PAUL, WEISS, RIFKIND, WHARTON & GARRISON

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SEC ISSUES SUPPLEMENTAL INFORMATION REGARDING TWO-BUSINESS DAY FILING DEADLINE FOR REPORTS OF TRADING BY CORPORATE INSIDERS

On August 6, 2002, in response to Section 403 of the Sarbanes-Oxley Act of 2002 (the "Act"), the SEC released "supplemental information" regarding the filing of beneficial ownership reports by officers, directors and principal security holders under Section 16(a) of the Securities Exchange Act of 1934 (Release No. 34-46313).

Section 16 applies to every person that is a beneficial owner of more than 10% of any class of equity security registered under Section 12 of the Exchange Act and each officer and director of the issuer of that security ("insiders"). After the insider files an initial report of beneficial ownership of equity securities of the issuer, Section 16(a) requires the insider to report changes in such ownership or the purchase or sale of a security-based swap agreement involving such securities ("reportable transactions"). As currently in effect, Section 16 provides for reportable transactions to be reported within 10 calendar days after the close of the calendar month in which the reportable transaction occurs.

This memorandum summarizes the views expressed by the SEC with respect to implementing the amendments to Section 16.

Impact of the Act on Section 16

Section 403(a) of the Act amends Section 16(a) to require beneficial owners to report reportable transactions "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." Section 403(b) of the Act provides that the amendments to Section 16(a) become effective on August 29, 2002. Thus, all reportable transactions executed on or after August 29, 2002 will be reportable by insiders on Form 4 subject to the two-business day deadline, except where SEC rules provide otherwise.

1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

1615 L Street, NW
Washington, DC 20036-5694
(202) 223-7300

Alder Castle, 10 Noble Street
London EC2V 7JU England
(44-20) 7367 1600

2, rue du Faubourg Saint-Honoré
75008 Paris, France
(33-1) 53.43.14.14

Fukoku Seimei Building 2nd Floor
2-2, Uchisawaicho 2-chome
Chiyoda-ku, Tokyo 100, Japan
(81-3) 3597-8120

2918 China World Tower II
No. 1, Jianguomenwai Dajie
Beijing 100004, People's Republic of China
(86-10) 6505-6822

12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
(852) 2536-9933

In addition, Section 403(a) amends Section 16(a) to require, not later than July 30, 2003, that all reportable transactions be reported electronically and that such reports be posted on an SEC-sponsored website and the issuer's website not later than the end of the business day following the filing.

The SEC's Supplemental Information

The August 6 release states that the SEC will adopt final rules that will become effective not later than August 29, 2002 in order to implement the accelerated filing requirements. Those rules will include:

- amendments to Form 4 to reflect the new, accelerated deadline and to reflect that Form 4 is no longer a monthly form;
- amendments to Rule 16a-3(f) so that transactions between officers or directors and the issuer exempted from Section 16(b) short swing profit recovery by Rule 16b-3 (which are currently reportable on Form 5 within 45 days after the issuer's fiscal year end) will be required to be reported on Form 4 within two business days; and
- provisions regarding extended due dates for Form 4 disclosing "narrowly defined specified transactions" for which the SEC determines the two-business day deadline is not "feasible."

The August 6 release did not explicitly mention reporting deadlines for small acquisitions (which are currently reportable on Form 5 within 45 days after the issuer's fiscal year end, as provided in Rule 16a-6) rather than on Form 4. It is therefore not clear whether those small acquisitions will need to be reported on Form 5 or Form 4.

Transactions that will be subject to accelerated reporting on Form 4 as a result of the amendments to Rule 16a-3(f) include:

- the issuance of equity securities, such as restricted stock;
- the grant and exercise of stock options;
- the cancellation and regrant of stock options; and
- the exercise of other derivative securities.

"Non-Feasibility" Exemptions from the Accelerated Reporting Requirements

Because Section 16(a)(2)(C) (as amended by Section 403(a)) permits the SEC to specify that the filing deadline should be "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," it initially seemed possible that the SEC would adopt broad exemptions from the accelerated reporting requirements. However, in the August 6 release, the SEC explicitly declined to consider rules providing broad "non-feasibility" exemptions from the accelerated reporting requirements for transactions based on type of issuer, type of insider or size of transaction. Rather, the SEC is reviewing the feasibility of the accelerated deadlines only for "narrowly specified types of

transactions where objective criteria prevent the insider from controlling (and in many cases from knowing) the timing of the transaction execution."

Among the types of transactions being considered for exemption are:

- transactions pursuant to a single market order that is executed over more than one day, but not to exceed a specified number of days;
- transactions involving a pre-existing arrangement the timing of which is outside the knowledge of the insider before confirmation or other notice is sent to the insider, with a delay not to exceed a specified number of days; and
- discretionary transactions involving an employee benefit plan, where the delay would be tied to notice of the transaction.

Practical Responses to the Accelerated Reporting Requirements

In contrast to the SEC's prior proposal (see below), which would have imposed filing obligations on issuers in respect of insider transactions, the amendments to Section 16 do not alter the fundamental aspect of Section 16(a) -- namely that the filing obligation is the responsibility of the insider. Nonetheless, in order to ensure compliance by insiders with the accelerated filing deadlines specified in amended Section 16(a) and minimize the likelihood of inadvertent failures to report transactions, issuers should review their securities trading policies. In addition, given the short deadlines, and the eventual requirements that Section 16 filings be made via EDGAR and posted on the company website, issuer involvement in the filing process will be critical.

Issuers will have to establish internal procedures to make sure that Forms 4 can be filed on a timely basis at all times during the year. Insiders should be required to notify an appropriate individual at the company either prior to or contemporaneously with completing a transaction that would be reportable on Form 4. Issuers may wish to consider whether, from a practical standpoint, it is best to require internal pre-clearance of all transactions effected by executive officers and directors. Because of the proposed amendments to Rule 16a-3(f), issuers should also consider procedures that require the appropriate individual to be notified promptly upon or in advance of the grant of stock options, exercise of stock options or other activity with respect to stock options or other stock-based compensation for insiders.

We will be circulating a new form of corporate securities trading policy reflecting the accelerated requirements before August 29.

Impact on Prior SEC Proposals

The SEC had previously proposed, in Release No. 33-8090 (April, 12, 2002), rules requiring certain transactions between issuers and directors or officers to be reported on Form 8-K within two business days. Because of the changes to Section 16(a) enacted by the Act, the SEC has discontinued further consideration of rulemaking relating to such reporting requirements, although it continues to consider the other rulemaking proposed in Release No. 33-8090, including requiring issuers to disclose on Form 8-K information about Rule 10b5-1(c) plans and any company loans and loan guarantees not prohibited by Section 402 of the Act.

Other Disgorgement Provisions

In addition, executive officers and directors should be aware that other sections of the Act have profit-disgorgement provisions that are similar to, but should not be confused with, the short-swing profit provisions contained in Section 16. Section 304 of the Act requires the CEO and CFO to disgorge profits realized from their sales of issuer securities, as well as bonuses and other incentive-based or equity-based compensation received, during the 12-month period following the original filing of a report with the SEC if the report is subsequently restated due to material noncompliance, as a result of misconduct, with applicable reporting requirements. Section 306 of the Act requires executive officers and directors to disgorge profits resulting from insider transactions that are prohibited by Section 306 during pension fund blackout periods.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to any of the following members of our Securities Group ("SG"), M&A Group ("MA") or Executive Compensation Group ("EC"):

Mark S. Bergman - SG	(44 20) 7367 1601	Toby S. Myerson - MA	(1) 212-373-3033
Richard S. Borisoff –SG	(1) 212-373-3153	Carl L. Reisner - MA	(1) 212 373 3017
Andrew J. Foley – SG	(1) 212-373-3078	Michael J. Segal - EC	(1) 212 373 3364
Paul D. Ginsberg - SG	(1) 212-373-3131	Judith R. Thoyer - MA	(1) 212-373-3002
John C. Kennedy - SG	(1) 212-373-3025	Lawrence G. Wee - SG	(1) 212-373-3052
Edwin S. Maynard – SG	(1) 212-373-3024		

In addition, memoranda on related topics may be accessed under Securities Group publications on our web site (www.paulweiss.com).

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