

**SEC PROPOSES RULES ON INSIDER TRADING DURING
PENSION PLAN BLACKOUT PERIODS**

The Securities and Exchange Commission (“SEC”) recently proposed rules¹ clarifying the application of Section 306(a) of the Sarbanes-Oxley Act of 2002 (the “Act”), which would prohibit an issuer’s directors and executive officers from trading in equity securities of the issuer during a pension plan blackout period when other plan participants or beneficiaries are unable to engage in equity securities transactions. The rule, which is termed Regulation “Blackout Trading Restriction” (“BTR”), becomes effective January 26, 2003. The SEC has requested comments on Regulation BTR on or before December 16, 2002.

Commentary

- The proposal contains numerous requests for public comment and will likely require significant clarification. As a result, the final rules may differ significantly from the proposal.

Issuers and Persons Subject to the Trading Prohibition

The trading prohibition of Section 306(a) applies to directors and executive officers of “issuers,” which are defined in the Securities Exchange Act of 1934 (the “Exchange Act”) as companies (i) with securities registered under Section 12 of the Exchange Act, (ii) required to file reports under Section 15(d) of the Exchange Act, or (iii) that have filed a registration statement that is not yet effective under the Securities Act of 1933. Foreign private issuers,² banks and savings associations, small business issuers, and registered investment companies³ meeting the definition of issuer are also subject to the trading prohibition. In defining “directors,” Regulation BTR adopts the definition of Section 3(a)7 of the Exchange Act (i.e., individuals who, regardless of title, function as directors). The term “executive officer” would mean any person who is an “officer” for purposes of Section 16 of the Exchange Act (generally, executive officers and other individuals that engage in policymaking functions).

¹ SEC Release No. 34-46778 (November 6, 2002).

² The prohibition would only apply to foreign private issuers if the blackout were to affect at least 50% of the pension plan beneficiaries located within the United States and such persons represented more than 15% of all participants and beneficiaries under all plans of the issuer.

³ Most registered investment companies do not have employees or employee pension plans; they therefore would typically not be subject to the prohibition.

For foreign private issuers, a “director” would mean any director who is also a management employee of the issuer, and executive officer would mean any of the principal executive, financial and accounting officers.

Transactions Subject to the Trading Prohibition

For purposes of Regulation BTR, the term “equity security of the issuer” includes any equity security or derivative security relating to an issuer, whether or not issued by the issuer.⁴

Regulation BTR would prohibit (i) any acquisition of equity securities of an issuer during a pension plan blackout period if the equity securities were acquired in connection with service or employment as a director or an executive officer, and (ii) any disposition of equity securities during a blackout period if the securities were acquired in connection with service or employment as a director or executive officer. An equity security is considered to have been *acquired* in connection with service or employment as a director or an executive officer if the security was acquired:

- pursuant to any plan, contract, authorization or arrangement whereby the director or executive officer received equity securities in exchange for performance of services or employment with the issuer, or its parent, a subsidiary or an affiliate;
- as a result of the individual’s status as a director or executive officer, regardless of whether or not the securities were acquired through arm’s-length commercial transactions;
- to satisfy requirements that the individual be a security holder of the issuer to serve on the issuer’s board of directors or to be an executive officer; or
- before the individual became an executive officer or director, if acquired as an inducement to his or her service to the issuer, or as a result of a merger, consolidation or other acquisition transaction involving the issuer.

Securities acquired by an individual prior to becoming a director or an executive officer are exempt from this prohibition. However, equity securities acquired by a director or executive officer before a company constituted an “issuer” under the above definition would remain subject to Regulation BTR, as would securities acquired before the effective date of the Act.

⁴ For foreign issuers the prohibition also applies to depositary shares evidenced by American Depositary Receipts.

The trading prohibition encompasses all transactions, both direct and indirect, so that any transaction involving securities in which the executive officer or director has a “pecuniary interest”⁵ will come under Regulation BTR.

Services or Employment Presumption

In an attempt to eliminate the need to trace the source of securities sold, the rules establish an *irrebuttable presumption* that any equity securities sold or otherwise transferred during a blackout period were acquired in connection with service or employment as a director or an executive officer to the extent the person holds *any* such securities, regardless of the source of the disposed securities.⁶

Commentary

- The irrebuttable presumption is intended to limit ambiguity as to whether a transaction made during a blackout period is subject to the prohibition. However, the presumption would effectively preclude most executive officers and directors from selling any equity securities of the issuer during a blackout period.

Exempt Transactions

The following transactions would be exempt from the trading prohibition:

- acquisitions of equity securities under dividend or interest reinvestment plans, if the plan is broad-based and operates on substantially the same terms for all plan participants;
- purchases or sales of equity securities pursuant to a contract, instruction or written plan satisfying the affirmative defense conditions of Exchange Act Rule 10b5-1(c), provided that the director or executive officer did not have knowledge of an impending blackout at the time the contract or plan was entered into, or at the time the instruction was given, as applicable;⁷

⁵ “Pecuniary interest” would be defined by reference to Section 16 of the Exchange Act and would include indirect interests held by immediate family members, or interests held through a partnership, corporation, limited liability company or trust, as determined in accordance with rules promulgated under Section 16.

⁶ The rules would limit the effect of the presumption by allowing for equity securities held by a director or executive officer that were acquired in connection with employment to count only against a single disposition transaction during that blackout period. For example, if an executive officer owns 1,000 shares of issuer stock, of which 250 were acquired in connection with service or employment, any shares sold during a blackout period up to 250 would be considered to have been acquired in connection with employment. Sales of additional shares would not be prohibited by Regulation BTR.

⁷ 17 CFR 240.10b5-1(c).

- purchases or sales of equity securities pursuant to certain "tax-conditioned" plans,⁸ other than discretionary transactions, such as those involving an intra-plan transfer or a cash distribution funded by a volitional disposition of an issuer equity security; and
- increases or decreases in the number of equity securities held as a result of a stock split or stock dividend applying equally to all equity securities of that class.

Commentary

- Under the proposed rules, executive officers and directors of foreign private issuers generally would not be able to avail themselves of the tax-conditioned plan exemption because the plans under which the shares are acquired would not normally satisfy the requirements of tax-conditioned plans under Section 16 of the Exchange Act, including certain Internal Revenue Code requirements.
- Although discretionary transactions would not be exempt solely because they are made pursuant to a tax-conditioned plan, they could still be exempt if made pursuant to an advance election satisfying the affirmative defense under Rule 10b5-1(c).

Determining the Blackout Period

The blackout period is any period of three consecutive business days when at least fifty percent (50%) of the participants or beneficiaries under all the individual account plans⁹ maintained by the issuer are prevented from commencing any transactions in equity securities of the issuer. This would include the suspension of transaction rights of individuals who are participants in 401(k) plans, profit sharing and savings plans, stock bonus plans and money purchase pension plans, as well as certain non-qualified deferred compensation plans, in each case where the individual holds *or could hold* equity securities of the issuer. For example a 401(k) plan with an "open brokerage window" permitting investment in any publicly traded company would have to be included.

When evaluating the 50% threshold, the rules would distinguish between domestic issuers and foreign issuers, as well as plan participants located in the United States and those abroad. For domestic issuers, the 50% threshold is triggered if at least 50% of the plan participants located in the United States and its territories are subject to a blackout. For foreign private issuers, the prohibition will only be triggered if the individuals subject to the blackout constitute at least 50%

⁸ Including Qualified Plans, Excess Benefit Plans, and Stock Purchase Plans as defined in Exchange Act Rule 16b-3(b).

⁹ An individual account plan is defined as a pension plan which provides for an individual account for each participant and for benefits based solely upon the amount contributed to the participant's account, and any income, expenses, gains and losses allocated to such participant's account.

of the plan participants located in the United States and more than 15% of the plan participants worldwide.

A suspension of trading under a plan would not be considered a blackout period in two instances:

- When it is a regularly scheduled suspension of transaction rights that is incorporated into the individual account plan and is timely disclosed to the employees prior to or soon after becoming plan participants.
- When it is done for the purpose of consolidating plans following a merger or similar transaction and its principal purpose is to allow individuals to become part of the plan or remove themselves from the plan.

Commentary

- Notice of a regularly scheduled blackout period would be considered timely if made within 30 days prior to or after enrollment in the plan. Notice could be made by including information about the blackout in the plan documentation. As proposed, proper notice must be given to *every* plan participant in order for the exception to apply, although the SEC is soliciting comment as to whether this requirement is reasonable.

Consequences for Violations of the Prohibition

According to the proposed rules, an executive officer or director who violates the statutory trading prohibition would be subject both to civil penalties levied by the SEC and private actions brought by the issuer or, if the issuer fails to bring or prosecute the suit within 60 days, by any holder of an equity security of the issuer.¹⁰ In a private action the executive officer or director will be held strictly liable and any profit realized from the transaction is recoverable by the issuer.¹¹ However, no action may be brought more than two years after the date when the profits were realized.

Notice to Executive Officers and Directors and the SEC of the Trading Prohibition Period

The proposed rules would require all issuers to provide notice to all executive officers and directors who are subject to the prohibition at least 15 calendar days prior to the start of a blackout period. If it is not feasible to provide this notice because of unforeseeable

¹⁰ Unlike Section 16 of the Exchange Act, directors and executive officers of foreign private issuers would be subject to private actions for profit recovery under Section 306(a) of the Act, although the SEC is soliciting comment as to whether foreign private issuers should be exempt from private actions under Section 306(a).

¹¹ The SEC did not propose a specific method for calculating profits from acquisitions and dispositions of equity securities, but solicited comment on the matter.

circumstances, the issuer would be excused if it makes a written determination that compliance with the 15-day rule was not possible, and notice was given as soon as reasonably practicable.

In addition to notification to those subject to the prohibition, issuers would need to file a Form 8-K disclosing the imposition of any blackout period. Because foreign private issuers are not required to file reports on Form 8-K, the SEC has proposed changing Forms 20-F and 40-F to require foreign private issuers to file all notices made available to executive officers and directors.

Transition

Section 306(a) of the Act and Regulation BTR will take effect on January 26, 2003. For all blackout periods commencing between January 26 and February 10, 2003, issuers should provide notice as soon as possible to the SEC and to the executive officers and directors. Companies should determine if a non-exempt blackout period will be taking place during this time and prepare the proper notice forms.

* * * * *

If you wish to obtain additional information regarding the proposed rules or assistance in developing a program to help ensure compliance, please contact Frank A. Daniele (212-728-8216, fdaniele@willkie.com), Peter J. Allman (212-728-8101, pallman@willkie.com), T.J. Duane (212-728-8631, tduane@willkie.com), or the partner who regularly works with you.

Willkie Farr & Gallagher is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000, and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

November 18, 2002