

**SEC ADOPTS ACCELERATED SECTION 16 REPORTING RULES
UNDER THE SARBANES-OXLEY ACT OF 2002**

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On August 27, 2002, the Securities and Exchange Commission adopted final rules to implement the accelerated two business day filing deadline for Form 4 effected by Section 403 of the Sarbanes-Oxley Act of 2002 (the "Act") and to establish a slightly later filing deadline for certain transactions for which the SEC determined that the two day period is not feasible. The new rules became effective on August 29, 2002.

EXECUTIVE SUMMARY

Section 16(a) of the Securities Exchange Act of 1934, as amended, provides that officers and directors of a company with equity securities registered pursuant to Section 12 of the Exchange Act and "beneficial owners" of 10% or more of any class of those equity securities (other than exempt securities) must report changes in their beneficial ownership of any equity securities of the company or the purchase or sale of a security-based swap agreement involving equity securities of the company. Section 403 of the Act amended Section 16(a) of the Exchange Act effective August 29, 2002 to require that those reports to be filed before the end of the second business day following the day on which the reportable transaction is executed, except for cases in which the SEC determines that this reporting deadline is not feasible. Prior to this amendment, these reports were generally required to be filed by the 10th day after the close of the calendar month during which the change occurred. The SEC has adopted amended Section 16 rules and forms to implement the accelerated filing deadline effected by the Act and to establish two narrowly defined types of transactions for which the SEC determined that

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the two day period is not feasible. The Release adopting the amended rules¹ also clarified a number of issues that had arisen since the passage of the Act regarding Section 16 reporting obligations.

With one exception, the amendment of Section 16(a) effected by the Act only accelerates the time for filing Form 4, but does not change any existing exemptions from Section 16 of the Exchange Act or existing provisions for annual reporting on Form 5 of most types of transactions that the SEC has determined are exempt from the "short-swing" liability provisions of Section 16(b) of the Exchange Act. The one exception to the foregoing is that accelerated reporting is necessary for officers' and directors' transactions with the issuer exempted from Section 16(b) liability by Rule 16b-3 that were previously reportable on Form 5. The new rules require these transactions now to be reported on Form 4 under the accelerated filing deadlines.

Notably, securities registered by foreign private issuers remain exempt from Section 16.

EFFECTIVE DATE OF NEW RULES

The Release clarifies that Section 403 of the Act is not intended to have any retroactive effect. The amendment to Section 16(a) and the new rules apply only to transactions that occur on or after August 29, 2002. Thus, a non-exempt transaction occurring on August 28, 2002 would not have to be reported until September 10, 2002.² A transaction permitted under the old rules to be reported on Form 5 that occurred on August 28, 2002 would continue to be permitted to be reported on Form 5, which is due by the 45th day after the end of the issuer's fiscal year.

A transaction that occurred on Thursday, August 29, 2002 that is required to be reported on Form 4 under the amended statute and new rules (and for which the SEC

¹ SEC Release No. 34-46421 (August 27, 2002).

² If, however, a Form 4 were required to be filed prior to that date to report a transaction reportable within two business days under the new rules, it would be sensible to report the pre-August 29 transaction early on the same Form 4.

has not determined that the two day period is not feasible) must be reported on a Form 4 filed by the close of business of the SEC (5:30 p.m., Eastern time) on Tuesday, September 3 (taking into account an additional day to file as a result of the three day Labor Day weekend).³

The Release notes that the Act did not amend the statutory filing deadline for an insider's initial report on Form 3 which, except in the case of the initial registration of an equity security of the issuer under Section 12 of the Exchange Act, is due within ten days after a person becomes an insider. Accordingly, situations may now arise in which an insider is required to file a Form 4 before the Form 3 is due. In these situations, the SEC encourages, but cannot require, insiders to file the Form 3 along with the Form 4 by the Form 4 reporting deadline.

Until such time as printed copies of the revised Form 4 are generally available, insiders may continue to file reports on the old forms, with appropriate changes to reflect that the forms are no longer a monthly report. The revised forms reflect the SEC's position that the holdings now required to be reported on Form 4 are the insider's holdings following the reported transactions.⁴

TWO BUSINESS DAY REPORTING

General Rule

Section 16(a) of the Exchange Act now provides that officers and directors of a company with equity securities registered pursuant to Section 12 of the Exchange Act and "beneficial owners" of 10% or more of any class of those equity securities (other than exempt securities) must file with the SEC (and any applicable exchange) a

³ Although the SEC's EDGAR system will accept electronic filings up to 10:00 p.m., Eastern time, any filing initiated after 5:30 p.m. is deemed to have been filed on the next business day.

⁴ The SEC stated in the Release that reporting an insider's holdings of securities following the reported transactions will satisfy the amended statutory requirement to report the insider's ownership "at the date of filing." This solves the logistical issue that may otherwise be created by the statute for paper filers who must in most cases deliver Forms 4 to an overnight courier on the day before the actual date of filing in Washington.

statement on Form 4 before the end of the second business day following the day on which the reportable transaction is executed, except for cases in which the SEC determines that this reporting deadline is not feasible.⁵

The Release clarifies that for open market purchases and sales of securities the “date of execution” is the trade date. This position is consistent with previous judicial interpretations that a “change” in beneficial ownership occurs for purposes of Section 16 when an insider enters into an irrevocable commitment with respect to a transaction in which the insider’s rights and obligations become fixed, not subject to any material condition, and the insider can no longer control the transaction in any way that can be turned to speculative advantage.

In general, the amended statute and new rules do not effect any changes in Section 16 reporting or liability, except for accelerated filing of Form 4 and current reporting on Form 4 of certain transactions between officers and directors and the issuer that were formerly permitted to be reported on an annual basis on a Form 5. Thus, the following securities or transactions continue to be exempt from Section 16(a) reporting at any time:

- securities registered by foreign private issuers;

⁵ Section 30(h) of the Investment Company Act of 1940, as amended, subjects to the same duties as Section 16 of the Exchange Act officers, directors, members of an advisory board, investment advisers and affiliated persons of investment advisers of registered closed-end companies and beneficial owners of more than 10% of any class of outstanding securities (other than short-term paper) of such a company. Accordingly, the deadline for Form 4 reports required pursuant to Section 30(h) of the Investment Company Act is also accelerated as a result of the Act.

On the other hand, the reporting obligations of officers and directors of registered holding companies under Section 17(a) of the Public Utility Holding Company Act of 1935, as amended, are not referenced to Section 16 of the Exchange Act and, accordingly, the deadline for Form 4 reports required pursuant to Section 17(a) of the Public Utility Holding Company Act has not been changed as a result of the Act. While this distinction has little practical effect in connection with transactions in *equity* securities of a public company (since persons subject to Section 17(a) would also be subject to Section 16 of the Exchange Act), Section 17(a) requires that a Form 4 be filed to report transactions in *any* securities of the holding company or its subsidiaries. Thus, the old Form 4 deadline of the 10th day after the close of the month during which a change occurred still applies for reporting transactions in *debt* securities of public holding companies and any securities of non-public subsidiaries.

- acquisitions resulting from the reinvestment of cash dividends under broad-based dividend reinvestment plans (DRIP plans);
- acquisitions resulting from stock dividends;
- routine, recurring acquisitions pursuant to certain qualified employee benefit plans; and
- mere changes in the form of ownership.

In addition, other transactions, such as gifts, transfers by inheritance and small acquisitions (other than acquisitions from the issuer or an employee benefit plan sponsored by the issuer) not exceeding \$10,000 in the aggregate continue to be permitted to be deferred and reported on Form 5.

The new rules, however, require accelerated reporting on Form 4 within two business days for officers' and directors' transactions with the issuer (including an employee benefit plan sponsored by the issuer) exempted from Section 16(b) liability by Rule 16b-3 that were previously reportable on Form 5. Consequently, grants, awards and other acquisitions from the issuer, dispositions to the issuer and "discretionary transactions" under employee benefit plans must now be reported on an accelerated basis on Form 4, even if such transactions continue to be exempt from Section 16(b) liability under Rule 16b-3. In addition to discretionary intra-plan transfers and cash-outs under employee benefit plans, examples of transactions that are now reportable on Form 4 include

- grants of stock options, restricted stock or other stock-based awards;
- material changes in the terms of previously granted stock options or other stock-based awards, including repricings;
- transactions under non-qualified deferred compensation plans;
- acquisitions in DRIP plans through voluntary contributions of additional funds;
- withholdings or deliveries of securities to satisfy income tax withholding obligations incident to the vesting of restricted stock; and

- deemed dispositions to the target company and deemed acquisitions from the acquiring company in connection with mergers.⁶

Cases in Which the Two Day Period is Not Feasible

Under the new rules, the two business day Form 4 filing due date is calculated differently for only two narrowly defined types of transactions. These two cases are the following transactions, with respect to which the SEC has determined that the two day period is not feasible and where objective criteria prevent the insider from controlling (and in some cases even knowing) the trade date:

- transactions pursuant to a contract, instruction or written plan⁷ that satisfies the affirmative defense conditions of Rule 10b5-1(c) where the insider does not select the date of execution; and
- “discretionary transactions” pursuant to employee benefit plans (which involve intra-plan transfers of previously invested assets into or out of a plan issuer securities fund or cash-outs from a plan issuer securities fund) where again the insider does not select the date of execution.

In these cases, the date on which the executing broker, dealer or plan administrator notifies the insider of execution of the transaction is deemed to be the “date of execution” for purposes of the two business day Form 4 filing requirement. If, however, the notification date is later than three business days following the trade date of the transaction, then the “date of execution” is deemed to be the third business day following the trade date. In short, the due date for filing a Form 4 to report transactions falling within these two “exceptions” to the two business day filing requirement will be not later than the end of the second through the fifth business day following the trade date, depending on when the insider is notified of the transaction.

⁶ To the extent that any of the foregoing transactions satisfies the affirmative defense conditions of Rule 10b5-1(c) and the insider does not select the date of the transaction, the due date of the required Form 4 may be calculated on the modified basis established by the SEC for cases in which the two day period is not feasible.

⁷ Including limit orders and transactions pursuant to employee benefit plans and DRIP plans that are not exempt from Section 16(a) reporting.

The SEC considers that three business days provides reasonable time for notification to be made, but admits that this very short period may require the modification of existing routine procedures, particularly in connection with notification of employee benefit plan information. Insiders will need to make specific arrangements with brokers, dealers and plan administrators to provide the insider (and his or her form preparers) with actual notice of transaction execution as quickly as feasible. Notification may be made by any means of communication, including oral, paper or electronic means. Many issuers are currently adopting procedures that require insiders' brokers and dealers to deliver immediate electronic notification of transaction execution to the issuer, whether in the case of insider-directed transactions or transactions pursuant to 10b5-1 plans, so that Forms 4 can be quickly prepared and timely filed.

Although the SEC had indicated in supplemental information issued on August 6, 2002⁸ that it was also considering calculating the Form 4 filing deadline differently in the case of a transaction pursuant to a single market order that is executed over more than one day, the SEC did not include such transactions in its final rules as meriting different treatment. In the Release, the SEC stated that it believed that it is feasible to report such transactions as they are executed.

Future Rule Making

Although the SEC did not adopt any rules to calculate the Form 4 filing deadline differently based on non-feasibility for any categories of transactions other than those narrowly defined cases described above, the Release requested comment as to whether there are other types of transactions that require regulatory changes to make it feasible for insiders to report them within the two business day deadline, as well as whether any additional time is necessary to make Form 4 reporting feasible for the types of transactions in which the new rules provide for calculating the due date on the modified basis.

The SEC is also seeking comment on the general treatment of stock options for both Section 16(a) reporting and Section 16(b) liability purposes – an area not addressed in the Act. The SEC appears to be reconsidering once again whether and how the six month “short-swing” profit period should be applied and calculated in connection with

⁸ SEC Release No. 34-46313 (August 6, 2002).

the sequence of stock option grant, exercise and sale of the underlying stock. As an example the Release asks whether a six month holding period should be required as a mandatory condition to the exemption of stock option grants, rather than be just one of the alternative permissible bases for an exemption.

The SEC has stated that it is no longer considering proposed amendments that would have required companies to report directors' and executive officers' transactions in company equity securities on Form 8-K. The Release, however, states that the SEC is continuing to consider its other proposed amendments,⁹ which would require companies to disclose on Form 8-K information about directors' and executive officers' 10b5-1 arrangements and company loans and guarantees to directors and executive officers to the extent that such loans and guarantees are not prohibited by Section 402 of the Act.

MANDATED ELECTRONIC FILINGS

The Act also provides that by July 30, 2003:

- Section 16 reports must be filed electronically;
- the SEC must provide each Section 16 report on a publicly accessible Internet site not later than the end of the business day following a filing; and
- the issuer (if it maintains a website) must provide each Section 16 report on the website not later than the end of the business day following a filing.

The SEC stated in the Release and in the open meeting at which the new rules were approved that it is proceeding expeditiously with rulemaking and systems programming to assure adoption of mandatory electronic filing and SEC website presentation as soon as practicable.

⁹ SEC Release No. 33-8090, 34-45742 (April 12, 2002).

Electronic filing has considerable benefit to insiders in enabling them to meet the accelerated Form 4 filing requirements. Insiders who have not previously been electronic filers are encouraged to submit Forms ID requesting EDGAR process codes as soon as possible to minimize processing delays. To encourage and facilitate electronic filing of Forms 4 and other Section 16 reports, the SEC had previously announced that it will accept EDGAR filings of reports that are not presented in the standard box format and omit the horizontal and vertical lines separating information items, so long as all required information is presented in the proper order.

SUGGESTED COMPLIANCE PROCEDURES

The accelerated Form 4 filing requirements will place significant burdens on insiders and form preparers to obtain accurate information on executed transactions quickly and to prepare and file timely the required reports. For a typical broker transaction, a Form 4 will be due before the settlement date of the transaction and generally before the insider will have received a mailed confirmation from the broker. Similarly, the due date of Forms 4 for reportable transactions pursuant to employee benefit plans will generally be significantly before the time that the insiders would receive the monthly plan reports typically provided by plan administrators prior to the new rules.

We, therefore, suggest that issuers consider adopting the following procedures in order to assist insiders in complying with the new Section 16(a) reporting requirements:

- Require that insiders (and related persons whose holdings and transactions can be attributed to insiders under the Section 16 rules) pre-clear proposed transactions in issuer securities and proposed 10b5-1 plans with specified persons at the issuer. Pre-clearance would have the additional benefit of helping ensure that the proposed transactions and plans will comply with the requirements of Rule 144 (to the extent applicable) and the issuer's trading policies.
- Ensure that insiders communicate to all persons whose holdings and transactions may be attributable to the insider information about the insider's obligations under the new Section 16(a) reporting requirements and that insiders make appropriate arrangements for those persons to

deliver immediate notice of the execution of transactions to the insider and the issuer.

- Have issuer personnel prepare and file the Section 16 reports on behalf of insiders, if this is not already done.
- Have notification of transaction execution delivered by brokers, dealers and plan administrators directly to the issuer, in addition to the insider. This is particularly important in cases where the insider does not select the date of execution (such as under 10b5-1 plans) and may be unavailable to receive notice of execution at the insider's customary address. All notices should be delivered to the issuer by facsimile or electronic mail immediately following each transaction execution and should provide the information necessary to complete the appropriate Section 16 report.
- Contact brokers, dealers and plan administrators to ensure that they understand the new reporting requirements and to receive assurance that they will notify the insider and the issuer immediately following the execution of transactions. In some cases issuers may wish to have these persons confirm with the issuer that the issuer's pre-clearance procedures or other policy requirements have been satisfied before they execute a transaction on behalf of the insider.
- Give multiple issuer personnel a power of attorney enabling them to execute and file the required forms in the insider's absence.
- Change to electronic filing of Section 16 reports at the earliest practicable time.
- Send a memorandum to all insiders immediately that explains the new Section 16 reporting requirements and any new procedures that are being instituted to assist the insiders in complying with the requirements. Some issuers may wish to have insiders acknowledge their receipt of the memorandum and their understanding of their responsibilities under Section 16. Additional memoranda should be circulated periodically as reminders of insiders' Section 16 obligations.

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Please contact your relationship partner or any of the individuals listed below if we can be of assistance regarding these important developments.

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