

## SEC ISSUES FINAL RULES FOR NEW SECTION 16 REPORTING REQUIREMENTS

As noted in our memorandum dated July 29, 2002, the Sarbanes-Oxley Act of 2002 (the “Act”) amended Section 16(a) of the Securities Exchange Act of 1934 (the “Exchange Act”) to require that all transactions in an issuer’s equity securities by executive officers, directors or 10 percent owners (collectively, “Insiders”) be reported on SEC Form 4 before the end of the second business day following the execution of the subject transaction.<sup>1</sup> On August 27, 2002, the SEC issued a release<sup>2</sup> adopting final rules for the new reporting requirements. The final rules are effective as of August 29, 2002, and will apply to all transactions that occur on or after that date.

Under the final rules, the following types of transactions must be reported on Form 4 within two business days: (i) all transactions that are not exempt from the short-swing profit disgorgement rules of Section 16(b) of the Exchange Act; (ii) all transactions between Insiders and the issuer that are exempt from Section 16(b) of the Exchange Act **by reason of Rule 16b-3**; and (iii) small acquisitions (i.e., \$10,000 or less in market value) **from the issuer**.

The rules contain exceptions for transactions effected under Rule 10b5-1(c) trading plans where the Insider does not choose the date of execution and for “discretionary transactions”<sup>3</sup> under 401(k) plans (and similar plans); such transactions must be reported within two business days of an Insider’s **receipt of notice** of execution of the trade from the broker, dealer or plan administrator (as applicable). If notice of these transactions is not given by the third day following the actual execution of the transaction, the transaction will be deemed to have occurred on such third day.

The final rules do **not** affect transactions previously reportable on Form 5 by reason of exemptions from Section 16(b) **other than** Rule 16b-3; such transactions continue to be reportable on Form 5 to the same extent as before. Also, all transactions that were previously

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<sup>1</sup> Previously, Forms 4 were due by the 10<sup>th</sup> day of the month following a month in which one or more reportable transactions had occurred. Under the new rules, Insiders may have to file more than one Form 4 in a given month.

<sup>2</sup> SEC Release No. 34-46421 (August 27, 2002).

<sup>3</sup> A “discretionary transaction” is a participant-directed intra-plan transfer into (or out of) a company stock fund, or a participant-directed cash distribution from such fund, under a 401(k) or other participant-directed retirement plan. The term does not include distributions made in connection with the plan participant’s death, disability, retirement or termination of employment, distributions required under IRS regulations, or acquisitions made pursuant to payroll reduction elections.

exempt from reporting under Section 16(a) will continue to be so exempt, and are not affected by the final rules.

The SEC has revised Form 4 and intends to publish new forms as soon as possible. Prior to publication, the current version of Form 4 should be used by Insiders, with certain modifications described below.

### **The Two-Business Day Reporting Requirement**

Under the final rules, all transactions that are not exempt from Section 16(b) of the Exchange Act must be reported within two business days on Form 4. Transactions of this type include open market and private purchases and sales, and transactions between an issuer and an Insider that do not qualify for a specific exemption from Section 16(b) (e.g., a sale of stock or warrants to a 10 percent owner).

The final rules also amend Rule 16a-3 to eliminate deferred reporting on Form 5 for transactions that are exempt from Section 16(b) **by reason of Rule 16b-3**. As a result, the following types of transactions, which previously could be reported on Form 5, must now be reported within two business days on Form 4: (i) grants, awards and other acquisitions from the issuer exempt from Section 16(b) under Rule 16b-3(d), such as stock option and restricted stock grants, stock option exercises, and acquisitions of stock units under non-qualified deferred compensation plans; (ii) dispositions to the issuer exempt from Section 16(b) under Rule 16b-3(e), such as the surrender of shares to pay for the exercise price of an option, the withholding of shares by the issuer to satisfy tax withholding amounts, the surrender of options in an option repricing, and any sale of shares to the issuer; and (iii) “discretionary transactions” under 401(k) plans (and similar plans) exempt from Section 16(b) under Rule 16b-3(f).

The final rules modify the two-day reporting requirement for two types of transactions: (i) transactions under Rule 10b5-1(c) trading plans, where the Insider has not selected the date of execution, and therefore cannot control, and may not be able to predict, when the transaction will occur<sup>4</sup>; and (ii) discretionary transactions under 401(k) plans (and similar plans), where the logistics of plan administration may prevent an Insider from selecting the date of execution. For these transactions, the transaction date is deemed to be the date on which the broker, dealer or plan administrator (as applicable) notifies the Insider of execution of the transaction, so long as the notification date is not later than the third business day following the actual transaction date. The Insider must then report the transaction on Form 4 before the end of the second business day following the deemed date of execution. It is the Insider’s responsibility to make suitable arrangements with the broker, dealer or plan administrator to provide for notice within the applicable three-day period. If timely notice is **not** provided, the transaction is deemed to occur

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<sup>4</sup> A Rule 10b5-1 plan that requires sales on a particular date, such as the first trading day of each month, would not qualify for this exception, and a transaction effected under such a plan would therefore have to be reported by the end of the second business day following actual execution of the transaction.

on the third business day following the actual transaction date, and reporting is due within two business days thereafter. For example, if the Insider receives notice on the fourth business day following the actual transaction date, reporting would be due by the next business day.

The final rules do not affect transactions that are **completely exempt from reporting under Section 16(a)**, such as (i) changes in the form of ownership that do not affect the Insider's pecuniary interest in the shares (e.g., changes from direct to indirect ownership); (ii) acquisitions under "tax-conditioned plans" that satisfy the requirements of Rule 16b-3(c), such as allocations to participant accounts under employee stock ownership plans, payroll deductions credited to company stock funds under 401(k) plans, and purchases under employee stock purchase plans that satisfy the requirements of Section 423 of the Internal Revenue Code; (iii) expirations of stock options, and forfeitures of stock options or restricted stock; and (iv) certain transactions occurring after termination of Insider status (i.e., provided the Insider did not effect a matchable transaction under Section 16(b) during the previous six months and while still an Insider). In addition, the final rules do not affect deferred reporting on Form 5 for transactions exempt from Section 16(b) other than by reason of Rule 16b-3, such as acquisitions or dispositions of shares through gifts or inheritance, or "small acquisitions" meeting the requirements of Rule 16a-6. The only exception is for small acquisitions **from the issuer** (or an employee benefit plan of the issuer), which are reportable within two business days on Form 4.

#### **Filing Form 4 Prior to Publication of the Revised Form**

The SEC has amended Form 4 to conform to the final rules, and intends to publish the new forms as soon as possible. Until the new forms are available, Insiders should continue to use current Form 4, but should modify box 4 to state the month, day and year of the subject transaction. When using current Form 4 to report a transaction with a "deemed" execution date (i.e., "discretionary transactions" and transactions under Rule 10b5-1(c) trading plans), an Insider should include an asterisk next to the trade date in the transaction date column, and add a footnote to disclose the deemed execution date.

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If you wish to obtain additional information regarding the foregoing, please contact Frank A. Daniele (212-728-8216), Michael A. Schwartz (212-728-8267) or David E. Rubinsky (212-728-8635), or the partner who regularly works with you.

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August 29, 2002