

SEC Adopts New Rules Requiring Accelerated Reporting of Insider Transactions

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the “Act”). The legislation addresses accounting and corporate governance issues of critical importance to public companies. Certain provisions of the Act took effect immediately upon the President’s signing, while other provisions require rule-making by the Securities and Exchange Commission (the “SEC”).

Section 403 of the Act has immediate implications for public company directors and officers who are reporting persons under Section 16 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Section 403 requires Section 16 “insiders” to file Forms 4 to report changes in beneficial ownership of the company’s securities within *two business days* following the date of execution of a transaction. This accelerated reporting requirement is applicable to all transactions occurring on or after *August 29, 2002*.

On August 27, 2002, the SEC adopted rules and amendments to the forms filed under Section 16 of the Exchange Act to implement the new accelerated filing requirement (the “Final Rules”).¹ Key aspects of the Final Rules are summarized below.

BACKGROUND

Section 16 of the Exchange Act applies to all directors and executive officers of a public company and every person who is the beneficial owner of more than 10 percent of any class of equity security registered under Section 12 of the Exchange Act (collectively, “insiders”). Section 16(b) of the Exchange Act imposes liability on insiders of a public company who profit from any purchase and sale, or sale and purchase, or other acquisition or disposition of equity securities of the company where such transactions occur within a period of less than six months. Under Section 16(a), an insider is required to file with the SEC an initial report disclosing his or her beneficial ownership of all equity securities of the company and to keep such information current by reporting changes in such ownership. The initial report is satisfied by the filing of a Form 3. Thereafter, changes in beneficial ownership are reported on Forms 4 or, for a limited number of transactions, Forms 5.

¹ Release No. 34-46421, 67 Fed. Reg. 56462 (2002) (to be codified at 17 C.F.R. pt. 240, 249 and 274).

ACCELERATED REPORTING OF INSIDER TRANSACTIONS

Effective August 29, 2002, insiders of public companies must file Form 4 reports of changes in beneficial ownership in the company's securities before the end of the second business day after the date of execution of a transaction (the "Two-Day Rule"). Prior to this date, Forms 4 were required to be filed no later than 10 days after the end of the month in which a change in beneficial ownership occurred.

Application of the Two-Day Rule

The Two-Day Rule applies to all changes in beneficial ownership (with a few exceptions noted below under the heading "Exceptions to the Two-Day Rule") including the following transactions that previously could be reported on a Form 5:

- Grants, awards or acquisitions of securities from the company;
- Dispositions of securities to the company; and
- Certain discretionary transactions pursuant to an employee benefit plan.

This means that all stock option grants, exercises of stock options, repricings of stock options and cancellations of stock options are subject to the Two-Day Rule and must be reported within two business days of the date of the transaction.

Exceptions to the Two-Day Rule

Section 403 authorizes the SEC to promulgate rules exempting transactions from the Two-Day Rule where such two-day filing is not feasible. Under the Final Rules, the SEC carved out two exemptions applicable to the following transactions:

- Transactions pursuant to a contract, instruction, or written plan that complies with Rule 10b5-1(c) of the Exchange Act, where the insider does not select the date of execution; and
- Certain transactions ("Discretionary Transactions") pursuant to an employee benefit plan that are made at the insider's direction, but where the insider does not select the date of execution (other than such transactions made in connection with the death, disability, retirement or termination of the insider), and that result in either intra-plan transfers of previously invested assets into or out of a company's securities fund or cash-outs from a company's securities fund.

Under these two limited circumstances, the two-day filing requirement is modified such that the date of execution is deemed to be the date on which the executing broker, dealer or plan administrator notifies the insider of execution of the transaction, so long as the notification is no later than the third business day following the trade date. If notification is later than the third business day following the trade date, the execution date is deemed to be the third business day following the trade date.

CHANGES TO FORMS 4 AND 5

Under the Final Rules, the SEC amended the format of Forms 4 to conform all references to the Form 4 filing deadline to the two-business day deadline and to reflect that the Form 4 is no longer a monthly filing. In addition, the SEC amended Forms 4 and 5 to require certain additional information, *i.e.*, by adding a column for “deemed execution dates” for Discretionary Transactions and 10b5-1 plan transactions. The SEC plans to publish new forms as soon as possible. In the meantime, the SEC advises insiders to continue to use the current versions of the forms, but to make certain modifications. In particular:

- an insider should modify Box 4 on Form 4 to state the month, day and year of the transaction; and
- in cases of transactions using a deemed execution date, an insider should include an asterisk next to such trade date in the transaction date column and disclose the deemed execution date in a footnote.

ELECTRONIC FILING REQUIREMENTS

Section 403 also requires that by July 30, 2003, all insiders must file Forms 4 electronically (*i.e.*, via EDGAR) and all public companies must make such forms publicly available on the company’s website no later than the end of the next business day following the filing. Although electronic filing of Forms 4 will not be required until July 30, 2003, we encourage all insiders to begin filing their Section 16 reports via EDGAR now.

To facilitate early compliance with Section 403, the SEC has suspended certain formatting requirements of such electronic filings in order to make the process easier. For the time being, the SEC will accept electronically-filed Section 16 reports that are not presented in the customary box format and omit horizontal and vertical lines separating information items, so long as the information presented is in the proper order with the proper captions. To file electronically, insiders will need an EDGAR access code, which may be obtained from the SEC by submitting a Form ID to the SEC requesting such code.

SANCTIONS

A late or delinquent filing under Section 16 is required to be reported in a company’s proxy statement naming the directors or officers who failed to comply with the reporting requirements and the frequency of such non-compliance. Neither the Act nor the Final Rules change the sanctions imposed by failure to timely file reports under Section 16. The SEC, however, continues to maintain its broad authority to seek “any equitable relief that may be appropriate or necessary for the benefit of investors” for violations of any provisions of securities law. How the SEC will exercise this authority in the context of Section 16 reports remains to be seen.

RECOMMENDATIONS

Public companies are encouraged to review their current insider trading and Section 16 compliance programs, and modify them as necessary, to conform to the new accelerated filing requirements. Further, before making any trade through a broker, an insider should ensure that the broker can and will provide immediate confirmation of the execution of the transaction.

This Update was prepared by Saul Ewing Business Department attorney Katayun I. Jaffari, Esq. This is the second in a series of Updates being prepared by Ms. Jaffari and Patricia A. Gritzan, Esq., on the Sarbanes-Oxley Act of 2002, and the rules promulgated thereunder. Ms. Jaffari and Ms. Gritzan are members of Saul Ewing's Securities Transactions Practice Group. For more information, contact Ms. Jaffari at (215) 972-7161, or kjaffari@saulewing.com, or Ms. Gritzan at (215) 972-7139, or pgritzan@saulewing.com.

The statements contained in this Update are intended for general information and do not constitute, and should not be construed as, legal advice or legal opinion on any specific facts or circumstances. You are urged to consult with a member of Saul Ewing's Securities Transactions Practice Group concerning your own situation and any specific legal questions you may have.

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