

Securities Law Update

SEC Adopts Accelerated Section 16 Reporting Rules

Last month's Securities Law Update summarized the Sarbanes-Oxley Act of 2002 (the "Act"). The Act, applicable to foreign and domestic issuers, represents sweeping legislation intended to increase corporate accountability and restore confidence in U.S. capital markets. Many of the Act's provisions became effective upon enactment on July 30, 2002, such as the requirement that chief executive and chief financial officers certify the issuer's periodic reports. Other provisions are to become effective in the near future, as the Securities and Exchange Commission (the "Commission") or other bodies adopt implementing rules. On August 29, 2002, Section 403 of the Act, amending Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act"), became effective.

This Securities Law Update summarizes Section 403 of the Act and the rules related thereto recently released by the Commission.¹ It has been prepared solely for informational purposes. Issuers are urged to contact a member of the Corporate Department of Honigman Miller Schwartz and Cohn LLP to consider how the Commission's new rules affect them.

¹ While the Act applies to foreign and domestic issuers, Section 16 of the Exchange Act does not apply to foreign private issuers, as defined in Rule 3b-4. Pursuant to Rule 3a12-3, securities registered by foreign private issuers are exempt from Section 16 of the Exchange Act.

A. Accelerated Reporting under the Act.

Before August 29, 2002, Section 16(a) of the Exchange Act required directors, officers, and 10% equity holders of issuers with securities registered under Section 12 of the Exchange Act to report changes of ownership of equity securities of such issuer within 10 days following the end of the month in which the transaction occurred. Effective August 29, 2002, Section 403(a) of the Act amended the reporting requirements of directors, officers, and 10% equity holders of public companies under Section 16(a), accelerating the time frame for reporting change of ownership transactions by such persons. Specifically, Section 403(a) amends Section 16(a) to provide that statements required under Section 16(a) shall be filed, "if there has been a change in such ownership, or if such person [directors, officers, and 10% equity holders] shall have purchased or sold a security-based swap agreement . . . involving such equity security, before the end of the second business day following the day on which the subject transaction has been executed, or at such other time as the Commission shall establish, by rule, in any case in which the Commission determines that such 2-day period is not feasible."

B. The Commission's Rules.

On August 27, 2002, the Commission adopted final rules (effective August 29, 2002) intended to implement Section 403(a) of the Act. In short, the rules generally provide that: (1) Form 4s reporting transactions occurring on or after August 29, 2002, must be filed by the close of business (5:30 p.m. eastern time) on the second business day after the execution date of transactions reportable on that form; (2) the two business day reporting requirement is "not feasible" for two categories of transactions (Rule 10b5-1(c) plan transactions and Discretionary Transactions under employee benefit plans, in each case where the reporting person does not select the date of execution); and, therefore, a deemed execution date shall determine the time at which the two business day filing period begins to run; (3) transactions between officers and directors and the issuer exempt from short-swing profit recovery by Rule 16b-3 previously reportable on Form 5 will be required to be reported within two business days on Form 4; and (4) the Section 16(a) forms shall be amended to conform all references to the accelerated filing deadline and to reflect that Form 4 is no longer a monthly form. Transactions previously reportable on Form 5 that are not covered by the amendments will remain reportable on Form 5, and transactions previously exempt from Section 16(a) reporting will remain exempt.

1. Instances in which Two Day Reporting is Not Feasible. Recognizing that compliance with the two business day reporting requirement may not be feasible in certain instances, Congress granted the Commission the authority to establish a different deadline applicable to such transactions. The Commission has identified two instances where the two

business day reporting requirement is not feasible:

- **10b5-1 Plans.** Transactions pursuant to a contract, instruction or written plan for the purchase or sale of equity securities that satisfies the affirmative defense conditions of Rule 10b5-1(c) where the reporting person does not select the date of execution; and
- **Discretionary Transactions.** Transactions pursuant to an employee benefit plan that are within the definition of "Discretionary Transaction" under Rule 16b-3(b) where the reporting person does not select the date of execution.

While the two business day reporting requirement under Section 16(a) applies to these transactions, the Commission has defined the date of execution of such transactions as the day the broker, dealer or plan administrator, as applicable, notifies the reporting person of the execution of the transaction, so long as the notification date is not later than the third business day following the trade date. If the reporting person does not receive notification within three business days of the trade date, the third business day following the trade date is deemed the date of execution for the purposes of calculating the two business day reporting deadline.

2. Grants, Issuances, Awards, Acquisitions, and Distributions. Prior to the effective date of Section 403 of the Act, transactions involving grants, issuances, awards and other acquisitions of securities from the issuer, dispositions to the issuer, and Discretionary Transactions pursuant to employee benefit plans exempt from short-swing liability under Section 16(b) of the

Exchange Act pursuant to Rule 16b-3(d), (e) or (f) were reportable on a deferred basis on Form 5. However, these transactions must now be reported on Form 4, within two business days of the date of execution of the transaction. Consequently, transactions involving certain derivative securities, such as grants, exercises, cancellations, re-grants and repricing of stock options, will be reportable on Form 4 within the two business day reporting deadline. Other transactions exempt from Section 16(b) of the Exchange Act, such as gifts and transfers by inheritance reported on Form 5 prior to the Act, will continue to be reported on Form 5 within 45 days of the end of the issuer's fiscal year or, voluntarily earlier on Form 4.

3. Small Acquisitions. The Commission has also amended its rules with respect to small acquisitions under Rule 16a-6. Prior to the amendment, if a transaction met the conditions of Rule 16a-6, such transaction was eligible for deferred reporting on Form 5. However, pursuant to Rule 16a-6, as amended, acquisitions from the issuer or an employee benefit plan sponsored by the issuer are specifically excluded from Rule 16a-6. As a result, acquisitions from the issuer or an employee benefit plan sponsored by the issuer must be reported on Form 4 within the two business day reporting deadline. Additionally, Rule 16a-6 was also amended to provide that the two business day reporting requirement will apply in the event that an acquisition previously qualifying under Rule 16a-6 ceases to meet the conditions of that rule.

4. Reporting Exemptions. Transactions previously exempt from Section 16(a) reporting will remain exempt. For example, the following transactions continue to be exempt from the reporting requirements of Section 16 of the Exchange

Act: (1) acquisitions of securities resulting from the reinvestment of dividends or interest on securities of the issuer if the acquisition is made pursuant to a plan providing for regular reinvestment of dividends or interest and the plan provides for broad-based participation, does not discriminate in favor of employees of the issuer, and operates on substantially the same terms for all plan participants; and (2) any transaction (other than a Discretionary Transaction) pursuant to specified tax conditioned plans, including employee benefit plans that satisfy the coverage and participation requirements of Section 410 and 401(a)(26) of the Internal Revenue Code or Section 423(b)(3) and (5) or Section 410 of the Internal Revenue Code, and certain excess benefit plans.

5. Conforming Amendments to Forms 4 and 5. The Commission conformed Form 4 (including its instructions) to reflect the statutory and rule changes. Specifically, the holdings columns now report holdings following reported transactions, rather than month-end holdings, and Form 5 has been amended to reflect the fact that certain transactions are no longer reportable on Form 5 on a deferred basis. In addition, a new column has been added to the amended Form 4 to require reporting of deemed execution dates as computed pursuant to Rule 16a-3(g), if applicable, so as to allow the Commission to determine whether the Form 4 was timely filed. The Forms are available at <http://www.sec.gov/about/forms>.

6. Application of the Amended Rules. Section 403 of the Act became effective on August 29, 2002. The Commission's amended rules apply to transactions occurring on or after August 29, 2002. Therefore, transactions executed before August 29, 2002 were allowed to be

reported as required pursuant to the former rules.

on time when the filer is not available to sign the report.

C. Compliance.

Although the responsibility of reporting rests with the reporting person, issuers should consider implementing procedures to coordinate the receipt of information from its directors, officers, and 10% equity holders before they engage in potentially reportable transactions in order to ensure compliance with the accelerated reporting deadline. To that end, we suggest the following:

- inform officers, directors and 10% equity holders of the new filing deadlines;
- coordinate pre-clearance and reporting of transactions with brokers, dealers and plan administrators, especially regarding trade dates of Rule 10b5-1 plan transactions and Discretionary Transactions;
- amend Section 16 procedures to require pre-clearance of transactions involving the issuer's securities, if not already a part of the issuer's procedures;
- prepare and file the Section 16 reports on behalf of reporting persons and have more than one person capable of doing so, to allow for timely filings even if the person primarily responsible for filing is unavailable; and
- obtain a power of attorney from reporting persons in order make it easier to file Section 16 reports

The Act also requires electronic filing of Form 4, and the posting of such forms on the issuer's website, no later than July 30, 2003. The Commission has announced that it intends to begin rulemaking to require the filing of Section 16(a) reports on EDGAR and has encouraged reporting persons and issuers to file these reports electronically now. The Commission will accept electronically-filed forms that are not presented in the standard box format, provided that the form includes the captions and all required information in the proper order.

The members of the Corporate Department at Honigman Miller Schwartz and Cohn LLP will be delighted to discuss any of the issues raised by this Update with you, and to work with you to assist you to respond appropriately to the Act.