

Client Alert

SEC Adopts Final Rules Restricting Insider Trading During Pension Fund Blackout Periods

Introduction

On January 15, 2003, the SEC adopted new Regulation Blackout Trading Restriction (Regulation BTR)¹ under §306(a) of the Sarbanes-Oxley Act of 2002 (SOA). SOA §306(a) prohibits directors and executive officers of an issuer from trading any equity security of the issuer during any pension fund blackout period if he or she acquired the equity security “in connection with his or her service or employment” as a director or executive officer.

Regulation BTR became effective on January 26, 2003.

Issuers and Persons Subject to Trading Prohibition

Regulation BTR applies to the directors and executive officers of public companies, including foreign private issuers. For foreign private issuers, a director is subject to Regulation BTR and SOA §306(a) only if he or she is also a management employee of the issuer and the term “executive officer” is limited to the issuer’s principal executive officer, principal financial officer and principal accounting officer.

Blackout Period

The trading prohibition applies during any period of more than three consecutive business days during which 50% or more of the participants or beneficiaries under all of a company’s individual account plans (such as 401(k) or profit sharing plans) are temporarily suspended by the company or by a plan fiduciary from purchasing, selling or transferring issuer equity securities held in the plans. For foreign private issuers, the trading prohibition applies during any such period in which the number of participants and beneficiaries located in the U.S. who are subject to the temporary trading

¹ Securities and Exchange Commission Release Nos. 34-47225; IC-25909; File No. S7-44-02. A copy of the release is available on the SEC website at <http://www.sec.gov/rules/final/34-47225.htm>.

The SEC originally proposed Regulation BTR on November 6, 2002. See Securities and Exchange Commission Release Nos. 34-46778; IC-25795; File No. S7-44-02. A copy of that release is available on the SEC website at <http://www.sec.gov/rules/proposed/34-46778.htm>.

suspension exceeds either (1) 15% of the total number of employees of the issuer or (2) 50,000.

Regulation BTR excludes the following from the definition of “blackout period”:

- regularly scheduled suspension periods if the periods are part of the plan, are properly disclosed and satisfy other specified conditions; and
- certain trading suspensions that are imposed in connection with corporate mergers, acquisitions, divestitures or similar transactions.

Securities Subject to Trading Prohibition

Regulation BTR’s insider trading prohibition applies not only to an issuer’s equity securities, but also to derivative securities relating to the issuer, whether or not issued by the issuer. The term “derivative security” has the same meaning as under the SEC’s Section 16 rules² and would include options, stock appreciation rights and certain cash-settled interests, such as phantom stock, the value of which is based on an equity security.

Transactions Subject to Trading Prohibition

SOA §306(a) makes it unlawful for directors and executive officers, directly or indirectly, to purchase, sell or otherwise acquire or transfer issuer equity securities during a blackout period if the director or executive officer acquires or previously acquired the equity security “in connection with his or her service or employment as a director or executive officer.” Regulation BTR establishes a rebuttable presumption that any equity securities sold or transferred during a blackout period by a director or executive officer are acquired in connection with service or employment as a director or executive officer if they are acquired:

- at a time when he or she was a director or executive officer, under a compensatory plan, contract or arrangement, including an option, warrant or rights plan, a pension, retirement or deferred compensation plan or a bonus, incentive or profit-sharing plan;
- at a time when he or she was a director or executive officer, as a result of any transaction or business relationship subject to disclosure under the SEC’s proxy

² See Rule 16a-1(c) under the Securities Exchange Act.

rules to the extent that he or she has a pecuniary interest (as defined under the SEC's Section 16 rules) in the equity securities;

- at a time when he or she was a director or executive officer, as directors' qualifying shares or other securities that he or she must hold to satisfy minimum ownership requirements or guidelines for directors or executive officers;
- before becoming, or while, a director or executive officer where the equity security was acquired as a direct or indirect inducement to service or employment as a director or executive officer; or
- before becoming, or while, a director or executive officer where the equity security was received in a business combination for an equity security of an entity involved in the business combination that he or she had acquired in connection with service or employment as a director or executive officer of that entity.

Regulation BTR permits the following transactions in equity securities during blackout periods:

- acquisitions under dividend or interest reinvestment plans;
- purchases or sales pursuant to a Rule 10b5-1(c) trading arrangement;
- purchases or sales, other than discretionary transactions, pursuant to certain "tax-conditioned" plans, such as 401(k), excess benefit and employee stock purchase plans;
- increases or decreases in the number of equity securities held as a result of stock splits or stock dividends;
- compensatory grants and awards (including options and SARs) pursuant to a plan that, by its terms, permits directors and executive officers to receive grants or awards, provides for grants or awards to occur automatically and specifies the terms and conditions of the grants and awards;
- exercises, conversions or terminations of derivative securities that were not written or acquired by a director or executive officer during the blackout period or while aware of the actual or approximate beginning or ending date of the blackout period, and where (1) the exercise, conversion or termination may only

occur on a fixed date or (2) the derivative security is exercised, converted or terminated by a counterparty with no influence by the director or executive officer;

- acquisitions or dispositions involving a *bona fide* gift or a transfer by will or laws of descent or distribution;
- acquisitions or dispositions pursuant to a domestic relations order;
- sales or other dispositions compelled by the laws or other requirements of an applicable jurisdiction; and
- acquisitions or dispositions in connection with a merger, acquisition, divestiture or similar transaction occurring by operation of law.

Notice Provisions

Regulation BTR requires issuers to provide notice of blackout periods to directors, executive officers and the SEC. The notice must include:

- the reasons for the blackout period;
- a description of the plan transactions to be suspended during, or otherwise affected by, the blackout period;
- a description of the class of equity securities subject to the blackout period;
- the actual or expected beginning and ending dates of the blackout period or the calendar weeks when the blackout period is expected to begin and end; and
- the name, address and telephone number of the person designated by the issuer to respond to inquiries about the blackout period, or, in the absence of such a designation, the issuer's human resources director or person performing equivalent functions.

Notice must be provided to directors and executive officers either within 5 business days after the issuer receives from the pension plan administrator the notice of a blackout period required under ERISA (which must be at least 30 and not more than 60 calendar days before the blackout period) or, if the issuer does not receive this notice, at least 15 calendar days before the actual or expected commencement of the blackout period. Issuers must provide directors and executive officers as soon as reasonably

practicable with an updated notice if there is a subsequent change in the beginning or ending dates of the blackout period.

Notice to the SEC must be on Form 8-K (under new Item 11) filed no later than the date notice must be provided to directors and executive officers. Foreign private issuers do not have a Form 8-K reporting obligation, but must file copies of the notices provided to directors and executive officers as exhibits to their next annual report on Form 20-F or 40-F, unless earlier voluntarily filed on a Form 6-K.

The notice requirements of Regulation BTR apply to blackout periods beginning on or after January 26, 2003. Notice to the SEC will be required beginning March 31, 2003 to allow time for new Item 11 of Form 8-K to be added to the EDGAR system. In the interim, issuers may provide the required SEC notice in the first quarterly report filed after the blackout period begins.

Remedies

Violations of the trading prohibitions or notice provisions of SOA §306(a) may be enforced by the SEC through civil injunctive actions, cease-and-desist proceedings, civil penalties and all other remedies available to the SEC to redress violations of the Exchange Act. In addition, the issuer, or an owner of the issuer's equity securities (on behalf of the issuer), may bring a private action to recover the profits realized by any director or executive officer in a transaction that violates the trading prohibitions of SOA § 306(a). An issuer's failure to provide the required notice will not preclude an SEC enforcement action for a violation of the trading prohibitions or a private action to recover profits.

Where a transaction involves an equity security of an issuer listed on a national securities exchange or listed in an automated inter-dealer quotation system of a national securities association, Regulation BTR provides that profit (including any loss avoided) may be calculated as the difference between the amount paid or received for the equity security during the blackout period and the average market price of the equity security calculated over the first three trading days after the end of the blackout period.

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For Additional Information

This client alert can be found, together with other recent Chadbourne & Parke LLP client alerts, at http://www.chadbourne.com/publications/sub_Publications.html. If you have any questions regarding Regulation BTR or SOA §306(a), please contact any of the following:

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