptions, the SEC issued Rule 701 to allow private companies to sell securities to employees for compensatory purposes. In 1999, the SEC added disclosure requirements for sales exceeding $5 million in a 12-month period. SEC Rule 701 permits private companies to offer their own securities as part of written compensation agreements to employees, directors, general partners, trustees, officers, or certain consultants without having to comply with federal securities registration requirements. Rule 701 exempts sales offerings to employees for compensatory purposes from registration if total sales (not offerings) of stock during a twelve-month period do not exceed the greater of: (i) $1 million; (ii) 15% of the issuer's total assets; or (iii) 3.15% of all the outstanding securities of that class. Regardless of the formula elected, Rule 701 restricts the aggregate offering price of securities subject to outstanding offers and the amount sold in the preceding 12 months to no more than $5 million dollars.

In addition, the Jumpstart Our Business Startups (JOBS) Act (P.L. 112–106) contains a provision that updated Section 12(g) of the Securities Exchange Act of 1934 to amend the employee registration exemptions. These exemptions assist privately-held companies that want to provide their employees with the option to purchase the company's securities to increase employee ownership. To complement these changes to the 12(g) employee registration exemptions, Rule 701 should be updated by raising the $5 million threshold requirement because the disclosures make it more expensive for companies to compensate their employees with the company's stock. In addition, these disclosure requirements put private companies at risk of disclosing confidential financial information.

By providing greater relief from these disclosure requirements, H.R. 1675 allows the employees of privately-held businesses ranging from relatively new start-ups to mature companies to take full advantage of the JOBS Act 12(g) employee shareholder provisions. Increasing the Rule 701 threshold gives private companies more flexibility to reward and retain employees with a company's securities and permits private companies to keep valuable employees without having to use other methods to compensate them, such as borrowing money or selling securities. Updating Rule 701 could encourage companies to offer incentives to their employees, for example through deferred compensation arrangements.

In testimony at an April 29, 2015, Subcommittee on Capital Markets and Government Sponsored Enterprises hearing, Shane Kovacs, the Executive Vice President and Chief Executive Officer of PTC Therapeutics, Inc., testifying on behalf of the Biotechnology Industry Organization (BIO), noted that:

> For companies like PTC, biotech emerging growth companies, we're in a position where we need to attract talent. We need to attract talent from other companies that may be larger and better capitalized and able to compensate with cash compensation more than maybe we could afford as a small, growing company. And therefore, we have to incentivize employees with stock and options in the com-

> pany which has growth potential. And certainly as a private company or public company we need to do that. And for a private company I can imagine that raising the threshold from $5 million to $10 million in terms of the value that you're going give to employees, without having to put together some large disclosure statement on the company and all that incremental costs, I don't foresee that raising that bar from $5 million to $10 million would really be any real impact to the—putting the employees at risk. In fact, I would almost think the employees would applaud that because it would enable the companies to give more equity in the company to them in the form of compensation.

In a statement submitted for the record of the same hearing, John C. Patigan, Partner and Securities Practice Group Leader at Nixon Peabody, stated that the current disclosure requirements put companies at risk of disclosing highly sensitive business information:

> I believe, as do others who have commented about Rule 701, that providing these disclosures is a significant issue for many privately-held companies. In my view, any assertion that the enhanced disclosures are not burdensome or problematic is wrong. Many of those asserting that releasing such information is not a problem have never spent significant time in the business world and may not appreciate how damaging the release of highly confidential financial information to competitors by an employee or former employee could be for the company. Moreover, these exempt offerings under Rule 701 differ from a company's attempt to raise capital under SEC Regulation D or other private placement exemptions. This distinction is critical and suggests different approaches for exempt offerings under Rule 701 and capital-raising transactions, which is exactly what the SEC has recognized for years under Rule 701.

HEARINGS

The Committee on Financial Services' Subcommittee on Capital Markets and Government Sponsored Enterprises held a hearing examining matters relating to H.R. 1675 on April 29, 2015.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on May 20, 2015, and ordered H.R. 1675 to be reported favorably to the House without amendment by a recorded vote of 45 yeas to 15 nays (recorded vote no. FC–30), a quorum being present.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. An amendment offered by Representative Lynch was not agreed to by a recorded vote of 21 yeas to 39 nays (FC–29). The second and final recorded vote was on a motion by Chairman Hensarling to report the bill favor-

ably to the House without amendment. The motion was agreed to by a recorded vote of 45 yeas to 15 nays (Record vote no. FC–30), a quorum being present.

[Please see attached vote tallies.]

Record vote no. FC-29

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling		X		Ms. Waters (CA)	X		
Mr. King (NY)		X		Mrs. Maloney (NY)	X		
Mr. Royce		X		Ms. Velázquez	X		
Mr. Lucas		X		Mr. Sherman	X		
Mr. Garrett		X		Mr. Meeks	X		
Mr. Neugebauer		X		Mr. Capuano	X		
Mr. McHenry		X		Mr. Hinojosa	X		
Mr. Pearce		X		Mr. Clay	X		
Mr. Posey		X		Mr. Lynch	X		
Mr. Fitzpatrick		X		Mr. David Scott (GA)	X		
Mr. Westmoreland		X		Mr. Al Green (TX)	X		
Mr. Luetkemeyer		X		Mr. Cleaver	X		
Mr. Huizenga (MI)		X		Ms. Moore	X		
Mr. Duffy		X		Mr. Ellison	X		
Mr. Hurt (VA)		X		Mr. Perlmutter	X		
Mr. Stivers		X		Mr. Himes	X		
Mr. Fincher		X		Mr. Carney		X	
Mr. Stutzman		X		Ms. Sewell (AL)		X	
Mr. Mulvaney		X		Mr. Foster	X		
Mr. Hultgren		X		Mr. Kildee	X		
Mr. Ross		X		Mr. Murphy (FL)		X	
Mr. Pittenger		X		Mr. Delaney		X	
Mrs. Wagner		X		Ms. Sinema		X	
Mr. Barr		X		Mrs. Beatty	X		
Mr. Rothfus		X		Mr. Heck (WA)	X		
Mr. Messer		X		Mr. Vargas	X		
Mr. Schweikert		X					
Mr. Guinta		X					
Mr. Tipton		X					
Mr. Williams		X					
Mr. Poliquin		X					
Mrs. Love		X					
Mr. Hill		X					
Mr. Emmer		X					

Record vote no. FC-30

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Waters (CA)		X	
Mr. King (NY)	X			Mrs. Maloney (NY)		X	
Mr. Royce	X			Ms. Velázquez		X	
Mr. Lucas	X			Mr. Sherman	X		
Mr. Garrett	X			Mr. Meeks	X		
Mr. Neugebauer	X			Mr. Capuano		X	
Mr. McHenry	X			Mr. Hinojosa		X	
Mr. Pearce	X			Mr. Clay		X	
Mr. Posey	X			Mr. Lynch		X	
Mr. Fitzpatrick	X			Mr. David Scott (GA)		X	
Mr. Westmoreland	X			Mr. Al Green (TX)		X	
Mr. Luetkemeyer	X			Mr. Cleaver		X	
Mr. Huizenga (MI)	X			Ms. Moore		X	
Mr. Duffy	X			Mr. Ellison		X	
Mr. Hurt (VA)	X			Mr. Perlmutter	X		
Mr. Stivers	X			Mr. Himes	X		
Mr. Fincher	X			Mr. Carney	X		
Mr. Stutzman	X			Ms. Sewell (AL)	X		
Mr. Mulvaney	X			Mr. Foster	X		
Mr. Hultgren	X			Mr. Kildee		X	
Mr. Ross	X			Mr. Murphy (FL)	X		
Mr. Pittenger	X			Mr. Delaney	X		
Mrs. Wagner	X			Ms. Sinema	X		
Mr. Barr	X			Mrs. Beatty		X	
Mr. Rothfus	X			Mr. Heck (WA)	X		
Mr. Messer	X			Mr. Vargas		X	
Mr. Schweikert	X						
Mr. Guinta	X						
Mr. Tipton	X						
Mr. Williams	X						
Mr. Poliquin	X						
Mrs. Love	X						
Mr. Hill	X						
Mr. Emmer	X						

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 1675 will reduce the regulatory burden on private companies providing shares to employees for compensation by providing for an increase in the threshold for SEC Rule 701 from $5 million to $10 million and indexing such threshold for inflation every five years.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

COMMITTEE COST ESTIMATE

The Committee adopts as its own the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, June 19, 2015.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 1675, the Encouraging Employee Ownership Act of 2015.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contacts are Susan Willie and Ben Christopher.

Sincerely,

KEITH HALL.

Enclosure.

H.R. 1675—Encouraging Employee Ownership Act of 2015

Under current law, public companies must disclose certain information to investors if the value of securities issued by the company exceeds $5 million. H.R. 1675 would direct the Securities and Exchange Commission (SEC) to raise that amount from $5 million to $10 million and to adjust the threshold every five years for inflation.

CBO expects that implementing H.R. 1675 would require the SEC to issue new rules to adjust the disclosure threshold. Based on information from the SEC, CBO estimates that implementing H.R. 1675 would cost less than $500,000 over the 2016–2020 period. Under current law, the SEC is authorized to collect fees sufficient to offset its appropriation each year; therefore, we estimate that the net cost to the SEC would be negligible, assuming appropriation actions consistent with that authority. Enacting H.R. 1675 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

H.R. 1675 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budgets of state, local, or tribal governments.

This estimate was prepared by Susan Willie and Ben Christopher. The estimate was approved by Theresa Gullo, Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

The Committee adopts as its own the estimate of Federal mandates prepared by the Director of the Congressional Budget Office pursuant to section 423 of the Unfunded Mandates reform Act.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

H.R. 1675 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as defined in clause 9 of rule XXI.

DUPLICATION OF FEDERAL PROGRAMS

Pursuant to section 3(g) of H. Res. 5, 114th Cong. (2015), the Committee states that no provision of H.R. 1675 establishes or reauthorizes a program of the Federal Government known to be duplicative of another Federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, 114th Cong. (2015), the Committee states that H.R. 1675 contains one directed rulemaking.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Short title

This section cites H.R. 1675 as the "Encouraging Employee Ownership Act of 2015."

Section 2. Increased threshold for disclosures relating to compensatory benefit plans

This section requires the SEC, within 60 days, to amend Rule 701 to increase its threshold from $5 million to $10 million and index the amount for inflation every five years.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 1675 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the House of Representatives.

MINORITY VIEWS ON H.R. 1675

H.R. 1675 would revise SEC's Rule 701 by both raising and then indexing for inflation the permissible aggregate sales threshold of securities sold without certain disclosures to employees and other parties as part of their compensation from $5 million to $10 million. While this bill is a modest improvement from a similar bill that the Committee considered last year, which would have raised the threshold 400%, to $20 million, more fundamental concerns remain.

Currently, if a private company provides more than $5 million worth of compensation in the form of stock over a twelve month period, the company must make relatively simple disclosures to its employees, including two years of financial statements—which do not need to be audited—and information about the risks associated with investment in the securities. Such information is necessary for investors to fully understand the value of their stake in a company, and employees, who may be more susceptible to suggestion and coercion, deserve no less protection. In addition, to take advantage of the increased threshold under the bill, a company would have to have more than $34 million in total assets and requiring those companies to provide minimal disclosures cannot be seen as too burdensome.

Another concern is that the bill only encourages employees to own more of their employer's stock, rather than encouraging more employees to own their employer's stock. Therefore, the bill could expose employees to concentration risk in their retirement accounts. This is made worse by the fact that the JOBS Act made it easier for privately-held companies to remain private by, for example, exempting employees who receive stock as a result of a compensation plan from being counted as "holders of record." By allowing companies to stay private longer, if not forever, the bill would enable companies to encourage overinvestment by employees in a company that they cannot value and that may never permit them to sell, except back to the company.

Some proponents of the bill cite the fear of companies in disclosing such information to employees that confidential information could be leaked to competitors. While this is an understandable concern, non-disclosure agreements and similar confidentiality agreements already provide an effective mechanism to address it.

For all of these reasons, we oppose H.R. 1675.

MAXINE WATERS.
AL GREEN.
JOYCE BEATTY.
GWEN MOORE.
WM. LACY CLAY.
DAVID SCOTT.
KEITH ELLISON.
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