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## Corporate Advisor

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### Summary of New Section 16 Reporting Requirements

The obligations of directors, officers and 10% stockholders to report changes to their beneficial ownership of company common stock have changed significantly as a result of both the Sarbanes-Oxley Act, which was enacted on July 30, 2002, and related changes to the rules and forms under Section 16 of the Securities Exchange Act of 1934, which were adopted by the SEC on August 27, 2002. This *Corporate Advisor* summarizes the new filing requirements, which apply to transactions effected on or after August 29, 2002.

#### Form 4

*Transactions to be Reported.* The types of transactions that must be reported on a Form 4 have been significantly expanded. The following are the most common transactions that must now be reported on a Form 4:

- a sale of common stock, including an open market sale, a sale in a privately negotiated transaction and a sale to the company;
- a purchase of common stock, including an open market purchase, a purchase in a privately negotiated transaction and a purchase directly from the company;
- a stock option exercise<sup>1</sup>;
- the receipt of a stock option or other equity security under an employee benefit plan of the company; and
- a “discretionary transaction” under an employee benefit plan that involves, at the director’s or officer’s volition, an intra-plan transfer involving company common stock or a cash distribution funded by a disposition of company common stock.

A sale of common stock to, or a purchase of common stock from, the company, as well as the transactions listed in the fourth and fifth bullets, previously did not have to be reported until

a year-end Form 5, provided they were effected in compliance with Rule 16b-3.

*Timing of Filings.* Except as described in the following paragraph, each Form 4 must be filed no later than 5:30 p.m. (eastern time) on the second business day following the date on which the transaction took place. Previously, the filing deadline was the tenth day following the end of the month in which the transaction took place. As was the case under the prior Section 16 rules, a purchase, sale or other transaction is deemed to occur at the time the person becomes irrevocably committed to it; in the case of an open market purchase or sale, this occurs when the trade is executed (and not when it settles).

The SEC has designated two types of transactions that must be reported on a Form 4 within two business days following the date the director or officer receives notice of the transaction, rather than two business days following the date on which the transaction occurs:

- a transaction pursuant to a Rule 10b5-1 plan or arrangement under which the director or officer does not select the date on which the purchases or sales take place<sup>2</sup>; and
- a “discretionary transaction” (as defined in Rule 16b-3) pursuant to an employee benefit plan for which the director or officer does not select the date on which transactions take place<sup>3</sup>.

In either such case, if the director or officer is not notified by the broker, dealer or plan administrator within three business days following the execution of the transaction, the insider will nonetheless be deemed to have been notified on the third business day, and the Form 4 will be due two business days following that date. It is therefore important that any director or officer with a Rule 10b5-1 plan that does not specify the days on which trades take place make arrangements with his or her broker to ensure that the broker promptly notifies the director or officer, by telephone or e-mail, of transactions that take place. Similarly, officers who participate in employee benefit plans in which they do not select the date on which transactions take place should ensure the plan administrator provides prompt notice to the officer of the date on which the plan actually effects each transaction.

*Form to be Used.* The SEC has published a new Form 4 that reflects the fact that Form 4 is no longer a monthly form and adds spaces for certain additional information to be reported. All Form 4s should now be filed on this new Form. The new Form 4 is posted on the [SEC's web site](#).

*Filing by EDGAR.* Although Form 4s do not currently have to be filed electronically via the SEC's EDGAR system, the SEC is required by the Sarbanes-Oxley Act to require filings by EDGAR by no later than July 30, 2003, and may adopt this requirement significantly earlier than that date. The SEC is also encouraging reporting persons to file Section 16 reports electronically and companies to post the reports on their web sites in advance of an SEC mandate. The SEC has indicated that it will accept electronically filed Section 16 reports that are not presented in the standard box format—for example, filings may omit the horizontal and vertical lines separating the information items—so long as the captions of the items and all required information are properly presented.

### **Form 5**

Form 5, which is due within 45 days after the end of each fiscal year of the company, has not been eliminated by the expanded and accelerated Form 4 filing requirements. However, the transactions that are reportable on a Form 5 have been significantly limited. The most common transactions that will now be reported on a Form 5 are:

- an acquisition or disposition of common stock by gift or by inheritance; and
- a transaction that should have been reported on a Form 4 during the prior fiscal year but was not.

Any transaction that is eligible for reporting on a Form 5 may instead be reported on a Form 4, thus obviating the need for a year-end Form 5. As a general rule, it remains advisable to report even Form 5-eligible transactions on a Form 4 on a voluntary basis.

### **Transactions Which Do Not Need to be Reported**

The following transactions, which were not required to be reported on either a Form 4 or a Form 5 under the previous rules, remain exempt from any Form 4 or Form 5 filing requirement:

- an acquisition under an employee stock purchase plan satisfying the requirements of Section 423 of the Internal Revenue Code;
- a transaction (other than a “discretionary transaction”) under an employee benefit plan satisfying the requirements of Section 410 and 401(a)(26) of the Internal Revenue Code (such as a pension plan or a 401(k) plan) or under a related excess benefit plan;
- an acquisition through a stock split, stock dividend or other *pro rata* distribution to stockholders of the company;
- an acquisition under a dividend or interest reinvestment plan that satisfies the

requirements of Rule 16a-11; and

- an acquisition or disposition pursuant to a domestic relations orders (such as a divorce decree).

Although these transactions do not require the filing of a Form 4 or Form 5, the next Form 4 or Form 5 filed should reflect the effects of these transactions in the column reporting post-transaction security ownership.

For more information, contact one of the following:

**Mark Borden**

[mark.borden@haledorr.com](mailto:mark.borden@haledorr.com)

**John Burgess**

[john.burgess@haledorr.com](mailto:john.burgess@haledorr.com)

**David Redlick**

[david.redlick@haledorr.com](mailto:david.redlick@haledorr.com)

<sup>1</sup> We recommend that company executive officers and directors do not exercise options by means of a typical broker-assisted cashless exercise because of the broad language in Section 402 of the Sarbanes-Oxley Act prohibiting any extension of credit, or arrangement of an extension of credit, by the company to its executive officers and directors.

<sup>2</sup> Please note that this provision does not apply to all Rule 10b5-1 plans, but only to those that do not specify the dates on which transactions occur.

<sup>3</sup> These transactions typically involve transfers in or out of, or cash withdrawals from, a company stock fund in a 401(k) plan or other employee benefit plan.