

Corporate and Securities Law Developments **NEWSLETTER**

AUGUST 28, 2002

NEW REQUIREMENTS FOR PROMPT REPORTING OF INSIDER STOCK TRANSACTIONS

The Sarbanes-Oxley Act of 2002 (the “Act”) requires directors, executive officers and large shareholders of public issuers to report transactions in the issuer’s equity securities within two business days of a transaction. The Securities and Exchange Commission adopted new rules implementing these changes on August 27, 2002, and the accelerated reporting takes effect for transactions occurring on and after August 29, 2002. The accelerated reporting requirement applies to many transactions that formerly were reportable after the end of the issuer’s fiscal year, on Form 5, including: stock and option grants, exercises and repricings; restricted stock grants; dispositions to the issuer; and most other equity compensation transactions.

The SEC allowed limited exceptions to the two business day filing requirement. It extended the deadline slightly for (1) transactions pursuant to trading plans qualifying under Rule 10b5-1 (including limit orders) if the insider does not determine the date of the transaction and (2) “discretionary transactions” under employee benefit plans as that term is defined in Rule 16b-3(b)(1) if the insider does not determine the date of the transaction. In these two circumstances, reporting is required two business days after the earlier of (a) notification to the reporting person of the transaction and (b) three business days after the transaction. As a practical matter, in order to take advantage of this exception to the two-day rule, an insider will need to

make arrangements to receive notice of these transactions within three business days of the trade. In addition, acquisitions (but not dispositions) of securities, other than an acquisition from the issuer, need not be reported until two business days after the market value of all unreported acquisitions exceeds \$10,000.

The accelerated filing deadline will increase the number and frequency of transactions reported and thus the difficulty of insiders filing these reports accurately and in a timely manner. As a practical matter, issuers will have to offer substantial assistance to executive officers and directors with these filings. In order to facilitate prompt filings, we recommend that issuers immediately set up compliance programs to assist officers and directors and to ensure that filings are made promptly and accurately. The key elements of such a compliance program are described below. If you would like assistance in setting up a program at your company, please contact any of the persons identified at the end of this newsletter.

1. Memorandum to insiders. Each issuer should send a memorandum to its executive officers, directors and 10% holders alerting them to the accelerated filing requirement and the issuer’s compliance program. In general, any memorandum should (as applicable) note:

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- pre-clearance procedures for transactions in the issuer's equity securities;
- the responsibilities the company will take for completing filings;
- the requirement (or encouragement) to use a specified broker for transactions in the issuer's securities, or the certifications required from brokers if no specific broker is required;
- the applicability of the rules to persons with business or family relations to the insider; and
- sanctions for failure to make timely filings.

Insiders should be required to sign and return the memo to ensure that it has been received by all insiders. Periodic reminders should be sent to insiders to re-enforce the filing requirements.

2. Filing by the issuer. Given the difficulty of making timely filings and the risk of inadvertent Form 4 filing violations under the Act, we recommend that issuers take primary responsibility for reporting and filing on behalf of Section 16 reporting persons. Issuers should request each reporting person to execute a power of attorney giving appropriate employees of the company the ability to act on behalf of such person with respect to the filing of Section 16 forms. Prior to any filing, the issuer should attempt to have the reporting person review and approve the filing. Given the short time periods involved, however, a complete approval may be impossible in some circumstances, and issuers should therefore seek advance permission to file if the issuer believes the filing is correct.

Electronic filing of Section 16 reports is not required until the SEC adopts implementing rules (which are required by next July and expected sooner), but electronic filing is permissible immediately and this may be the easiest way to ensure timely filing. Each executive officer, director and 10% shareholder must have its own set of

EDGAR filing codes. Issuers should determine whether their insiders already have these codes and obtain them for them if they do not.¹

3. Mandatory pre-clearance procedures. Issuers should establish a mandatory pre-clearance procedure requiring all Section 16 persons to obtain approval to trade before completing any transaction in the issuer's equity securities. This requirement should apply to family members and entities through which an executive officer may hold interests in securities of the issuer. Under this procedure, these individuals would be prohibited from engaging in any transaction involving the company's securities (including a stock plan transaction such as an option exercise, a gift, a loan or pledge or hedge, a contribution to a trust, or any other transfer) without first obtaining pre-clearance of the transaction from a compliance officer. The compliance officer should determine whether the transaction may proceed and, if so, assist in complying with the new reporting requirements.

4. Designated or qualified brokers. To facilitate compliance with the new accelerated reporting of transactions, issuers should either designate a single broker through whom all transactions in issuer stock by insiders must be completed or require insiders to use only brokers who will agree to the procedures set out below. A designated broker can help ensure compliance with the company's pre-clearance procedures and reporting obligations by monitoring all transactions and reporting them promptly to the issuer. If designating a single broker is not feasible, issuers should require insiders to obtain a certification from their broker that the broker will:

- Verify with the issuer that each transaction entered on behalf of the insider was pre-cleared; and
- Report immediately to the issuer the details of each of the insider's transactions in the issuer's securities.

¹ Reporting persons who have Section 16 filing obligations with respect to more than one issuer should be asked to coordinate with all such issuers to make sure that only one reporting code is obtained and used for the reporting person.

5. Filing Procedures. Issuers should establish filing procedures that include:

- Completing the report by the end of the day of the transaction so it can be sent to the insider for review;
- Delivery to the SEC (i) via overnight courier sent by the end of the business day following the transaction; (ii) delivery by fax or e-mail to an address in Washington by noon of the second business day following the transaction for hand delivery to the SEC; or (iii) electronic filing on the second business day following the transaction.

If you have any questions regarding the new Section 16 reporting requirements or would like assistance in setting up a compliance program, please contact:

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