SEC ADOPTS FINAL RULES PURSUANT TO THE SARBANES-OXLEY ACT: INSIDER TRADES DURING RETIREMENT PLAN BLACKOUT PERIODS

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MARCH 28, 2003

On January 23, 2003, the Securities and Exchange Commission adopted final rules including Regulation Blackout Trading Restriction ("Regulation BTR") under Section 306 of the Sarbanes-Oxley Act of 2002 (the "Act") relating to restrictions on insider trades during retirement plan blackout periods.[1] The final rules are intended to facilitate compliance with Section 306(a) of the Act and to equalize the treatment of corporate executives and rank-and-file employees of an issuer with respect to their ability to engage in transactions involving the issuer's equity securities during retirement plan blackout periods. Blackout periods most commonly occur in connection with changes in retirement plan investment alternatives or recordkeepers, and in connection with corporate transactions, such as mergers and acquisitions. Section 306 of the Act and Regulation BTR took effect on January 26, 2003.

The final rules differ in several important respects from the rules that were released by the SEC in proposed form in November 2002.[2] Key modifications were made to the definition of "blackout period," to the scope of several important exceptions to the trading restrictions, and to the tracing rules applicable to directors' and executive officers' securities holdings.

The SEC has recently adopted final rules regarding several other provisions of the Act as well. Separate memoranda regarding these other important developments (including a separate memorandum for registered investment companies) are available upon request or at our website at *www.simpsonthacher.com*.[3]

STATUTORY BACKGROUND

[1] SEC Release No. 34-47225; IC-25909; 68 FR 4338 (the "SEC Release").

[2] The proposed rules were released on November 15, 2002 in SEC Release No. 34-46778.

[3] This is an updated version of our memorandum on the SEC's final rules, originally published on March 18, 2003. This memorandum also supplements our earlier memoranda regarding the Act, which are available upon request or at our website at *www.simpsonthacher.com*. If you would like to be added to our mailing list, please e-mail *sbussy@stblaw.com*.

Section 306(a) of the Act:

- imposes trading restrictions on directors and executive officers of issuers of equity securities (other than exempted securities)[4] during certain retirement plan blackout periods; and

- requires notice of blackout periods by issuers of equity securities to the SEC and affected directors and executive officers.

The term "issuer" for these purposes means an issuer (as defined in Section 3(a)(8) of the Securities Exchange Act of 1934, as amended), the securities of which are registered under Section 12 of the Exchange Act or that is required to file reports under Section 15(d) of the Exchange Act or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, as amended, and that it has not withdrawn. The definition of issuer includes domestic issuers, foreign private issuers, small business issuers and registered investment companies.

REGULATION BTR

Regulation BTR clarifies the scope and application of Section 306(a) of the Act in a number of significant respects, including its application in non-U.S. jurisdictions, the types of retirement plans covered, the scope of several important exceptions, and the timing and content requirements for the notices regarding blackout periods that issuers must provide to their directors and executive officers and to the SEC.

Trading Restrictions

It is unlawful under Section 306(a) of the Act for any director or executive officer of an issuer of any equity security (other than an exempted security), directly or indirectly, to purchase, sell or otherwise acquire or transfer any equity security of the issuer (other than an exempted security) during certain individual account retirement plan blackout periods with respect to the equity security if the director or executive officer acquired the equity security in connection with his or her service or employment as a director or executive officer. Regulation BTR clarifies many of these concepts, as described below.

- Definitions of "Director" and "Executive Officer." Under Regulation BTR, in the case of a domestic issuer, the term "director" has the meaning set forth in Section 3(a)(7) of the Exchange Act, which defines a "director" to mean any director of a corporation or any person performing similar functions with respect to any

[4] For these purposes, an "exempted security" has the meaning set forth in Section 3(a)(12) of the Exchange Act.

organization, whether incorporated or unincorporated. In the case of a foreign private issuer, the term "director" includes individuals within the meaning of Section 3(a)(7) of the Exchange Act, provided that such individuals are also management employees of the issuer.

In the case of a domestic issuer, the term "executive officer" has the same meaning as the term "officer" has under Exchange Act Rule 16a-1(f), which defines an "officer" to mean an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parents or subsidiaries are deemed officers of the issuer if they perform such policy-making functions for the issuer. In the case of a foreign private issuer, the term "executive officer" means the principal executive officer or officers, the principal financial officer or officers, and the principal accounting officer or officers, of the issuer.

The SEC Release indicates that the SEC borrowed certain Section 16 concepts in order to facilitate enforcement of the trading prohibitions of Section 306(a) of the Act by allowing reference to trading reports filed pursuant to Section 16(a) of the Exchange Act. Reference to Section 16 reports for the purposes of enforcement will only be possible in relation to domestic issuers, as foreign private issuers remain exempt from Section 16.

- Equity Securities. The term "equity security of the issuer" includes any equity security or derivative security[5] relating to the issuer, whether or not issued by that issuer. This includes, for example, phantom stock interests that are settled in cash and, in the case of foreign private issuers, American Depositary Receipts.

- In Connection With Service or Employment.

  -- Scope. Regulation BTR clarifies that the phrase "acquired in connection with his or her service or employment as a director or executive officer" includes equity securities acquired, directly or indirectly:

    - at a time when the individual was a director or executive officer of the issuer, under compensatory plans and arrangements, such as option

[5] For these purposes, "equity security" has the meaning set forth in Section 3(a)(11) of the Exchange Act and Exchange Act Rule 3a11-1, and "derivative security" has the meaning set forth in Exchange Act Rule 16a-1(c).

plans, retirement plans, deferred compensation plans, and bonus arrangements, of the issuer or any of the issuer's affiliates;

- at a time when the individual was a director or executive officer of the issuer, as a result of certain affiliated party transactions as described in paragraph (a) or (b) of Item 404 of Regulation S-K or, in the case of a foreign private issuer, Item 7.B of Form 20-F (in each case without application to the disclosure thresholds for these provisions), to the extent the individual has a pecuniary interest in the equity securities;

- prior to becoming, or while, a director or executive officer of the issuer, if the equity security was acquired as a direct or indirect inducement to service or employment as a director or executive officer of the issuer;

- prior to becoming, or while, a director or executive officer of the issuer, if the equity security was received as a result of a business combination in respect of an equity security of an entity involved in the business combination that the individual acquired in connection with service or employment as a director or executive officer of that entity; or

- at a time when the individual was a director or executive officer of the issuer, as director's qualifying shares or other securities required to be held to meet an issuer's minimum ownership guidelines.

Equity securities acquired in connection with service or employment as a director or executive officer before the issuer became subject to the Act or before the effective date of the Act are within the scope of the trading prohibitions.

-- Tracing Source of Securities Allowed. The equity securities disposed of in a transaction will be presumed to have been acquired "in connection with service or employment" as a director or executive officer to the extent the director or executive officer holds any such securities at the time of the disposition, unless the individual establishes that the equity securities disposed of were not acquired in connection with service or employment as a director or executive officer. To establish this defense, the individual will need to identify the origin of the equity securities and demonstrate that this identification is consistent for purposes relating to the transaction (such as tax reporting and disclosure and reporting requirements).[6]

[6] The tracing rule included in the SEC's final rules represents a significant change from the rules as originally proposed by the SEC which would have established an irrebuttable presumption that the securities disposed of were acquired "in connection with service or employment" as a director or executive

- Certain Transactions Exempted from Prohibitions on Trading. Regulation BTR lists a number of transactions that will be exempt from the trading prohibitions, including:

    - acquisitions under certain broadly-based dividend reinvestment plans;

    - purchases or sales pursuant to 10b5-1(c) contracts, instructions or plans, provided that the arrangement was not entered into or modified during the blackout period or at a time when the director or executive officer was aware of the actual or approximate beginning or ending dates of the blackout period;

    - increases or decreases in the number of equity securities held as a result of stock splits or stock dividends applying equally to all securities of that class, and acquisitions of security holder rights pursuant to a pro rata grant to all holders of the same class of equity securities;

    - compensatory grants and awards of equity securities (including options and stock appreciation rights) pursuant to a plan that by its terms permits directors and executive officers of the issuer to receive awards, provides for awards to occur automatically, and specifies the terms of the awards; or

    - purchases or sales under qualified employee benefit plans, excess benefit plans or stock purchase plans (in each case, as defined in Exchange Act Rule 16b-3),[7] unless the transaction is a "discretionary transaction" [8] that does not otherwise meet the 10b5-1(c) exemption specified above.

officer to the extent the director or executive officer actually held securities so acquired. In effect, the presumption under the SEC's proposed rules would have prevented insiders from trading any equity securities of the issuer during blackout periods, if the director or executive officer then held any equity securities of the issuer acquired in connection with service or employment as a director or executive officer.

[7] Plans maintained by foreign private issuers that are not required to satisfy the U.S. Internal Revenue Code, but that have been approved by the taxing authority of a foreign jurisdiction, or that are eligible for preferential treatment under the tax laws of a foreign jurisdiction because the plan provides for broad-based participation, also could qualify for this exemption.

[8] As defined under Exchange Act Rule 16b-3(b)(1), discretionary transactions include intra-plan transfers involving the issuer's equity securities and cash distributions funded by a volitional disposition of an issuer's equity securities. Discretionary transactions do not include acquisitions or dispositions of securities in connection with termination of employment, or transactions involving diversification or distributions that are required by the U.S. Internal Revenue Code to be made available under the plan.

Regulation BTR includes additional exemptions that generally cover transactions that occur automatically or that are otherwise outside the control of the director or executive officer, such as acquisitions or dispositions of securities in connection with a corporate merger or similar transaction occurring by operation of law.

Blackout Periods

For purposes of the trading restrictions, a "blackout period" generally means any period of more than 3 consecutive business days during which the ability of 50% or more of the participants or beneficiaries under all "individual account" retirement plans maintained by the issuer to purchase, sell or otherwise acquire or transfer an interest in any equity security of the issuer held in the individual account retirement plan is temporarily suspended by the issuer or by a fiduciary of the plan.

- Individual Account Plans. Regulation BTR clarifies that prohibitions on insider trades apply in the event of blackout periods under non-qualified deferred compensation plans as well as tax-qualified retirement plans such as 401(k) plans, profit sharing plans, saving plans, stock bonus plans and money purchase pension plans.[9]

- Definition of Blackout Period – 50% Test / Foreign Private Issuers. In general, the statutory prohibitions on insider trades do not apply unless a significant portion (at least 50%) of the participants or beneficiaries under all individual account retirement plans "maintained by"[10] the issuer are affected by the restrictions under the plan. Regulation BTR clarifies the application of this 50% test in several key respects.

    - The individual account plans to be considered for purposes of the 50% test are individual account plans maintained by the issuer that permit participants located in the United States to acquire or hold equity securities of the issuer, whether or not the plan actually holds equity securities at the time of the relevant determination. Individual account plans maintained outside of the United States primarily for the benefit of nonresident aliens are excluded from consideration.

    - The 50% test will only be met if at least 50% of plan participants or beneficiaries in the United States (and its territories and possessions) are restricted from trading under all applicable individual account retirement

[9] Plans that are limited to directors of the issuer are not included in this definition. Otherwise, the definition of an "individual account plan" closely tracks the definition set forth in Section 3(34) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

[10] A plan is considered maintained by the issuer if the issuer is part of the same controlled group as the plan sponsor under Section 414 of the U.S. Internal Revenue Code.

plans maintained by the issuer.[11] The Regulation BTR prohibitions on trading will not apply if a blackout period affected only plan participants or beneficiaries located outside the United States.

- In addition to the 50% test described above, in order for the Regulation BTR prohibitions on trading to be applicable to the directors and executive officers of foreign private issuers, the number of participants and beneficiaries in the United States that are restricted from trading under the applicable individual account plans will need to be at least 50,000 or will need to constitute more than 15% of the total number of employees of the issuer and its consolidated subsidiaries worldwide.[12]

- Certain Transactions Exempted from Definition of Blackout Period. A "blackout period" for purposes of the prohibitions on insider trades will not include:

  - temporary trading suspensions imposed principally to permit employees to become or cease to be participants in an individual account plan in connection with certain corporate transactions involving the plan or plan sponsor, provided that the employees who become participants in the plan are not able to participate in the same class of equity securities after the transaction as before the transaction; or

  - regularly scheduled periods under the plan in which participants and beneficiaries may not purchase, sell, or otherwise acquire or transfer an interest in any equity security of the issuer, if the period is incorporated in the plan and timely disclosed to affected employees and participants.

Notice Requirements

In any case in which a director or executive officer of an issuer is subject to the Act's prohibitions on insider trades, the issuer must timely notify the director or executive officer, as well as the SEC. Regulation BTR describes certain content requirements, including the

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[11] Regulation BTR contains additional guidance on the application of this 50% test in response to comments to the SEC's proposed rules. For example, plan census data does not need to be measured as of the date of the blackout period, but can be measured as of a date within the 12 month period preceding the blackout period, provided that the date selected offers reasonably accurate data. Similarly, issuers are permitted to aggregate participants under all plans without regard to overlapping participation. Thus, individuals that participate in multiple plans may be counted for purposes of each plan.

[12] The SEC appears to have relaxed the 50% test applicable to directors and executive officers of foreign private issuers in response to comments to the SEC's proposed rules.

requirement that the notice explain the reason for the blackout period and the length of the period.

- Notice to directors and executive officers is considered timely if it is provided no later than 5 business days after the issuer receives notice of the blackout period from the plan administrator pursuant to Section 306(b) of the Act and the DOL Rules (described below). If no such notice is received by the issuer, notice to directors and executive officers is considered timely if it is provided at least 15 calendar days in advance of the actual or expected commencement of the blackout period. If advance notice cannot be given due to events that were unforeseeable or due to circumstances beyond the reasonable control of the issuer (as reasonably determined in writing by an authorized representative of the issuer), notice (and representative's determination) must be given as soon as reasonably practicable.

- Notice to the SEC is considered timely if:

    - the issuer files a Form 8-K within the time prescribed for filing such report (generally, the same day notice of the blackout period is transmitted to directors and executive officers); or

    - the issuer is a foreign private issuer and includes the notice information in the first annual report on Form 20-F or Form 40-F required to be filed after receipt of notice of a blackout period, or in an earlier report filed on Form 6-K.

- Special transition rules apply prior to March 31, 2003.

Remedy for Violations

Any profit[13] realized by a director or executive officer of the issuer from any transaction in violation of the trading restrictions will be recoverable by the issuer, irrespective of the intentions of the director or executive officer in entering into the transaction. An action to recover profits may be instituted by the issuer, or by the owner of any security of the issuer in the name and on behalf of the issuer if the issuer does not bring the action within 60 days after

[13] Regulation BTR clarifies that a "profit" for these purposes means any direct or indirect pecuniary benefit. This benefit can be measured as the difference between (i) the amount paid or received for the equity security on the date of the transaction during the blackout period and (ii) the average market price of the equity security calculated over the first three trading days after the end of the blackout period. For transactions involving equity securities that are not registered pursuant to Section 12(b) or 12(g) of the Exchange Act and that are not listed on a national securities exchange, this benefit can be measured in a manner consistent with the objective of identifying any gain realized or loss avoided by the director or executive officer as a result of the transaction taking place during the blackout period rather than outside of the blackout period.

the date of request, or fails diligently to prosecute the action thereafter. No such suit, however, may be brought more than two years after the date on which the profit was realized.

A violation of the trading prohibitions may also give rise to an SEC enforcement action.

FINAL DOL RULES

On January 24, 2003, the Department of Labor ("DOL") issued final rules (the "DOL Rules") pursuant to Section 306(b) of the Act relating to advance notice requirements for retirement plan blackout periods.[14] The DOL Rules specify the content and timing of blackout period notices that must be provided to participants and beneficiaries under individual account retirement plans, as well as to issuers of employer securities subject to the blackout period.

In this context, the term "blackout period" has a broader meaning than in the context of the trading prohibitions discussed above, and is not limited to a suspension affecting the equity securities of the issuer held under an individual account retirement plan. A blackout period under the DOL Rules generally means any period of more than 3 consecutive business days during which the ability of individual account retirement plan participants and beneficiaries to direct or diversify any assets credited to their accounts, to obtain loans from their accounts, or to obtain distributions or withdrawals from their accounts is temporarily suspended, limited or restricted.

Limited exceptions apply, including an exception for regularly scheduled suspensions, limitations or restrictions that are properly disclosed to participants and beneficiaries.

Notice generally must be provided to affected participants, beneficiaries and issuers at least 30 days in advance of the start of the blackout period, although limited exceptions apply if necessary to avoid fiduciary violations, in the event of unforeseeable circumstances, and in the case of certain corporate transactions.[15]

The DOL Rules provide model notice language to assist plan administrators in complying with these new notice requirements.

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[14] 68 FR 3716, 3729. The DOL Rules became effective January 26, 2003, and apply to blackout periods commencing on or after that date.

[15] If the blackout period is imposed solely in connection with participants becoming or ceasing to be participants under the plan as a result of a merger, acquisition, divestiture or similar transaction involving the plan or the plan sponsor, the normal 30-day advance notice provision does not apply. Rather, notice must be provided as soon as reasonably possible under the circumstances, unless notice in advance of the end of the blackout period is impracticable. By contrast, Regulation BTR treats these events as an exception to the definition of a blackout period for purposes of the trading restrictions.

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This memorandum is for general informational purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as additional memoranda regarding recent corporate governance developments, can be obtained from our website, *www.simpsonthacher.com*.

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