5. By amending § 97.31 RADAR SIAPs identified as follows:

. . . Effective November 26, 1981

South Bend, IN—Michiana Regional, RADAR-1, Amdt. 5
Terre Haute, IN—Hulman Regional, RADAR-1, Original

. . . Effective November 12, 1981

Lansing, MI—Capital City, RADAR-1, Amdt. 8

6. By amending § 97.33 RNAV SIAPs identified as follows:

. . . Effective November 26, 1981

Terre Haute, IN—Hulman Regional, RNAV Rwy 31, Amdt. 3
Dowagiac, MI—Cass County Meml, RNAV Rwy 9, Amdt. 3
Dowagiac, MI—Cass County Meml, RNAV Rwy 27, Amdt. 3
Nashua, NH—Boire Field, RNAV Rwy 32, Amdt. 2

. . . Effective November 12, 1981

Jacksonville, IL—Jacksonville Muni, RNAV Rwy 31, Amdt. 3, cancelled
Peoria, IL—Greater Peoria, RNAV Rwy 12, Amdt. 1, cancelled
Greenwood, MS—Greenwood-LeFlore, RNAV Rwy 18, Amdt. 2
Greenwood, MS—Greenwood-LeFlore, RNAV Rwy 36, Amdt. 2
West Point, MS—McCharen Field, RNAV Rwy 36, Amdt. 2
Newark, OH—Newark-Heath, RNAV Rwy 9, Amdt. 1
Newark, OH—Newark-Heath, RNAV Rwy 27, Amdt. 1

(Secs. 307, 313(a), 601, and 1110, Federal Aviation Act of 1958 (49 U.S.C. §§ 1348, 1354(a), 1421, and 1510); Sec. 6(c), Department of Transportation Act (49 U.S.C. § 1655(c)); and 14 CFR 11.49(o)(3))

Note.—The FAA has determined that this regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore—(1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal; and (4) will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.
Issued in Washington, D.C. on September 25, 1981.

John M. Howard,
Acting Chief, Aircraft Programs Divisions.

Note.—The incorporation by reference in the preceding document was approved by the Director of the Federal Register on December 31, 1980.

[FR Doc. 81-28614 Filed 9-30-81; 8:45 am]
BILLING CODE 4910-13-M

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 210

[Release Nos. 33-6348, 34-18117, 35-22203, and AS-298]

Revision of Property, Plant, and Equipment Disclosure Requirements

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Commission announces the adoption of amendments to the disclosure requirements for the detailed property, plant and equipment schedule and the related schedule of accumulated depreciation, depletion and amortization [Schedules V and VI]. The amendments limit the presentation of these schedules to instances where property, plant and equipment is at a high level of significance, and clarify the existing rules to make it explicit that the schedules, when required, shall be included for each year for which an income statement is presented.

EFFECTIVE DATE: October 1, 1981.

FOR FURTHER INFORMATION CONTACT: Eugene W. Green (202-272-2130), M. Elizabeth Rader (202-272-2133), or LeGrand C. Kirby (202-272-2050), Office of the Chief Accountant, Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: On February 25, 1981, the Commission published Securities Act Release No. 33-6293 [46 FR 15278] in which it proposed amendments to (1) liberalize the percentage tests for exemption from the requirement to file Schedules V (Property, Plant, and Equipment) and VI (Accumulated Depreciation, Depletion, and Amortization), and (2) modify and expand the information content of those schedules. The adopted amendments broaden the proposed exemption criteria requiring the presentation of Schedules V and VI only by those registrants that are relatively capital intensive. The proposed changes to the form and content of the schedules have not been adopted; thus the schedules retain their current form. This release discusses the background of the proposed amendments, the comments received, and the final rules adopted.

Background

As part of the overall project to consider general revisions to Regulation S-X, the Commission in January 1980 initially proposed amendments which would have revised the schedule requirements in Rules 5-04, 12-06, and 12-07 [17 CFR 210.5-04, 210.12-06 and 210.12-07] for property, plant and equipment ("PP&E") and accumulated depreciation, depletion and amortization. This proposal was later withdrawn for further study. A second proposal, published for comment in February 1981, would have required the PP&E information in Schedules V and VI to be organized by business segments and would have modified the exemption rules to reduce the number of registrants required to file the schedules. Disclosures of fully depreciated assets still in use and idle capacity were retained in the second proposal but were required only if significant to the business segment to which they related.

Views of Commentators and Final Rules

The revised proposal to expand and significantly modify the detail information reported in the schedules met with substantial criticism. A majority of the respondents strongly opposed expansion of the existing requirements and recommended that these sections of the proposed amendments be withdrawn. Opposition to the proposed disclosure requirements was generally based on the high cost and/or impracticability of accumulating the data as well as a lack of demonstrated need for the expanded disclosure. Commentators emphasized that they did not maintain property records in this detail on a segment basis, and that they would have to incur substantial additional costs to develop the necessary systems. Most of the commentators estimated that the accumulation of data on fully depreciated assets in use and idle capacity would be very costly since the information was not part of the basic property records. Further, the identification of fully amortized assets in use would often require a physical inventory and would be virtually impossible for companies that use a composite depreciation method. The commentators also stated that allocations of jointly used facilities often made it unrealistic to track assets and accumulated depreciation balances by segment. Based on these arguments, the Commission has concluded that the proposed expanded disclosures would not be a cost-beneficial addition to existing segment data. The Commission continues to believe that information about idle facilities may be important to an analysis of an enterprise. However, generally accepted accounting principles require disclosure of the existence of significant idle facilities; and Instruction 1 to Item 2(a) of Regulation S-K (Description of Property) calls for information on the extent of utilization of facilities. In addition, where current year changes in idle facilities have a material impact on the results of operations, it would also be necessary to address such matters in Management's Discussion and Analysis of Financial Condition and Results of Operations.[1]

Most commentators expressed general support for the proposed liberalization of the exemption from the schedule requirements. Moreover, the Commission understands that the supplemental PP&E disclosures are primarily of benefit to investors and potential investors analyzing companies in capital intensive industries. Accordingly, the Commission has concluded that the PP&E schedules should be required only of relatively capital intensive registrants. The Commission is adopting amendments to Rule 5-04 of Regulation S-X which exempt from presentation of the schedules those registrants whose PP&E, net of accumulated depreciation, depletion and amortization, is less than 25 percent of total assets at both the beginning and end of the latest fiscal year. This 25-percent test represents a revision of the February 1981 proposal to allow exclusion if net PP&E is less than 10 percent and gross PP&E is less than 20 percent of total assets. Focusing only on net PP&E simplifies the test, and the increase in the percentage threshold to 25 percent limits the schedule requirements to those registrants that are relatively capital intensive.

The test is to be applied at both the beginning and end of the year in order to offset unusual fluctuations in total assets. Since the test focuses on the latest fiscal year, schedules will not be necessary for prior years if not required currently. However, the schedules will be required for previous years if the schedules are required for the current year.

The exemption of noncapital intensive entities from the schedule requirements is in furtherance of the Commission's goal to reduce reporting burdens while maintaining adequate disclosure for users. The Commission is also adopting minor technical amendments to Rule 5-04 to make it explicit that the PP&E schedules are required for each year for which an income statement is presented.

Regulatory Flexibility Certification

Section 604(a) of the Administrative Procedures Act, as amended by the Regulatory Flexibility Act ("Flexibility Act"), generally requires the Commission to prepare for final rules a final regulatory flexibility analysis which addresses the impact of such rulemaking on small entities as defined under the Flexibility Act. Section 605(b) of the Flexibility Act, however, specifically exempts from this requirement any final rule which will not "have a significant economic impact on a substantial number of small entities." The Commission believes that the final amendments announced in this release will not impose an additional regulatory burden on entities subject to the rules. Accordingly, the Chairman of the Commission has certified that the final amendments will not have a significant impact on a substantial number of small entities.

Effective Date

The amendments shall be effective October 1, 1981.

Text of Amended Rule

Part 210 of Title 17 CFR Chapter II is amended as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, PUBLIC UTILITY HOLDING COMPANY ACT OF 1935, INVESTMENT COMPANY ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

1. By revising Schedules V and VI in § 210.5-04 to read as follows:

§ 210.5-04 What schedules are required to be filed.

* * * * *

Schedule V—Property, plant and equipment. The schedule prescribed by § 210.12-06 shall be filed for each period specified in paragraph (a)(2) of this section, provided that these schedules may be omitted if, at both the beginning and end of the latest fiscal year, the total of property, plant and equipment (caption 13 on the balance sheet) less accumulated depreciation, depletion and amortization (caption 14 on the balance sheet) is less than 25 percent of total assets as shown by the related balance sheet.

Schedule VI—Accumulated depreciation, depletion and amortization of property, plant and equipment. The schedule prescribed by § 210.12-07 shall be filed for each period specified in paragraph (a)(2) of this section. This schedule may be omitted if Schedule V is omitted.

* * * * *

These amendments are adopted pursuant to authority in sections 6, 7, 8, 10 and 19(a) [15 U.S.C. 77f, 77g, 77h, 77j, 77s] of the Securities Act of 1933; sections 12, 13, 15(d) and 23(a) [15 U.S.C. 78*l*, 78m, 79o(d), 78w] of the Securities Exchange Act of 1934; and Sections 5(b), 14 and 20(a) [15 U.S.C. 79e, 79n, 79t] of the Public Utility Holding Company Act of 1935. Pursuant to section 23(a)(2) of the Securities Exchange Act of 1934, the Commission has considered the impact of these amendments on competition and is not aware of any burden that they would impose on competition. Inasmuch as the above described amendments do not impose any additional requirements under § 210.5-04, the Commission finds, for good cause, that the thirty-day notice provision specified in the Administrative Procedure Act [5 U.S.C. 553(d)] is unnecessary and, accordingly, the amendments shall be effective on October 1, 1981.

By the Commission.

September 24, 1981.

George A. Fitzsimmons,

Secretary.

Regulatory Flexibility Act Certification

I, John S. R. Shad, Chairman of the Securities and Exchange Commission, hereby certify, pursuant to 5 U.S.C. 605(b) that the adoption of amendments to the disclosure requirements for the detailed schedule of property, plant and equipment and the related schedule of accumulated depreciation, depletion and amortization contained in Securities Act Release No. 6348 (September 24, 1981), "Revision of Property, Plant and Equipment Disclosure Requirements," will not have a significant economic impact upon any reporting entity and, therefore, will not have a significant economic impact on a substantial number of small entities. The reasons for this certification are that the revisions should reduce the number of registrants required to file the detailed property, plant and equipment schedules and will have no effect on the compliance burden of registrants required to file the schedules.

Dated: September 24, 1981.

John S. R. Shad,

Chairman.

[FR Doc. 81-28598 Filed 9-30-81; 8:45 am]

BILLING CODE 8010-01-M

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17 CFR Parts 230 and 239

[Release No. 33-6346; File No. S7-860]

Report of Sales of Securities and Use of Proceeds

AGENCY: Securities and Exchange Commission.

ACTION: Final rule and form.

SUMMARY: The Commission announces the amendment of Rule 463 and related Form SR which require filings by issuers with respect to their first effective registration statements disclosing information concerning their offerings and the use of proceeds therefrom. The amendments, which do not substantially change either the application of the rule

[1] Item 11 of Regulation S-K.

or the disclosures required by the form, include: a standardized short-answer format for Form SR; a materiality standard for disclosure of differences between actual uses of proceeds and the uses stated in the prospectus; clarified provisions for the time for filing the form and filings by successor issuers; and additional exemptions from the filing requirement. The amendments are intended to simplify and clarify the requirements relating to Form SR and to enhance the usefulness of reports on Form SR.

EFFECTIVE DATE: January 4, 1982.

FOR FURTHER INFORMATION CONTACT: Prior to the effective date of the amendments, Susan Davis, (202) 272-2604, Office of Disclosure Policy, Division of Corporation Finance; after the effective date of the amendments, David Martin, (202) 272-2573, Office of Chief Counsel, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today announced the adoption of amendments to Rule 463 (17 CFR 230.463) under the Securities Act of 1933 (the "Securities Act") [15 U.S.C. 77a et seq.] and to related Form SR (17 CFR 239.61) pursuant to section 19(a) of the Securities Act. The amendments are designed to maintain the applicability of Form SR to issuers with respect to their first effective registration statements ("first-time issuers"), to enhance the usefulness to investors and the Commission of the disclosures in reports on Form SR, to clarify and simplify reporting requirements and to reduce reporting burdens, to the extent practicable. The amendments do not represent a significant change in either the application of, or disclosures required by, the current rule or form. Among the amendments are the following:

(1) Amendments to Rule 463 to make clear that the Form SR filing requirement applies to successor issuers to the extent that the filing requirement filings on Form SR are required of the predecessor and that the filing requirement does not apply to issuers that succeed to seasoned issuers;

(2) An amendment to Rule 463 to make clear that, where an offering of a first-time issuer has terminated but the issuer has not yet finally applied the offering proceeds, the issuer must continue to file reports on Form SR until the final application of the proceeds has been reported;

(3) An amendment to Rule 463 to exempt from the Form SR filing requirement issuers of securities offered in connection with certain business combination transactions, pursuant to employee benefit plans, or pursuant to dividend or interest reinvestment plans;

(4) Revision of Form SR's narrative format to a standardized short-answer format; and

(5) An amendment to Form SR to include a materiality standard in the requirement to disclose differences between the actual uses of proceeds and the uses stated in the prospectus.

Originally adopted in 1971,[1] Rule 463 and Form SR require first-time issuers, absent an exemption, to file reports with the Commission concerning the progress of their offerings and the use of proceeds therefrom. In addition to eliciting information for investors and the marketplace, Rule 463 and Form SR are intended to permit the Commission to monitor the compliance of first-time issuers with the prospectus delivery and updating requirements of Sections 4(3)[2] and 10(a)(3)[3] of the Securities Act.

On October 23, 1980, the Commission proposed for comment[4] the first substantial revisions of Rule 463 and Form SR since 1971.[5] Rule 463 was proposed to be amended: to extend the filing requirement to offerings by issuers through direct distributions and by best efforts underwritings; to eliminate the current exemption for public utility companies and to add three new exemptions to the filing requirement;[6] to reduce the number of reports on Form SR required to be filed; and to clarify the time at which reports on Form SR must be filed. Form SR was proposed to be amended: to change its narrative format to a standardized short-answer format easily digested by a data processing system; to obtain more detailed information from issuers regarding their offering expenses and use of proceeds; to obtain certain identifying and market information from issuers; and to include a materiality standard in connection with the requirement to disclose differences between the actual uses of proceeds and the uses set forth in the prospectus. The proposals were designed to provide investors and the Commission with information concerning offerings pursuant to a direct distribution or by a best efforts underwriting, in addition to those by first-time issuers.

The Commission received five comment letters on the proposals.[7] The commentators generally supported the proposals that were designed to simplify the reporting procedures, such as the change to a short-answer format. While certain commentators supported the application of Form SR to first-time issuers, the majority opposed any increase in the Form SR reporting burdens, particularly the proposed extension of the filing requirement to direct distributions and best efforts offerings.

Based on the Commission's reconsideration of the proposals in light of the views expressed by the commentators, the adopted amendments differ from the proposals but do not constitute significant changes in the current regulation. Thus, the Commission is not extending the application of Form SR to direct distributions or best efforts offerings, as proposed, nor is it substantially expanding the disclosures required concerning offering expenses and the use of proceeds, as proposed. In this regard, the Commission affirms the need for first-time issuers to provide the disclosures required by Form SR to investors and the Commission.

This release contains a synopsis of the amendments which is intended to assist in a better understanding of the Commission's actions. Attention is directed, however, to the text of the rule and form for a more complete understanding of the amendments.

I. Synopsis

A. Amendments to Rule 463

1. *Applicability.*

While existing Rule 463, and the adopted amendments, require only first-time issuers to file reports on Form SR, the proposal would have extended the filing requirement to issuers of securities

[1] Securities Act Release No. 5141 (April 19, 1971) [36 FR 7896].

[2] Section 4(3) provides that dealers effecting transactions in a security registered for the first time under the Securities Act must deliver a prospectus to prospective customers during the ninety-day period following the commencement of the offering.

[3] Section 10(a)(3) provides that if a prospectus is used more than nine months after the effective date of the registration statement the information contained therein must be no more than sixteen months old.

[4] Securities Act Release No. 6251 (October 23, 1980) [45 FR 71811] (the "1980 Release").

[5] Rule 463 had previously been amended in one minor respect to make clear that a report on Form SR should be filed at the office of the Commission where the registration statement was filed. Securities Act Release No. 6049 (April 3, 1979) [44 FR 21562].

[6] The proposed exemptions were for securities issued in connection with a business combination under paragraph (a) of Securities Act Rule 145, pursuant to an employee benefit plan, or pursuant to a dividend reinvestment plan.

[7] The five commentators may be categorized as follows: law firms and associations (2); corporations (2); and individuals (1). Copies of the comment letters are available for public inspection and copying at the Commission's Public Reference Room (File No. S7-860).

offered pursuant to direct distributions or best efforts underwritings. The 1980 Release stated that the purpose of the proposed extension was to facilitate the determination of whether an issuer of securities offered pursuant to a direct distribution or by a best efforts underwriting is complying with the prospectus delivery and updating requirements of the Securities Act and to provide additional information to investors and the Commission concerning direct distributions and best efforts offerings.

The proposed extension, which received more comment than any other proposal, was not favored by the commentators. One stated that the Commission has not shown that problems of non-compliance with prospectus delivery and updating requirements have arisen in connection with direct distributions and best efforts offerings to warrant an extension of the Form SR filing requirement to those offerings. Another stated that the extension of the filing requirement to such offerings as "shelf" registrations by seasoned issuers would result in minimal improvement in the quality of disclosure. The commentators generally, however, did not object to the use of Form SR to elicit information from first-time issuers regarding the progress of their offerings or their use of proceeds. Two commentators strongly supported the Form SR reporting requirement for regulating the new issuer market and for having a prophylactic effect on new issuers with respect to the use of proceeds.

The Commission believes that it is both necessary and appropriate for the protection of investors that first-time issuers provide the information required by amended Form SR. In its Report of Special Study of Securities Markets, the Commission recognized that there are special characteristics and risks associated with first-time offerings and that the disclosure process should be especially refined and adapted in connection with such offerings.[8] In the case of first-time offerings, the use by an issuer of the proceeds of the offering may well determine the nature of the business, so that the use of proceeds for a purpose other that than stated in the prospectus is apt to be of substantial importance to investors.

Furthermore, the Commission believes that it is not necessary to extend the Form SR filing requirement beyond its current application to first-time issuers. An extension of the filing requirement to direct distributions and best efforts offerings would substanitally increase the number of issuers required to file reports on Form SR. In view of the comments received, it is not clear at this time that the benefits that would be derived from such an extension outweigh the additional reporting burdens that would be imposed on issuers. Accordingly, the Commission is not amending Rule 463 to require issuers of securities sold pursuant to direct distributions or best effort underwritings to file reports on Form SR.

In the 1980 Release, the Commission also proposed to extend the Form SR filing requirement by eliminating the current exemption for any public utility company and public utility holding company required to file reports with any state or federal authority. At the same time, however, the Commission proposed to add three new exemptions for securities issued in connection with a business combination as described in Rule 145(a) (17 CFR 230.145(a)) under the Securities Act; pursuant to an employee benefit plan; and pursuant to a dividend reinvestment plan. In light of the degree of state regulation over public utility companies' uses of proceeds and the Commission's determination to limit the application of the Form SR filing requirement as much as practicable consistent with the public interest, the Commission is retaining the exemption from Rule 463 for public utility companies. Moreover, the Commission is adopting the three additional exemptions. The exemption for dividend reinvestment plans has been revised, however, to include interest reinvestment plans, which are substantially similar in nature. All exemptions are contained in paragraph (d) of the rule.

Finally, the Commission proposed to amend Rule 463 to clarify the application of the Form SR filing requirement to certain successor issuers. Although the one commentator expressing views on this issue supported the Commission's intent to clarify the matter, that commentator suggested changes to avoid any implication that a successor to a seasoned issuer (an issuer that has had one or more registered offerings and thus is not subject to the Form SR filing requirement) would be required to file reports on Form SR with respect to its first effective registration statement after the succession.

The Commission agrees that successor issuers to seasoned issuers should not be subject to the Form SR filing requirement. The proposed clarification of the term was intended to ensure that, where a first-time issuer that is required to file reports on Form SR is succeeded by another issuer before a final report has been filed, investors and the Commission should continue to receive meaningful information concerning the offering and use of proceeds with respect to the predecessor's effective registration statement. In such a situation, the successor issuer should assume responsibility to file any report(s) on Form SR that remain to be filed in connection with the registration statement when such reports are due.

To clarify the applicability of the Form SR filing requirement to an issuer that succeeds to another issuer while that other issuer is engaged in distributing its first offering or has not yet applied all of the proceeds of such offering, Rule 463(a) has been amended to require that a successor issuer file reports on Form SR with respect to the first effective registration statement of its predecessor issuer. Paragraph (b) of Rule 463 has been added to state that a successor issuer is required to file reports on Form SR only to the extent that filings on Form SR are required with respect to the first effective registration statement of the predecessor issuer.

A related addition was made in Rule 463(d) to make clear that an issuer that has succeeded to a seasoned issuer is not required to file reports on Form SR with respect to any effective registration statement subsequent to the succession. More specifically, Rule 463(d)(2) will exempt registration statements for securities to be offered by an issuer which, pursuant to a business combination described in Rule 145(a) under the Securities Act, has succeeded to another issuer that, prior to such business combination, had a registration statement declared effective under the Securities Act and, on the date of such business combination, was not subject to the requirements of paragraph (a) of Rule 463 to file reports on Form SR.

2. *Filing procedures.*

Currently, Rule 463 requires that Form SR be filed within 10 days after the end of the first three-month period following the effective date of the registration statement and within 10 days after the end of each successive six-month period, with a final report being filed within 10 days after "completion or termination of the offering and application of the proceeds therefrom."[9]

[8] Report of the Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 95, 88th Cong., 1st Sess., Part 1, at 487–559 (1963).

[9] Form SR includes an instruction to the effect that a registrant shall continue to file reports on Form SR as long as the offering proceeds have only been temporarily invested and not applied to their ultimate use.

The 1980 Release proposed to amend Rule 463 to require an initial report on Form SR within 30 days after the date that is six months after the effective date of the registration statement (if the offering has not yet terminated), a report within 30 days after the termination of the offering ("termination" being defined to mean the date on which securities cease to be offered for sale) and within 30 days after the application of the proceeds, if that occurs subsequent to the termination of the offering ("application" being defined not to include the temporary investment of proceeds pending final application). The proposals were intended to minimize reporting burdens on issuers, particularly in view of the proposed extension of the Form SR filing requirement to direct distributions and best efforts underwritings. They were also intended to clarify the time at which reports on Form SR must be filed in the case of an offering that terminated prior to the application of proceeds and to clarify when the proceeds are deemed to be applied. In connection with these proposals, the 1980 Release specifically requested comment on whether the existing filing procedures should be retained.

Commentators did not object to the existing filing requirements nor did they express much support for the proposed amendments. One commentator specifically objected to reducing the number of reports required to be filed by first-time issuers stating that, although reduction of filing burdens is normally desirable, it need not be given priority in the case of first-time issuers, as there is need of special care in introducing such issuers into the responsibilities of the federal disclosure system.[10]

On the basis of the comments received, it does not appear that the filing requirement is overly burdensome on first time issuers. Moreover, as commentators indicated, the existing Form SR reporting system has worked well to make disclosure available to investors and the Commission and to prevent abuses in connection with first-time offerings. In view of this, and since the application of Rule 463 is not being expanded, the Commission has determined to retain the current filing procedures.

The Commission believes, however, that the existing filing procedures need certain clarification. Rule 463 requires an issuer to file a final report after the application of the proceeds received from the offering, in order that investors and the Commission may evaluate whether the proceeds were used for substantially the same purposes as stated in the prospectus. By requiring, however, that a final report on Form SR be filed "at completion or termination of the offering and application of the proceeds therefrom," Rule 463 may not make clear an issuer's continuing reporting obligation where its offering has terminated but the proceeds have not yet been finally applied. Similarly, an issuer may be confused under Rule 463 as to its final reporting obligation where its offering has terminated but there are no offering proceeds or the offering proceeds have already been applied.

To remedy these interpretive problems, the Commission is amending paragraph (a) of Rule 463 to require an issuer to file a final report on Form SR within 10 days after the application of proceeds or within 10 days after the termination of the offering, whichever is later. Thus, the date on which the offering terminated will be the trigger for the final filing requirement only in those situations where an offering terminates without any offering proceeds to be applied, or where the proceeds from the offering were applied before the offering terminated. Definitions of the terms "application" and "offering proceeds" are also included in paragraph (c) of Rule 463. The term "application" would not include the temporary investment of proceeds prior to their final application and the term "offering proceeds" would exclude any amounts received for the accounts of selling security holders. The term "termination" has not been included in Rule 463(c) since the term is generally understood to mean the date on which the securities cease to be offered for sale.[11]

The Commission has adopted one other amendment to the filing procedures that is designed to clarify those procedures. As proposed in the 1980 Release, Rule 463(a) is amended to require that copies of the report on Form SR be filed at the same office of the Commission where the registration statement to which the report relates was filed.

B. *Amendments to Form SR*

1. *Short-answer format.*

The 1980 Release proposed to change the current narrative format of Form SR to a standardized short-answer format. The proposal was intended to make it possible for data reported on Form SR to be digested by a data processing system, thereby enhancing the usefulness of Form SR to investors and the Commission. Commentators supported the proposal for the reasons that it would simplify reporting on Form SR and would minimize burdens on the Commission's staff without decreasing the level of regulatory oversight or significantly increasing burdens on issuers. To enhance the usefulness by investors and the Commission of the information provided on Form SR, Form SR is being amended from a narrative format to a standardized short-answer format.

2. *Instructions.*

In connection with the proposal to change Form SR to a standardized short-answer format, the 1980 Release included two proposed instructions dealing with the method of entering information on the form and the preparation of a report by a successor issuer. Designed to assist issuers in the preparation and filing of reports on Form SR, these instructions are adopted essentially as proposed.

To further assist issuers in the preparation of reports, three additional instructions have been adopted. The first directs issuers to refer to Rule 463 and, in addition, to Rules 405 (17 CFR 230.405) and 409 (17 CFR 230.409) under the Securities Act regarding definitions of terms used in the form and information unknown or not reasonably available, respectively. Just as Rules 405 and 409 provide guidance to issuers in the preparation of registration statements for the offering of securities under the Securities Act, they are appropriate sources of guidance for the preparation of reports on Form SR. The second instruction makes clear that there is no need for an issuer to report information, other than identifying information, in subsequent reports if the information has not changed from the previous Form SR filed. Finally, the third instruction would indicate where, and how many copies of, Form SR should be filed.

3. *Expenses and Use of Proceeds.*

The disclosure requirements concerning expenses and use of proceeds are central to Form SR, as the form's primary purpose is to enable investors and the Commission to track

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[10] The Form SR filing procedures are substantially similar to those in effect in connection with Forms 242 (17 CFR 239.242) and 4(6) (17 CFR 239.246) under the Securities Act.

[11] It should be noted that, if the Commission adopts proposed Rule 462A, which would permit registration of securities to be sold on a delayed or continuous basis (i.e., a "shelf" registration) under certain conditions (Securities Act Release No. 6334 (August 6, 1981)[46 FR 42001]), the Form SR filing requirement would be applicable to any shelf registration that is the first effective registration statement of the issuer. If Rule 462A is adopted, as proposed or in a revised form, the Commission may consider at that time whether any of the filing requirements of Rule 463, particularly the requirement to file successive six-month reports, should be changed for shelf registrations.

the expenses and use of proceeds stated in the prospectus, through the offering, to the actual uses of the offering proceeds. Currently, the issuer provides this information through a reasonably itemized list of the uses made of its proceeds from the sale of securities, with certain expenses and purposes stated separately,[12] and payments to affiliates [13] stated separately from payments to others. Form SR also contains requirements to disclose the nature and terms of any temporary investments and to disclose the existence of, and reasons for, any difference between the actual uses of proceeds and the uses stated in the prospectus.

The 1980 Release proposed to amend the disclosure requirements to obtain more detailed information concerning expenses and the use of proceeds, and to include general partners of the issuer among the persons to whom payments must be separately stated. The proposal would also have required an explanation of only material differences between the use of proceeds described in the prospectus and the actual use of proceeds. The amendments to Form SR substantially retain the existing disclosure requirements, include general parnters of the issuer among those affiliates to whom payments must be separately stated, and include a materiality standard in disclosure of differences in the use of proceeds.

The change to a short-answer format of necessity requires an enumeration of expenses and uses of proceeds. The Commission is amending the requirements relating to disclosure of these items to contain enumerated categories, analogizing the new requirements to existing requirements to the extent practicable.[14] In the case of expenses, amended Form SR lists those expenses that are currently required to be stated separately. With respect to the uses of proceeds, the amended form enumerates those purposes that are normally contained in registration statements or are currently required by Form SR, such as construction of plant, building, or facilities, acquisition of other businesses, working capital, and temporary investments. Like the current form, amended Form SR instructs the issuer to enumerate each purpose for which 5 percent of its total offering proceeds or $50,000, whichever is less, has been used. Thus, an issuer reporting on amended Form SR would indicate the amounts used for the specific categories of expenses and uses of proceeds enumerated. The amended Form SR makes clear, however, that amounts should not be stated as having been applied to "working capital" where a more specific category applies.

In addition, the Commission is making two revisions in the disclosure requirements relating to expenses and use of proceeds designed to decrease reporting burdens without reducing the quality of reports on Form SR. First, the requirement that the issuer disclose any difference between the actual uses of proceeds and the uses described in the prospectus has been amended to require that the issuer indicate only whether the uses of proceeds represent a material change from those disclosed in the prospectus and, if so, to explain briefly the reasons for such material change.[15] This change was proposed in the 1980 Release and was not objected to by commentators. Second, an issuer may provide an estimate of any expense or amount applied to a particular purpose if the actual amount is not known.[16] Where an estimated, rather than an actual, amount is provided, the issuer is required to so indicate by checking a box on the form.[17]

4. *Other disclosure requirements.*

Currently, Form SR requires, in addition to information on expenses and the use of proceeds, information concerning the names of the managing underwriters, if any, and information concerning the progress of the offering.[18] The Commission's proposal that these items be put into a short-answer format resulted in the proposed consolidation or separation of certain items. In addition, the 1980 Release proposed to revise the disclosure requirements of Form SR to require certain identifying information (e.g., the issuer's CUSIP number and Standard Industrial Classification number), market information (e.g., the market on which the securities are traded), and additional information concerning the progress of the offering (e.g., the total amount of securities sold, but not delivered, as of the most recent practicable date) currently not required by the Form.

Consistent with its determination to essentially retain the existing Form SR disclosure system and not to substantially change the applicability, filing procedures, or disclosure requirements as to expenses and use of proceeds, amended Form SR includes, for the most part, only the proposed short-answer disclosure items that are analogous to the existing disclosure items in Form SR. Certain requirements were revised to clarify their application in the case of a registration statement pursuant to which more than one class of securities is being offered or pursuant to which securities are being offered for the accounts of selling security holders as well as for the issuer.

The Commission is not amending Form SR to require additional identifying and market information with the exception of the effective date of, and file number assigned to, the registration statement and the issuer's CUSIP number, if such a number has been assigned. In addition, Form SR is not being amended to require disclosure of the amount of securities sold, but not delivered, as of the most recent practicable date. Identifying and market information can be obtained, if necessary, from various sources without substantial difficulty. Information concerning the amount of securities sold but not delivered, while possibly helpful to the Commission in monitoring first-time filings, might not be readily available to issuers without incurring undue expense. Accordingly, the Commission does not believe that it is necessary to impose additional burdens on issuers to provide such information.

II. Statutory Authority

These amendments are being adopted pursuant to Section 19(a) of the Securities Act, 15 U.S.C. 77s(a).

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[12] Form SR requires separate disclosure of separate payments to directors and officers of the issuer and their associates, persons owning 10 percent or more of any class of equity securities of the registrant and affiliates of the registrant.

[13] Specifically, Form SR requires separate disclosure of underwriting discounts and commissions, finders' fees, expenses paid to or for the underwriters, other expenses paid to date, and other purposes for which the lesser of $50,000 or 5% of the total proceeds has been used.

[14] In this regard, the Commission is not revising the dislosure items, as proposed in the 1980 Release, to require substantially more detailed information regarding expenses and the use of proceeds than that currently required by Form SR. Based on commentators' objections to these proposals, the Commission believes that an enumeration more detailed than that provided in the prospectus is not necessary.

[15] It should be noted that the Commission recently proposed to modify the definition of the term "material" contained in Rule 405 to bring that definition into conformance with the Supreme Court's decision in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) and with subsequent case law. Securities Act Release No. 6333 (August 6, 1981) [46 FR 41971].

[16] In this regard, the appropriate standard of knowledge is whether the expense or amount applied to a particular purpose is known to the issuer, not whether it is known to the individual signing the report.

[17] This requirement is derived from Forms 242 and 4(6).

[18] Specifically, Form SR requires information concerning the date the offering commenced or, if it has not commenced, the reasons why; the date the offering was completed and, if the offering terminated prior to completion, the reasons why; the amount of securities registered, sold and still being offered; and the total amount received from the public from the sale of securities for the account of the registrant.

III. Text of Rule and Form

In accordance with the foregoing, the Commission is amending Title 17, Chapter II, of the Code of Federal Regulations as follows:

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933; REGULATION C: REGISTRATION

1. Section 230.463 is revised to read as follows:

§ 230.463 Report of offering of securities and use of proceeds therefrom.

(a) Except as hereinafter provided in this section, within 10 days after the end of the first three-month period following the effective date of the first registration statement filed under the Act by an issuer, and within 10 days after the end of each six-month period following such three-month period, the issuer or successor issuer shall file with the Commission four copies of a report on Form SR (§ 239.61 of this chapter) containing the information required by that form. A final report shall be filed within 10 days after the later of (1) the application of the offering proceeds or (2) the termination of the offering. A report on Form SR shall be filed at the same office of the Commission where the registration statement to which it relates was filed.

(b) A successor issuer shall comply with paragraph (a) of this section only to the extent that filings on Form SR are required with respect to the first effective registration statement of the predecessor issuer.

(c) For purposes of this section—

(1) The term "offering proceeds" shall not include any amount(s) received for the account(s) of any selling security holder(s).

(2) The term "application" shall not include the temporary investment of proceeds by the issuer pending final application.

(d) This section shall not apply to any effective registration statement for securities to be issued:

(1) In a business combination described in Rule 145(a) (§ 230.145(a));

(2) By an issuer which pursuant to a business combination described in Rule 145(a) has succeeded to another issuer that prior to such business combination had a registration statement become effective under the Act and on the date of such business combination was not subject to paragraph (a) of this section;

(3) Pursuant to an employee benefit plan;

(4) Pursuant to a dividend or interest reinvestment plan;

(5) As American depository receipts for foreign securities;

(6) By any investment company registered under the Investment Company Act of 1940; or

(7) By any public utility company or public utility holding company required to file reports with any State or Federal authority.

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

Subpart A—Forms for Registration Statements

2. By revising § 239.61 to read as follows:

§ 239.61 Form SR, Report of sales of securities and use of proceeds therefrom.

This form shall be used for filing a report of sales of securities in use of proceeds pursuant to § 230.463 of this chapter.

BILLING CODE 8010-01-M

U. S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

REPORT OF SALES OF SECURITIES AND USE OF PROCEEDS THEREFROM

For period ending Mo Day Year

Indicate whether the report is

an initial report ☐, an amendment ☐, or a final report ☐.

If the report is an amendment, indicate the number of such amendment ☐.

GENERAL INSTRUCTIONS:

A. The report shall be filed in accordance with the provisions of Rule 463 (17 CFR 239.463). The provisions of Rule 405 (17 CFR 230.405) regarding definitions of terms and Rule 409 (17 CFR 239.409) regarding information unknown or not reasonably available are applicable to the report.

B. Answer each item in the box(es) or space provided. If additional space is required for any response, continue the response on the attached sheet. Where the number of boxes provided exceeds the number required for the response, enter zero(es) in any unnecessary box(es) to the left of the response. For example, if the date August 1, 1981 is to be entered into the boxes provided, the entry should appear as Mo 0/8 Day 0/1 Year 8/1.

C. If the report is being filed by a successor issuer, answer each item with respect to the successor issuer.

D. If the issuer is required to file any report(s) on this form subsequent to its initial filing thereon, each subsequent filing shall be deemed to be an amendment to the initial filing. Do not report in any amendment on this form any response to Items 3-12 unless the response reported on the most recent prior filing has changed.

E. No fee is required to be paid in connection with the filing of the report.

F. File four copies of the report at the office of the Commission where the registration statement was filed. At least one copy shall be manually signed; the other three copies may bear typed or printed signatures.

1. (a) State the name of the issuer or successor issuer filing the report.

(b) If a successor issuer is filing the report with respect to the registration statement of its predecessor, state the name of such predecessor issuer.

2. (a) Indicate the effective date of the registration statement for which this form is filed. Mo Day Yr

(b) Provide the SEC file number assigned to the registration statement. 2 -

(c) If the issuer has been assigned a CUSIP number, specify the first six (6) digits.

3. (a) Has the offering commenced? Yes ☐ No ☐

(b) If yes, indicate the date the offering commenced. Mo Day Year

If no, explain briefly. . . . .

. . . .

. . . .

4. Did the offering terminate before any securities were sold? Yes [ ] No [ ]

If yes, explain briefly . . . .

. . . .

. . . .

Note: If the offering terminated before any securities were sold, see Rule 477 under Regulation C (17 CFR 239.477) regarding withdrawal of the registration statement.

Instruction: If the answer to Item 4 is "yes," do not answer Items 5-12.

5. Did the offering terminate prior to the sale of all securities registered? Yes [ ] No [ ]

If yes, explain briefly . . . .

. . . .

. . . .

6. Furnish the name(s) of the managing underwriters, if any.

(01)
(02)
(03)
(04)

7. (a) Indicate the title and code of each class of securities registered and, where a class of convertible securities is being registered, indicate the title and code of any class of securities into which such securities may be converted.

Title of security	Code
(01)	
(02)	
(03)	
(04)	

Instruction: Select the appropriate code for each class of securities registered. Debt — DE; Convertible Debt — CD; Equity -EQ; Limited Partnership Interest — LP; Other (e.g., investment contracts, warrants, rights, and options) — OT.

(b) Describe briefly any class of securities categorized as "other." . . . .

. . . .

8. Indicate on the following table the amount and aggregate offering price of securities registered and sold to date for the account of the issuer and for the account(s) of any selling security holder(s).

Title of security	For the account of the issuer: Amount registered	Aggregate offering price of amount registered	Amount sold	Aggregate offering price of amount sold	For the account(s) of any selling security holder(s): Amount registered	Aggregate offering price of amount registered	Amount sold	Aggregate offering price of amount sold
(01)								
(02)								
(03)								
(04)								
(05) Total								

Instructions: 1. List each class of securities registered except any class of securities into which a class of convertible securities registered may be converted without additional payment to the issuer. Match any class listed with the line on which it was listed in Item 7(a) (e.g., the class listed on line (01) of the table should be the same class as listed on line (G1) of Item 7(a)). 2. Compute all amounts from the effective date of the registration statement to the ending date of the reporting period for this report. 3. Round all dollar amounts to the nearest dollar.

9. State, if known, or furnish a reasonable estimate of, the amount of expenses incurred for the issuer's account in connection with the issuance and distribution of the securities registered for each category listed below. Place an "X" in the box to the left of any amount given that is an estimate.

	(A) Direct or indirect payments to directors, officers, general partners of the issuer or their associates; to persons owning ten percent or more of any class of equity securities of the issuer; and to affiliates of the issuer	(B) Direct or indirect payments to others
(01) Underwriting discounts and commissions	$	$
(02) Finders' Fees		
(03) Expenses paid to or for underwriters		
(04) Other expenses		
(05) Total Expenses	$	$

Instruction: Compute all amounts from the effective date of the registration statement to the ending date of the reporting period for this report. 2. Round all amounts to the nearest dollar.

10. Indicate the net offering proceeds to the issuer after the total expenses in Item 9 above. $

11. State, if known, or furnish a reasonable estimate of, the amount of net offering proceeds to the issuer used for each of the purposes listed below. Do not include any amount in "working capital" to which a more specific category is applicable. Place an "X" in the box to the left

of any amount given that is an estimate.

	(A) Direct or indirect payments to directors, officers, general partners of the issuer or their associates; to persons owning ten percent or more of any class of equity securities of the issuer; and to affiliates of the issuer	(B) Direct or indirect payments to others
(01) Construction of plant, building and facilities	$	$
(02) Purchase and installation of machinery and equipment		
(03) Purchase of real estate		
(04) Acquisition of other businesses		
(05) Repayment of indebtedness		
(06) Working capital		

Temporary investment (specify)

(07)		
(08)		
(09)		
(10)		

Other purposes (specify)

(11)		
(12)		
(13)		
(14)		
(15)		
(16)		

BILLING CODE 8010-01-C

Instructions: 1. Specify under "other purposes" any purpose for which 5 percent of the issuer's total offering proceeds or $50,000, whichever is less, has been used. 2. Compute all amounts from the effective date of the registration statement to the ending date of the reporting period for this report. report. 3. Round all amounts to the nearest dollar.

12. Do the use(s) of proceeds in Item 11 represent a material change in the use(s) of proceeds described in the prospectus? Yes ☐ No ☐

If yes, explain briefly . . . .

. . . .

. . . .

SIGNATURE

Pursuant to the requirements of Rule 463 under the Securities Act of 1933, ________ has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

____
Issuer

________ (Date) By________________ (Signature)

Instruction: The report shall be signed by an executive officer, general partner or counsel of the issuer or by any other duly authorized person. The name and any title of the person who signs the report shall be typed or printed beneath his/her signature.

ATTENTION: Intentional misstatements or omissions of facts constitute Federal criminal violations (See 18 U.S.C. 1001).

Form SR Continuation Sheet

Item of Form: Response

* * * * *

[Sec. 19(a), 48 Stat. 85; Sec. 209, 48 Stat. 908; 15 U.S.C. 77s(a)]

George A. Fitzsimmons,

Secretary.

September 21, 1981.

[FR Doc. 81-28559 Filed 9-30-81; 8:45 am]

BILLING CODE 8010-01-M

17 CFR Part 241

[Release No. 34-18114]

Interpretive Release on Rules Applicable to Insider Reporting and Trading

AGENCY: Securities and Exchange Commission.

ACTION: Publication of staff interpretations.

SUMMARY: The Commission has authorized the issuance of this release setting forth the views of its Division of Corporation Finance on various interpretive questions regarding the rules promulgated under Sections 16(a) and 16(b) of the Securities Exchange Act of 1934. These views are being published to resolve certain recurring issues that arise under the rules and to establish uniform interpretations for the benefit of those persons subject to their requirements.

FOR FURTHER INFORMATION CONTACT: Persons with specific questions concerning the subject matter of this release should contact Michael R. Kargula or William E. Toomey, (202) 272-2573, Office of Chief Counsel, Division of Corporation Finance, Securities and Exchange Commission, 500 North Capitol Street, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act") [15 U.S.C. 78a et seq.] was designed to provide the public with information on insider [1] securities transactions and holdings and to deter insiders from profiting on short term trading transactions in the securities of their corporations on the basis of undisclosed information. The section was enacted primarily in response to abuses, described in detail in the legislative history of the Exchange Act,[2] where insiders with advance knowledge of facts which would produce a rise or fall in the market value of securities of their companies bought and sold such securities as the circumstances warranted to their personal advantage. On occasion, insiders actually manipulated the market price of their stock by causing a corporation to follow financial policies calculated to produce sudden changes in market prices in order to obtain short swing profits. To combat these practices, Congress enacted Section 16 to require reports of securities transactions by insiders and to provide for the recovery of any short swing profits.[3]

Congress believed prompt publicity to be a potent weapon in the effort to curb the abuse of inside information. Thus, Section 16(a) requires insiders to file public reports with respect to transactions in the equity securities of their corporations. This publicity was intended to encourage voluntary maintenance of proper fiduciary standards by those in control of corporations and at the same time give public investors information as to purchases and sales by insiders, which might in turn indicate their private opinions as to the prospects of the company.[4] In addition, the reports may reveal insider purchases and sales of securities which are subject to the profit recovery provisions of Section 16(b) of the Exchange Act. Section 16(b) provides that any profit realized by an insider as a result of a purchase and sale or sale and purchase of an equity security of the insider's company made within a six-month period shall inure to the company.[5] The intent of this section is to deprive officers, directors and substantial stockholders of the incentive to utilize their positions to trade in the securities of their companies on the basis of inside information.

The Commission has general rulemaking power under the Exchange Act to interpret and define statutory provisions and to exempt securities from any provision of the Act.[6] In addition, it has specific power under Section 16(b) to exempt from that subsection "any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." Since 1934, the Commission has exercised this authority by adopting a number of rules designed to implement and administer the insider trading and reporting provisions of Section 16. During this period, the staff has responded to a great many requests for interpretations of these rules as applied to particular facts.

In an effort to provide guidance to the public, and as part of a continuing program to clarify and simplify the application of the various rules administered by the Division, a number of these interpretations have been selected for publication in this release. The interpretations selected are not exhaustive. Rather, they represent fundamental, recurring questions which arise under the rules. Most of the illustrations used in the release represent actual inquiries received by the staff. While the Commission has authorized the issuance of this release, the views expressed are those of its Division of Corporation Finance.

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[1] By its terms, Section 16 applies to every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of equity security of an issuer registered pursuant to Section 12 of the Exchange Act, and to any director or officer of the issuer of such security. Persons who are subject to Section 16 are often termed "statutory insiders" or, simply, "insiders." This release does not treat questions raised by the trading activities of persons who may not be within the statutory definition of insider, but who nonetheless acquire non-public information about a particular company and utilize it to enhance their trading in the company's securities. See *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

[2] For example, as observed by the Senate Committee which considered the bill:

"Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came to them in such positions, to aid them in their market activities. Closely allied to this type of abuse was the unscrupulous employment of inside information by large stockholders who, while not directors and officers, exercised sufficient control over the destinies of their companies to enable them to acquire and profit by information not available to others." Stock Exchange Practices, Report of the Committee on Banking and Currency, S. Rep. No. 1455, 73rd Cong., 2d Sess. p. 55 (1934). The section was "aimed at the general evil of officers and directors rigging their stock up and down squeezing out their own stockholders." Stock Exchange Practices, Report of the Committee on Banking and Currency, S. Rep. No. 1455, 73rd Cong., 1st Sess., Part 15, p. 6559 (1934).

[3] Substantially identical provisions appear as Sections 17(a) and 17(b) of the Pacific Utility Holding Company Act of 1935 [15 U.S.C. 79a et seq.], and the reporting requirements of Section 16(a) are adapted in Section 30(f) of the Investment Company Act of 1940 [15 U.S.C. 81a et seq.]. The exemptive rules under Section 16 are fully applicable to these parallel statutes, as are the illustrations herein.

[4] Committee on Interstate and Foreign Commerce, H. Rep. No. 1383, 73rd Cong., 2d Sess., pp. 13 and 24 (1934).

[5] Section 16(b) provides that the profits obtained by an insider from transactions completed within six months in equity securities of the insider's company may be recovered by the corporation or by any security holder suing on behalf of the corporation.

[6] See, e.g., Sections 3(a)(12), 3(b), and 23(a) of the Exchange Act. The Commission also has authority under Section 12(h) of the Exchange Act to exempt any officer, director or beneficial owner of securities from the provisions of Section 16, so long as such action is not inconsistent with the public interest or the protection of investors. This particular exemptive power has rarely been used.

Although many of the issues dealt with in this release have previously been addressed by the staff in public interpretive letters, the release clarifies and, in some instances, revises certain positions expressed in those letters. Any previous staff interpretations which are contrary to those set forth in this release should be regarded as superseded by this release. Similarly, the views expressed in previous interpretive letters on issues which are not addressed by this release, may still be considered to represent the staff's position on the questions raised. To the extent that particular facts and circumstances are substantially similar to those set forth in this release, interested persons may rely on the views expressed herein and need not seek individual interpretive advice.

The Commission is hopeful that the issuance of this release will reduce the need for members of the public to request interpretive advice from the staff regarding the rules in question. It should be noted, however, that the staff is considering possible amendments to the rules promulgated under Sections 16(a) and 16(b), particularly Rule 16b-3, and invites interested persons who wish to express an opinion on the rules, or on the interpretations contained in this release to submit their views in writing.

The staff routinely responds to interpretive requests concerning the rules adopted under both Sections 16(a) and 16(b). However, the staff declines to take no-action or interpretive positions on questions involving the scope of liability under Section 16(b). Whether liability under Section 16(b) will result from particular transactions can only be determined on the basis of the facts in each case in an appropriate action brought by the issuer or a security holder.[7]

This release considers first the reporting rules under Section 16(a) with a prefatory discussion of concepts and definitions, some of which are essential to an understanding of the Section 16(b) rules which follow. The rules are treated simply in their numerical order, and no attempt has been made to group them by function. A table of contents follows.

17 CFR Part 241 is amended by adding this release thereto.

Table of Contents

I. Section 16(a)—The Reporting Requirement

Section 16(a) of the Exchange Act provides that every person[8] who is directly or indirectly the beneficial owner of more than 10 percent of any class of equity security (other than an exempted security) registered pursuant to Section 12,[9] or who is an officer or director of the issuer of such security, shall file with the Commission an initial report disclosing the amount of all equity securities of such issuer of which he is the beneficial owner, and a subsequent transaction report within 10 days after the close of each calendar month in which there has been any change in his holdings.[10] If the registered security is also listed on a national securities exchange, such ownership reports must also be filed with the exchange.

A. Definition of Officer

The term "officer" is defined by Rule 3b-2 [17 CFR 240.3b-2] under the Exchange Act to mean a president, vice-president, treasurer, secretary, comptroller, and any other person who performs for an issuer, whether incorporated or unincorporated, functions corresponding to those performed by the foregoing officers.[11]

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[7] Letters re *Chromalloy American Corporation* dated May 5 and May 15, 1980.

[8] The term "person" is defined in Section 3(a)(9) of the Exchange Act as meaning "a natural person, company, government, or political subdivision, agency, or instrumentality of a government."

[9] Section 12 of the Exchange Act provides for the registration of securities to be listed on a national securities exchange, and requires the registration of equity securities of companies having more than $1,000,000 in assets and a class of equity security held by over 500 persons. For convenient reference, and only for purposes of this release, a company with a class of equity securities registered pursuant to Section 12 of the Exchange Act will be termed a "registered company." Section 16, of course, does not apply to unregistered companies, including those which file periodic reports with the Commission pursuant to Section 15(d) of the Exchange Act. Section 16 becomes operative only after registration under Section 12 has become effective.

[10] Initial reports of ownership are filed on Form 3 [17 CFR 249.103] within ten days after the date a person acquires insider status. Reports of subsequent transactions and holdings are made on Form 4 [17 CFR 249.104].

[11] Although similar in thrust, this definition is somewhat narrower than the definition of "executive officer" found in Items 3 and 4 of Regulation S-K [17 CFR 229.20.3 and .4, respectively]. It should also be noted that, in connection with the Commission's sunset review of existing rules and regulations, Rule 3b-2 is proposed

Continued

The determination whether a particular individual is an officer hinges on an examination of all the relevant facts. Generally, it is not difficult to identify a company's principal officers by their traditional titles and functions. However, an employee who does not possess a title may nevertheless be an officer because of the significant functions he performs; similarly, an employee who holds a title may nonetheless not be an officer because his functions and duties are insignificant, despite his formal position. The staff generally takes the view that anyone holding an appropriate title is an officer for purposes of Section 16(a). The staff, however, no longer expresses opinions on questions of officer status. These questions usually involve difficult assessments of fact which can best be made by the issuer and its counsel. For the same reason, the staff will not express a view as to whether a particular individual is in fact a director. Nevertheless, as an indication of staff analysis in this area, the following three hypotheticals are set forth.

(1) *Question:* Would the following persons be deemed to be "officers" for purposes of Section 16(a):

(a) An assistant treasurer, assistant vice president or assistant comptroller?

(b) The president of a wholly-owned subsidiary?

(c) A vice president who has no significant duties, and who does not participate in the management of the company?

Answer: The persons named in (a) may be officers if they regularly perform a substantial part of the duties of the officers they assist. An assistant who performs only some of the duties of his superior would not normally be considered an officer, so long as those functions are performed under the supervision of his chief. Finally, assistants would not be considered officers if they regularly perform only routine administrative duties.[12]

The president referred to in (b) would not ordinarily be considered an officer under Section 16(a) since he is not an officer of the issuer.[13] If the vice president described in (c) is vice president in name only, and has no access to inside information, he is not an officer for purposes of Section 16(a).[14]

B. Definition of Director

Section 3(a)(7) of the Exchange Act defines the term "director" to mean any director of a corporation or any person performing similar functions with respect to an organization whether incorporated or unincorporated. As with the application of the term "officer," the determination whether a particular person is a director sometimes involves the evaluation of unusual or difficult facts. The staff will not express a view as to whether a particular person may be deemed to be a director.

(2) *Question:* Is a person who is an honorary director of an issuer, but does not attend board meetings and is inactive in the affairs of the issuer, considered to be a director for Section 16(a) purposes?

Answer: If an honorary director does not take part in formulating and deciding policy issues, and does not have access to inside information, he is not a director under Section 16(a).[15]

(3) *Question:* Can the term "director" include a person who designates another to be a director on a theory of deputization? [16]

Answer: Yes. A person who has the power, by agreement or otherwise, to name another to be a corporate director is likely to have the same sort of access to inside information by reason of that relationship as any other insider and should be considered a director for purposes of Section 16(a) of the Exchange Act.

Illustration: Company X lends Company Y a substantial amount of money in order for Company Y to complete its plans for expansion. One of the express terms of the loan agreement permits Company X to designate a person to serve on the board of directors of Company Y. Company X designates its vice president to sit on Y's Board.

Interpretation: Company X may be considered a director for purposes of Section 16(a).

C. *Definition of Beneficial Ownership*

The Commission has never specifically defined the term "beneficial ownership" for purposes of Section 16(a) of the Exchange Act. However, some of the generally accepted indicia of beneficial ownership include: (1) the right to vote or control the voting of the securities; (2) the right to transfer the securities or control their transfer; (3) the right to receive income from the securities or control the disposition of such income; and (4) the right to receive or control the disposition of the proceeds in liquidation. The staff has interpreted the term broadly to implement fully the disclosure function of Section 16(a).[17]

(4) *Question:* The spouse and minor children of a director of a registered company hold securities of that company in their own name. The director owns additional securities of the company which are held of record by a broker. Can the director be considered the beneficial owner of all of these securities?

Answer: Yes. Absent countervailing facts, it is expected that securities held by a spouse, minor children and other relatives who share the same home as the insider will be reported as being beneficially owned by the insider since such relationships ordinarily result in the insider obtaining benefits substantially equivalent to ownership.[18] The sharing of economic benefits among the members of the family group, as well as the potential influence of the reporting person over securities held by family members, are factors which tend to support this view. Securities held by a broker in street name, of course, are generally beneficially owned by the broker's principal. Accordingly, Section

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to be amended to include an issuer's "principal financial officer" and "principal accounting officer" within the definitional scope of the term "officer." Such persons were previously covered by the rule although not specifically mentioned. See Securities Act Release No. 6333 (August 6, 1981) [46 FR 41971].

[12] Securities Exchange Act Release No. 2687 (November 15, 1940) [5 FR 4501].

[13] Letters re *CMI Investment Corp.* dated June 11, 1974 and *Associated Bank & Services, Incorporated* dated June 23, 1971.

[14] See *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Livingston*, 566 F.2d 1119 (9th Cir. 1978).

[15] While access to inside information is a key factor in determining insider status under Section 16, the staff has taken the view that the term "director," as defined in Section 303(5) of the Trust Indenture Act of 1939, does not include emeritus, honorary or advisory directors who are appointed rather than elected and who serve merely as advisors without any other customary responsibilities or duties of directors. See letter re *Wells Fargo Bank* dated June 22, 1981.

[16] The existence of deputization if a factual question determined on a case-by-case basis. The United States Court of Appeals for the Second Circuit has held that a defendant corporation was in fact liable as a director under a deputization theory. *Feder v. Martin Marietta Corp.*, 406 F. 2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970). For a discussion of the factual elements that may establish deputization, see Wagner, *Deputization under Section 16(b): The Implications of Federal v. Martin Marietta Corporation*, 78 Yale L. J. 1151 (1969).

[17] Rule 13d-3 [17 CFR 240.13d-3] under the Exchange Act sets out a very detailed definition of beneficial ownership for purposes of the reporting requirements under Section 13(d) and the Commission's tender offer rules. While the concepts of beneficial ownership under Section 16(a) and under Rule 13d-3 have much in common, the former stresses the economic benefit to be derived from the securities and the latter emphasizes the ability to control or influence the voting or disposition of the securities. As a result, different determinations of beneficial ownership under the section and rule are possible.

[18] Securities Exchange Act Release No. 7824 (February 14, 1966) [31 FR 3175]. A person may also be regarded as the beneficial owner of securities held in the name of a spouse, minor children or other person, even though he does not obtain benefits substantially equivalent to ownership, if he can vest or revest title in himself at once or at some future time.

16(a) would require the director to report the holdings of the spouse and minor children, and other relatives who share the home, as well as any securities held of record by a broker, bank or other nominee for the director's account.[19] It should be noted, however, that a reporting person may disclaim that a report filed is an admission of beneficial ownership with respect to any particular security. See Rule 16a-3 [17 CFR 240.16a-3].

(5) *Question:* Mr. Smith is a director of a registered company and has recently become president of a non-profit foundation which is operated exclusively for charitable purposes and is qualified under Section 501(c)(3) of the Internal Revenue Code. The foundation owns approximaterly 3 pecent of the outstanding common stock of the registered company. Should Mr. Smith include the holdings and transactions of the foundation in the company's stock on his own ownership report?

Answer: The determination of beneficial ownership of securities is dependent upon the relevant facts and circumstances in a particular situation. Additional facts which should be considered are: (1) whether Mr. Smith has voting power, investment power, or other indications of control with respect to the securities held by the foundation; and (2) whether he has any other interest in the foundation itself, or transactions entered into by the foundation. If the answers to these questions are affirmative, Mr. Smith may be considered the beneficial owner of the securities held by the foundation.[20]

(6) *Question:* Must a member of a partnership take into account the entire holdings of the partnership in determining whether he is a 10 percent beneficial owner of a class of equity security of a registered company?

Answer: No. A partner is required to include only his own economic interest in the partnership holdings. Thus only his pro rata interest in the securities held by the partnership must be added to his own personal beneficial interest.[21]

Of course, where a partnership holds for its own account more than 10 percent of a class of equity security of a registered company, it should file reports of such holdings in accordance with the requirements of Rule 16a-1, whether or not individual reports are filed by the partners, since the partnership would be the direct beneficial owner of more than 10 percent.[22]

Illustration: Three individuals form a general partnership in which each has an equal interest. The partnership holds 29 percent of a class of registered equity security. The partners do not hold any other securities of that class.

Interpretation: Since each partner's pro rata interest in the securities is less than 10 percent of the class, the individual partners are not subject to Section 16(a). Of course, the partnership itself would be subject to the reporting requirements.

(7) *Question:* If an officer or director of a registered company were a member of a partnership, would that relationship automatically subject the partnership to the requirements of Section 16(a)?

Answer: No. However, the officer or director-partner should report his indirect beneficial ownership of all partnership holdings in the securities of the registered company. If the partnership ever owned more than 10 percent of a class of registered equity security of the company, it would be required to report independently.

(8) *Question:* Should a director of a registered company, who is also a control person of a closely-held company, file ownership reports with respect to transactions by the latter company in the securities of the registered company?

Answer: Yes. As a control person of the closely-held company, the insider is deemed to be the beneficial owner of all securities held by that company. Since all of the indicia of beneficial ownership are present, the insider should report the closely-held company transactions, even if that company itself files separate reports as a 10 percent beneficial owner.[23]

(9) *Question:* Would the answer to Question (8) be different if the company holding the registered security were a public company which the insider did not control?

Answer: Yes. The basic question is whether the insider may be deemed to be the beneficial owner of the securities held by the other company. Normally, an insider who is a shareholder of a publicly held company would not be obligated to report his interest in that company's transactions in the registered security, since he would not usually be considered to be, even indirectly, the beneficial owner of that security.

(10) *Question:* An insider is the trustee of an irrevocable trust. Neither the insider nor any member of his or her family is the beneficiary of the trust. Must the insider aggregate the shares held in trust with his personal holdings for purposes of Section 16(a)?[24]

Answer: No. The trustee of an irrevocable trust or a trust revocable at the discretion of another person,[25] who has no interest in the income or corpus of the trust, is not the benefical owner of any securities held in the trust.

Illustration: A member of the board of directors of a registered company is also the trustee of 3 trusts established solely for the benefit of the minor children of the company's president. The trusts hold less than 4 percent of the outstanding common stock of the company. The director, as an independent trustee, has the power to manage the assets of the trusts, including the power to make acquisitions and dispositions and to vote the securities held by the trusts.

Interpretation: The shares of common stock of the registered company held by the trusts would not be deemed beneficially owned by the director trustee.[26]

(11) *Question:* If the facts of question (10) were modified so that the trustee had a vested interest in the income or corpus of the trusts, would the answer be the same?

Answer: No. If the trustee has a vested interest in the income or corpus of the trusts, attribution would be required, i.e., the trustee should report the holdings and transactions of the trusts as his own.

(12) *Question:* A person is trustee and sole beneficiary of a trust which owns less than 10 percent of a class of registered equity security. In his personal capacity, he owns an amount of the same security which, if added to the holdings of the trust, would exceed 10 percent of the class outstanding. Must this individual file Section 16(a) reports?

Answer: Yes. Although the trustee owns less then 10 percent of the

[19] *Whiting v. The Dow Chemical Co.*, 523 F. 2d 680 (2d Cir. 1975).

[20] Letter to *Dean L. Buntrock and Elizabeth Buntrock Foundation* dated September 24, 1980.

[21] Opinion of General Counsel, Securities Exchange Act Release No. 1965 (December 21, 1938) [11 FR 10971].

[22] The names of the individual members of the partnership do not have to be set forth when the partnership itself files a Section 16(a) report.

[23] The insider may, if he so desires, indicate in a footnote the extent of his individual interest in the transaction.

[24] Questions (10) through (14), inclusive, should also be read in conjunction with the discussion of Rule 16a-8 [17 CFR 240.16a-8], *infra*.

[25] If the trust is subject to revocation, the person who possesses the power to revoke the trust for his own benefit would appear to be the beneficial owner of the securities held by the trust, and, if an insider, such person would have to report the trust shares as his own. It should be noted, however, that if the trust holds more than 10 percent of a registered equity security, the fact that a power of revocation exists would not relieve the trustee from his duty to file reports concerning transactions of the trust in that security. See Rule 16a-8(c).

[26] Letter re *Chilton Corporation* dated May 15, 1973.

securities in this personal capacity, he would be deemed to be the beneficial owner of the trust securities.

(13) *Question:* Must a report be filed to reflect a transaction whereby an insider, as settlor, establishes a trust with the settlor as the sole beneficiary and in whose administration the settlor has a voice?

Answer: No. The creation of a trust which does not substantially alter the benefits of ownership, including rights to the income or corpus of the trust, is not a change in beneficial ownership required to be reported under Section 16(a).[27]

(14) *Question:* Is an insider required to report the securities held by his or her spouse as trustee for the benefit of their children?

Answer: Yes. The insider is considered to have a sufficient interest in the securities held by such a trust. Since an insider is considered to be the indirect beneficial owner of securities held by his or her spouse and children, the insider should report the indirect beneficial ownership of the holdings of the spouse as trustee for their children.[28]

(15) *Question:* A director of a registered company transfers stock of that company to his or her spouse pursuant to a divorce settlement. Should the director report the transfer under Section 16(a)?

Answer: Yes. The director has effected a change in the beneficial ownership of that security which is required to be reported.

(16) *Question:* When is an insider who purchases securities under an installment agreement, deemed to have acquired beneficial ownership of such securities thereby triggering his reporting obligation under Section 16(a)?

Answer: As a general rule, an insider is deemed to have acquired beneficial ownership of a security at the time he makes a firm commitment for its purchase. Similarly, he divests himself of such beneficial ownership at the time he makes a firm commitment for its sale.[29]

Illustration: A director of a registered company enters into a contract to purchase 2,000 shares of the company's common stock. The terms of the contract call for a 25 percent down payment, with the balance of purchase price paid in installments over the next six months. At the time of the final payment, the director will receive the stock.

Interpretation: The director would be deemed to have acquired beneficial ownership of the securities at the time the contract was entered into, i.e., the time he agreed to purchase the securities, and made the down payment, notwithstanding the fact that the purchase price had not been paid in full and the stock was not delivered until final payment.

(17) *Question:* For purposes of Section 16(a), when is an insider deemed to acquire beneficial ownership of a stock dividend: on the declaration date, the record date, or the payment date?

Answer: On the record date. The record date generally fixes the time when security holders are entitled to receive the dividend. The fact that delivery of the stock certificate has not been effected or transfer recorded on the stock transfer books of the issuer is immaterial.

(18) *Question:* When an insider sells "short against the box,"[30] must he report the sale as of the date his sell order is executed by the broker, or the date when he ultimately delivers stock to cover his short position?

Answer: The insider effects a change in his beneficial ownership of the security at the time the sell order is executed. The date of the transaction for purposes of Form 4 is the date of execution.

D. Definition of 10 Percent Beneficial Owner

Under the framework of Section 16, officers and directors automatically become insiders of a registered company by virtue of the positions they hold with the company. Persons who are not officers or directors may also become insiders by accumulating more than 10 percent of any class of an equity security which is registered pursuant to Section 12 of the Exchange Act.[31] Once insider status has been acquired, changes in beneficial ownership of the equity securities of the company should be reported.

(19) *Question:* Is a person required to file an initial ownership report reflecting the transaction which increases his beneficial ownership to more than 10 percent?

Answer: Yes. For purposes of Section 16(a), it does not matter that the person was not a 10 percent holder prior to the transaction. Section 16(a) specifically requires the filing of reports by all persons who own beneficially more than 10 percent of a class of registered equity security. The obligation to report arises at the time of the transaction which results in one's owning more than 10 percent of the class and, accordingly, such person must report within 10 days after the date on which the transaction occurred.

Illustration: A company has 2,000,000 shares of common stock outstanding which are listed on a national securities exchange. On October 1, a stockholder, not otherwise affiliated with the company, acquires 10,000 additional shares of its common stock, bringing his total ownership to 205,000 shares. Thereafter, on January 5, he sells 30,000 of these shares at a profit.

Interpretation: This stockholder would be required to file ownership reports covering both of these transactions.[32]

(20) *Question:* Must a person who owns more than 10 percent of the registered common stock of a company also report his transactions in any unregistered equity securities of the company?

Answer: Yes. An insider must report all changes in beneficial ownership arising from transactions involving any equity security of the company, whether or not such equity security is registered pursuant to Section 12 of the Exchange Act. However, to be a 10 percent beneficial owner within the meaning of Section 16(a), one must beneficially own

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[27] Letters re *Park Chemical Company* dated June 2, 1976, and *Litton Industries, Inc.* dated April 27, 1973.

[28] See letter to *Jane Gillespie*, dated October 7, 1971; See also question 4, *supra*; and Rule 16a–8(a), *supra*.

[29] See Securities Exchange Act Release No. 116 (March 9, 1935) [11 FR 10968].

[30] A "short sale against the box" is a brokerage transaction in which the seller already owns an amount of securities at least equal to the amount he wishes to sell short. While Section 16(c) of the Exchange Act prohibits insiders from making short sales, i.e., the sale of a security which the seller does not own, this prohibition does not extend to short sales against the box where the securities ultimately to be delivered already belong to the seller. See letter to *Michael G. Marks* dated February 26, 1980.

[31] Rule 16a–2 [17 CFR 240.16a–2] provides that for the purpose of determining whether a person is the beneficial owner of more than 10 percent of a class of equity security, other than voting trust certificates or certificates of deposit, such class is deemed to consist of the total amount of the securities of the class outstanding, exclusive of any securities of the class held by or for the account of the issuer or a subsidiary of the issuer. The rule further provides that such person will be deemed to be the beneficial owner of securities which he or she has the right to acquire through the exercise of presently exercisable options, warrants or rights or through the conversion of presently convertible securities.

[32] It should be noted, however, that this individual has not incurred any short swing trading liability because he was not a 10 percent beneficial owner prior to the October 1 transaction. To incur liability under Section 16(b) one must have insider status both at the time of purchase and sale. Although this insider was beneficial owner of more than 10 percent immediately after the purchase transaction, he was not such a beneficial owner at the time of purchase. *Formost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976). See also *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972).

more than 10 percent of a registered equity security.

Illustration: An individual owns 15 percent of the common stock of a company which is registered on a national securities exchange. He also owns 15 percent of its cumulative preferred stock and 15 percent of a class of subordinated debentures, neither of which is registered pursuant to Section 12. In order to diversify, he sells both the preferred stock and the subordinated debentures.

Interpretation: This individual is an insider since he owns more than 10 percent of the common stock which is a class of registered equity security. Accordingly, he must report the sale of the preferred stock since it is an equity security. The subordinated debentures are debt rather than equity securities and so their sale need not be reported. Note that insider status based on ownership of securities derives *only* from ownership of an equity security which is registered pursuant to Section 12 of the Exchange Act. Had this person owned less than 10 percent of the common stock, he would not have been an insider despite his other holdings, and his sale of the preferred stock would not have been reportable because it was not registered.

E. Definition of Equity Security

Section 3(a)(11) of the Exchange Act broadly defines the term "equity security" to include any stock or similar security; or any security convertible into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission by rule shall deem an equity security. Rule 3a11-1 [17 CFR 240.3a11-1] under the Exchange Act interprets the statutory definition by enumerating a number of the less familiar securities ranging from voting trust certificates to various rights to subscribe to or purchase a security.

(21) *Question:* Does the term "equity security" include puts and calls? [33]

Answer: Yes. In Securities Exchange Act Release No. 10129 (April 27, 1973) [38 FR 11449], Rule 3a11-1 was amended specifically to include puts, calls, straddles, and other rights to buy and sell securities within the definition of equity security. Rule 16a-6 [17 CFR 240.16a-6] requires the reporting of puts, calls and similar rights whether or not such securities are issued by a registered company since the ownership of such rights may have a real impact on the insider's beneficial ownership of the security to which the right relates.[34] It must be emphasized that the reporting provisions of Section 16(a) relate not only to purchases and sales of securities, but also to changes in their beneficial ownership. The acquisition or disposition of a put, call or other right or obligation to sell an equity security of a registered company not only effects a change in the insider's beneficial ownership of the right, but it also gives rise to derivative right with respect to the beneficial ownership of the underlying security.

(22) *Question:* Must an insider report the acquisition of a stock appreciation right?

Answer: Yes. A stock appreciation right ("SAR") is a form of deferred incentive compensation, generally granted pursuant to a plan adopted for the benefit of key employees. In practice, a key employee is granted a number of SAR units representing an equal number of shares of a company's common stock. When the employee exercises a SAR, the company pays him an amount equal to the appreciation in market value of the number of shares subject to the SAR for the period between the date of grant and the date of exercise. This amount may be paid or "settled" in cash or stock, or a combination of both, usually at the discretion of a committee administering the plan. The grant of a SAR may be coupled with the grant of a stock option, in which case the SAR units are generally awarded in an amount equal to the number of shares subject to the option. Exercise of any portion of the stock option or the SARs results in a corresponding reduction in the number of shares or SAR units remaining subject to exercise. An award in this form is often referred to as a "tandem grant."

The stock appreciation right in its various forms has posed important interpretive questions under both Sections 16(a) and 16(b). It is generally agreed, for example, that the acquisition of a SAR which may be settled in stock creates the kind of derivative right in an equity security which must be reported as a change in beneficial ownership pursuant to Rule 16a-1. There has been a broad difference of view, however, with respect to the obligation to report the acquisition of a SAR exercisable only for cash. Although such an instrument would not seem to represent a direct claim on the equity securities of a company, its cash settlement has been viewed by some as a simultaneous purchase and sale of the related common stock, a theory which would suggest the applicability of both the reporting and the liability provisions of Section 16 of the Exchange Act.[35] Indeed, the very nature of the stock appreciation right as an instrument falling within the definition of "equity security" has been controversial, and although this question has been touched upon by at least three courts, as yet there is no clear judicial statement as to whether a stock appreciation right is an equity security for purposes of Section 16(b).[36]

These, and other issues were a source of genuine concern to many who wished to use the stock appreciation right concept as a part of their employee benefit programs. The stock appreciation right appeared to be a valuable new tool for employee compensation, but its use raised novel concerns under Section 16. The Commission recognized the legitimacy of these concerns and, in 1976, amended Rule 16b-3 to provide an exemption for the transactions necessary to implement a plan involving stock appreciation rights, that is, the acquisition and disposition of the rights by employee participants as well as the cash settlement of rights pursuant to the terms of the plan.[37] The exemption is subject to a number of conditions which are intended to guard against the abuse of inside information. The amendment does not attempt to resolve the troublesome legal issues posed by the stock appreciation right; it simply exempts the transactions required to effectuate stock appreciation right plans without addressing the legal implications of the transaction themselves under Section 16 of the Exchange Act.[38]

(23) *Question:* Are debt securities which are convertible into the common stock of an issuer considered to be "equity securities" within the meaning of Section 3(a)(11) of the Exchange Act?

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[33] Generally, a put is a contract giving its holder the right to sell a fixed amount of securities within a specified period at a set price. A call is a similar arrangement conferring the right to purchase securities. Exchange traded options are essentially put and call contracts.

[34] Read discussion of Rule 16a-6, *infra.*

[35] See footnote 108, *infra.*

[36] *Id.*

[37] See Securities Exchange Act Release No. 13097 (December 22, 1976) [42 FR 755].

[38] In the 1976 release, the Commission observed that its "action in revising Rule 16b-3 in order to provide a 'safe harbor' for certain transactions in stock appreciation rights should not be construed as a statement by it that SAR transactions which do not satisfy the conditions of the rule necessarily are subject to Section 16(b). In this regard, the Commission wishes to emphasize that because of the unsettled legal status of stock appreciation rights under Section 16, it is expressing no view as to the applicability of that section to transactions in stock appreciation rights that are outside the scope of Rule 16b-3, and no inference in that connection should be drawn from the Commission's actions today."

Answer: Yes.[39] However, the purchase of over 10 percent of a class of non-registered securities by itself will not subject a person to the requirements of Section 16(a). In order for Section 16(a) to apply, a person must be the beneficial owner of over 10 percent of a class of equity security registered under Section 12 or an officer or director of the issuer of such security. Once a person acquires this status, he must report ownership of convertible securities which are not themselves registered under Section 12. If, however, the convertible securities are registered, a person owning more than 10 percent thereof would be required to report his ownership of the convertibles, even though the common stock which could be acquired upon conversion represents less than 10 percent of the class of common stock outstanding.

(24) *Question*: Should ownership reports be filed with respect to limited partnership interests which are registered under Section 12, even though they are not publicly traded?

Answer: Yes. Limited partnership interests are considered to be equity securities. General partners of a limited partnership are deemed to perform functions corresponding to those of directors and officers. Thus, a person owning more than 10 percent of a class of such interests and the general partners should file the requisite reports.

F. Definition of Exempted Security

Section 3(a)(12) of the Exchange Act exempts certain specified securities from some or all of the statute's provisions, including Section 16. Among those securities exempted are obligations of the United States, certain municipal bonds, interests in bank-maintained trust funds, and securities issued in connection with certain employee benefit plans. In addition, the Commission has exempted by rule certain other securities from the Exchange Act's requirements, again including Section 16. These exemptive rules generally cover mortgages sold by the Federal Home Loan Mortgage Corporation;[40] securities substantially guaranteed by the states;[41] and securities of foreign issuers.[42]

(25) *Question:* Are registered securities issued by foreign companies exempt from the operation of Section 16?

Answer: Yes, if the provisions of Rule 3a12-3, promulgated under the Exchange Act, are met. The rule cannot be relied upon if (1) more than 50 percent of the outstanding voting securities of the issuer are held of record either directly or through voting trust certificates or depository receipts by residents of the United States, and (2) the business of such issuer is administered principally in the United States or if 50 percent or more of the members of the issuer's board of directors are residents of the United States.

G. Section 12

Section 12(b) of the Exchange Act provides that a company may register or list a security on a national securities exchange by filing an application with the exchange and duplicate originals of that application with the Commission. The application must contain the disclosures required by Section 12(b)(1) of the statute. In addition, the company and the security must meet the individual exchange requirements for listing. Once the exchange certifies to the Commission that the security has been approved for listing and registration, the registration becomes effective thirty days after the receipt of such certification by the Commission or within such shorter period of time as the Commission may determine by order. Accordingly, the provisions of Section 16(a) and 16(b) become operative for insiders on the effective date of the registration.

Section 12(g) of the Exchange Act, on the other hand, provides for the mandatory registration of the equity securities of companies of a certain size.[43] Section 12(g) requires that any company with total assets exceeding $1,000,000 and a class of equity security held by 500 or more persons must file a registration statement with the Commission to register such equity security.[44] The information disclosed in this registration statement is comparable to that required for registration under Section 12(b). The registration statement becomes effective sixty days after filing, or within such shorter period as the Commission may direct. As with Section 12(b) registration, the mandates of Section 16 become operative on the effective date of the registration statement.

(26) *Question:* A company recently completed its first public offering registered under the Securities Act of 1933. As a result it files periodic reports with the Commission pursuant to Section 15(d) of the Exchange Act. At the end of its fiscal year, its assets total $900,000 and it has over 600 common shareholders. Are the company's officers and directors subject to Section 16 of the Exchange Act?

Answer: No. Since the company does not have $1,000,000 in assets, it is not required to register its common stock under Section 12(g). Until the company's common stock or other class of equity security is registered under Section 12(b) or 12(g), the insiders are not subject to Section 16.[45]

(27) *Question:* If the same company were to list its securities on a national securities exchange, would the insiders be subject to Section 16?

Answer: Yes. A class of equity securities is now listed on a national securities exchange and registered pursuant to Section 12(b). Section 16 applies to all insiders of companies with a class of equity security registered under Section 12, and its obligations attach as soon as registration becomes effective.[46]

II. Interpretations Relating to the Commission's Rules Under Section 16(a)

A. Rule 16a-1 [17 CFR 240.16a-1]

Rule 16a-1 implements the statutory reporting requirement by establishing Form 3[47] for initial reports of securities beneficially owned by insiders and Form 4[48] for statements of subsequent changes in such beneficial ownership.[49]

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[39] See Securities Exchange Act Release No. 8202 (December 6, 1967) [32 FR 18063] and footnote 57, *infra*.

[40] [17 CFR 240.3a12-1].

[41] [17 CFR 240.3a12-2].

[42] [17 CFR 240.3a12-3].

[43] Of course, an issuer may at any time voluntarily register a class of equity security under Section 12(g) even if it has not reached the specified size. (See Section 12(g)(1)(B)). Voluntary registration may be motivated by any number of practical considerations, such as broadening the market for an issuer's securities through more regular distribution of information. Or an issuer may choose to register to accomplish a related objective. For example, in order to elect to be regulated as a business development company, an issuer must register a class of its equity securities under Section 12. (See Section 54 of the Small Business Incentive Act of 1980) [15 U.S.C. 80a-53].

[44] Section 12(g)(2) of the Exchange Act provides varying types of exemptions from the registration provisions of Section 12(g) for specific classes of issuers (e.g., cooperative organizations and insurance companies).

[45] Letter re *Superior Packing Company* dated January 13, 1978.

[46] However, Rule 16a-(d) [17 CFR 240.16a-(d)] requires that certain transactions which occurred prior to registration under Section 12 must be reported pursuant to Section 16(a) after registration becomes effective.

[47] A Form 3 must be filed within 10 days after the occurrence of the event which requires the filing of the form.

[48] A Form 4 must be filed within 10 days after the close of the month in which a change in beneficial ownership of the securities of the issuer has occurred.

[49] At one time, different forms were required to be filed by insiders under each of the relevant statutes: Forms 4, 5 and 6 under the Securities Exchange Act of 1934; Forms U-17-1 and U-17-2 under the Public Utility Holding Company Act of 1935; and Forms N-30F-1 and N-30F-2 under the Investment Company Act of 1940. These forms were consolidated into

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(28) *Question:* Are there any provisions under Section 16 which would permit an insider to file a late ownership report?

Answer: No. The reporting provisions of Section 16(a) are designed to insure prompt disclosure of insider holdings. There are no provisions in the Exchange Act, or the rules, permitting an extension of time for filing an ownership report. However, instruction 15 to Form 3 and instruction 17 to Form 4 allow the reports to be filed and signed by an agenct on behalf of the reporting person, provided the authority for such an arrangement is furnished to the Commission.

Illustration: A director of a registered company purchases shares of the company's common stock and immediately leaves the country on a month long business trip.

Interpretation: The director is still required to arrange for the filing of a Form 4 within the time prescribed, notwithstanding the fact that he is abroad.

(29) *Question:* Must a person selected to become an officer or director of a registered company file an initial ownership report on Form 3, within the time prescribed, even though he beneficially owns no securities of the company?

Answer: Yes. The purpose of this report is simply to indicate the status of the insider's holdings at the time he becomes subject to Section 16(a). The fact that he owns no securities does not eliminate the filing requirement.

(30) *Question:* Should the officers and directors of a registered company file an additional Form 3 report when the company registers a new class of equity security under Section 12(g)?

Answer: No. The purpose of filing the Form 3 report is to determine and disclose the holdings of officers, directors and certain beneficial owners of registered companies at the time such persons become subject to Section 16(a). Since the officers and directors are already subject to the reporting requirements of Section 16(a), they do not need to file an additional Form 3 report for the newly registered class of equity security. Of course, an insider who acquires shares of the new class would be required to file a report on Form 4 disclosing the amount of securities acquired.

Illustration: In a proposed corporate reorganization, Company B will become a wholly-owned subsidiary of newly-formed Company A. To effect the reorganization, Company B will merge into a wholly-owned subsidiary of Company A and, upon the effective date of the merger, each outstanding share of common stock of Company B will be automatically converted into one share of common stock of Company A. For a number of years, the common stock of Company B has been registered pursuant to Section 12 of the Exchange Act. Company A will file a registration statement at the time of the merger to register its own common stock pursuant to Section 12.

Interpretation: Former insiders of Company B, who have now become insiders of Company A, need not file initial statements of beneficial ownership on Form 3 to reflect their new interest in Company A, inasmuch as Company A is the successor corporation of Company B. However, in the interest of ownership reporting continuity, the initial filing on Form 4 by an insider reporting a change in his ownership of Company A equity securities should reflect the fact that Company A is the successor issuer to Company B for purposes of filings under Section 16(a).

(31) *Question:* The Vice President of Finance of a registered company is selected to fill a vacancy on the company's Board of Directors. Must he file an additional Form 3 report showing his change in status?

Answer: No. The newly selected director is already subject to the reporting requirements of Section 16(a) since he is an officer of the company, and no additional filing is required to indicate his change of status.

(32) *Question:* A company's common stock is listed on three national securities exchanges. Must insiders file copies of Forms 3 and 4 with each exchange as well as with the Commission, in order to satisfy the requirements of Section 16(a)?

Answer: No. Rule 16a–1(c) allows an issuer listed on more than one exchange to designate which exchange will receive the reports required to be filed under 16(a). However, if no designation is made, ownership reports must be filed with each national securities exchange on which an equity security of the issuer is listed.

(33) *Question:* Must a person who becomes an officer or director of a registered company report changes in his beneficial ownership which occurred prior to his assuming that status?

Answer: Yes. When he becomes an officer or director he files a Form 3; in addition, he must file a Form 4 with respect to any subsequent purchase or sale. In his first Form 4, the insider must report all prior purchases or sales that occurred within the preceding six months even though they were effected before he became an officer or director. Transactions which occur outside of this six month period need not be reported. The purpose of this requirement is to provide disclosure with respect to all transactions which may be subject to the recovery provisions of Section 16(b).[50]

Illustration: On May 1, an employee purchases stock of his registered company on a national securities exchange. Thereafter, on June 30, he becomes an officer of the company and files his Form 3 within 10 days. On September 15, he acquires additional shares of the company under an employee benefit plan and prepares to file his first Form 4.

Interpretation: The officer's May 1 purchase should be included in his first Form 4 report.

(34) *Question:* Should directors and officers of an issuer report changes in their beneficial ownership of equity securities of such issuer which occur prior to the issuer's first registration of an equity security under Section 12 but within six months of an otherwise reportable transaction?

Answer: Yes. Pursuant to Rule 16a–1(d) [17 CFR 240.16a–1(d)], directors and officers are required to report in their initial Form 4 all changes of beneficial ownership which occur within six months prior to the date of the transaction which required the filing of the form.

Illustration: On January 3, a non-registered company sells 1,000 shares of its common stock to one of its directors. On April 2, the company's common stock is registered under Section 12(g) and the director files his Form 3. From May 15 through May 28, the director acquires an additional 5,000 shares of the common stock in a series of private transactions.

Interpretation: The first Form 4 report is triggered by the purchase of the common stock on May 15. Accordingly, the director would have to report all his transactions in the company's common

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Forms 3 and 4 in Securities Exchange Act Release No. 6487 (March 9, 1961) [26 FR 2465].

[50] Securities Exchange Act Release No. 8697 (September 18, 1969) [34 FR 15246]. See also *Adler v. Klawans*, 172 F. Supp. 502 (S.D.N.Y. 1958), *aff'd*, 267 F.2d 840 (2d Cir. 1959); *Blau v. Allen*, 163 F. Supp. 702 (S.D.N.Y. 1958). In both cases the courts held that for purposes of Section 16(b), a purchase of an equity security made before a person becomes a director or officer of a registered company may be matched with a sale within 6 months, at a time when such person is a director or officer of the issuer.

It should be noted that while directors and officers are subject to the requirements of Section 16 for certain transactions occurring before becoming directors and officers, there is no corresponding requirement for 10 percent beneficial owners. See footnote 32, *supra*.

stock which occured since the preceding November 15.

(35) *Question:* If a person ceases to be a director or officer of a registered company or if his company ceases to be a registered company, does he have any obligation to report changes in his beneficial ownership which occur following termination of his office or of the company's status as a registered company?

Answer: Yes. Rule 16a-1(e) requires that such person report any change in beneficial ownership which occurs on or after the date he ceases to be an officer or director, if such change occurs within six months of any other change prior to that date.[51] Under the rule the same result would obtain were the company to terminate its registered status. The rule provides, in effect, that the last reportable transaction occurring while a person is an officer or director, or while the company still has an equity security registered, establishes the time from which the six month period is measured.[52]

B. Rule 16a-2 [17 CFR 240.16a-2]

Rule 16a-2 sets out standards to help determine whether a person is the beneficial owner, directly or indirectly, of more than 10 percent of a class of equity security for purposes of Section 16(a).

(36) *Question:* Where a company has two series of registered preferred stock outstanding, differing only with respect to dividend rate and redemption price, is each series considered a separate "class" of security for the 10 percent computation?[53]

Answer: No. Securities with substantially similar characteristics are generally considered to constitute one class, even though they may confer slightly different ancillary privileges. Accordingly, a person who owns over 10 percent of one such series, but less than 10 percent of both series combined, is not subject to Secton 16(a).[54]

(37) *Question:* In determining whether a person is the beneficial owner of more than 10 percent of a class of securities, is the base the number of shares outstanding, excluding the number of shares held by or for the account of the issuer or its subsidiaries?

Answer: Yes.

Illustration: A registered company has 2,000,000 shares of authorized common stock. There are 1,100,000 shares outstanding, of which the company's subsidiary holds 100,000 shares.

Interpretation: A person owning 99,000 shares of the company would not be considered a 10 percent holder since such person would own only 9.9 percent of the class (99,000-1,000,000).

(38) *Question:* Are substantial stockholders charged with the responsibility of knowing exactly how many shares a company has outstanding at any particular time?

Answer: No. The Commission realizes that an issuer may engage in numerous transactions involving its securities, with the result that the total amount of securities outstanding may fluctuate. Even major shareholders may not be aware of these changes on a timely basis. In recognition of this fact, Rule 16a-2 provides that a person acting in good faith may rely on the information contained in the latest consolidated financial statement in a registration statement or annual report filed with the Commission in determining the amount of a class outstanding.

Illustration: Assume that the registered company referred to in the above illustration acquires 19,000 shares of its stock in the open market. The person owning 99,000 shares, who has no knowledge of the issuer's purchase, becomes a beneficial owner of more than 10 percent. Unaware of this fact, he does not file an initial report on Form 3.

Interpretation: Absent actual knowledge, this person would not be deemed to be in violation of the reporting requirements of Section 16(a). However, he must report no later than 10 days after the close of the month in which the company's annual report on Form 10-K is filed with the Commission indicating the reduced amount of stock outstanding or such earlier time when he obtains knowledge of such reduction.[55]

(39) *Question:* Are securities issuable pursuant to the exercise of warrants or a conversion privilege excluded from the 10 percent class computation?

Answer: No. Rule 16a-2(b) provides that for purposes of determining whether a person is a beneficial owner of more than 10 percent of any class of equity security he shall be deemed to be the beneficial owner of securities which he has the right to acquire through the exercise of presently exercisable options, warrants, or rights, or through the conversion of presently convertible securities. Securities subject to such options, warrants, rights or conversion privileges, held by such person, are deemed outstanding for the purpose of computing the percentage of the class owned by him, but are not deemed outstanding for the purpose of computing the percentage of the class owned by any other person.[56]

Illustration: An individual owns 10,000 shares of common stock and $90,000 principal amount (of a total outstanding principal amount of $1,000,000) of debentures which are presently convertible into 50,000 shares of common stock of a registered company. That company currently has 700,000 shares of common stock outstanding.

Interpretation: Since this individual would be deemed to own only 60,000 shares of the total 750,000 shares which would be outstanding in the event of his conversion, he would not be considered a 10 percent beneficial owner of the common stock.

(40) *Question:* Are ownership reports required for persons owning in excess of 10 percent of a class of registered security which is convertible into less than 10 percent of a class of equity security?

Answer: Yes. The staff is of the view that the statute requires reports to be filed by persons holding more than 10 percent of a class of any registered security which is convertible into an equity security. The same result would obtain where a person held more than 10 percent of a registered class of warrants exercisable for shares of common stock of the company.[57]

Illustration: A person owns 8 percent of a class of presently exercisable warrants and 15 percent of a class of presently convertible debentures, both of which are registered on a national securities exchange. Upon exercise and conversion, he would own approximately 6 percent of the outstanding common stock.

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[51] Letter to *Michael J. Halloran, Esq.* dated May 30, 1980 and letter re *Biospherics, Inc.* dated October 2, 1975.

[52] See *Feder* v. *Martin Marietta Corp.*, 406 F.2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970), where the United States Court of Appeals for the Second Circuit held that Section 16(b) liability arose if a director who had purchased shares of a company while he was a director sold them at any time within 6 months after the purchase even though he had in the interim resigned as a director.

[53] Section 12(g)(5) defines the term "class" as: ". . . all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges."

[54] *Ellerin* v. *Massachusetts Mutual Life Insurance Company*, 270 F.2d 259 (2d Cir. 1959).

[55] Securities Exchange Act Release No. 7667 (August 3, 1965) [30 FR 9878].

[56] Securities Exchange Act Release No. 8325 (June 6, 1968) [33 FR 8774].

[57] The United States Court of Appeals for the Second Circuit has stated in *Chemical Fund v. Xerox Corp.*, 377 F.2d 107 (2d Cir. 1967), that a class of registered securities which is convertible into equity securities of the issuer should not be considered a separate class of equity security for purposes of determining liability for short-swing profits under Section 16(b). In light of the differing purposes of Section 16(a), the staff does not believe this decision to be determinative of the obligation to file ownership reports under that section.

Interpretation: Notwithstanding the fact that in the event of exercise and conversion this person would own less than 10 percent of the common stock outstanding, ownership reports are required because such person owns more than 10 percent of a class of a registered equity security, i.e., the convertible debentures. In the event such debentures were not registered under Section 12, no reports would be required provided the person is not otherwise an insider. However, if the person is a director or officer of the issuer, ownership information with respect to all equity securities of the issuer, whether registered or not, must be reported.

C. Rule 16a–3 [17 CFR 240.16a–3]

Rule 16a–3 permits a person to include a declaration in his ownership report that the filing of such report is not to be construed as an admission that such person is, for the purpose of Section 16 of the Act, the beneficial owner of securities covered by the report.

(41) *Question:* Could Mr. Smith in Question 5, *supra*, disclaim beneficial ownership with respect to the securities held by the foundation?

Answer: Yes. In case of genuine doubt, Mr. Smith can include such holdings in his own ownership report and in a footnote disclaim beneficial ownership pursuant to Rule 16a–3.

D. Rule 16a–4 [17 CFR 240.16a–4]

Rule 16a–4 provides an exemption from the operation of both Sections 16(a) and 16(b) for executors and administrators of various kinds of estates for a limited period of twelve months following their appointment. Thereafter, ownership reports are required under Section 16(a) and liability attaches under Section 16(b), but only if the estate is a more than 10 percent beneficial owner of a registered class of equity security.

(42) *Question:* Should the executrix of an estate which holds over 10 percent of the equity securities of a registered company, report estate transactions in such securities occurring during the first 12 months of her appointment as executrix?

Answer: No. Rule 16a–4(a) states that executors and administrators of the estate of a decedent, guardians and committees for an incompetent, and various administrators of the estates or assets of others are exempt during the first twelve months of their administration from the duties and liabilities imposed by Section 16(a) and Section 16(b).

Illustration: On January 1, a person is appointed the executrix of the estate of a decedent who, at the time of his death, was a director of a registered company. The only securities held by the estate are 100,000 shares of the common stock of the company, which is equal to 10.1 percent of the common stock outstanding. On February 1, the executrix sells 20,000 of these shares in order to pay some expenses.

Interpretation: The executrix is not required to report this transaction since it occurred within twelve months of her appointment.[58]

(43) *Question:* Must a registered company report repurchases of its own equity securities pursuant to Section 16(a)?

Answer: No. Issuer repurchases are exempt from the application of Sections 16(a) and 16(b) by virtue of Rule 16a–4[59]

E. Rule 16a–5 [17 CFR 240.16a–5]

Purchases and sales by odd-lot dealers insofar as such transactions are reasonably necessary in the ordinary course of their business are exempt from Section 16 of the Exchange Act pursuant to Rule 16a–5. Odd-lot dealers perform the function of purchasing and selling securities in amounts less than the exchange unit of trading, usually 100 shares. Since odd-lot dealers must accept every order transmitted, [60] their transactions in odd-lots and adjustment of their inventory positions caused by such transactions do not ordinarily provide an opportunity for speculative abuse. It should be noted that any person who properly performs the functions of an odd-lot dealer would be entitled to the exemption provided by the rule.

(44) *Question:* Is a specialist on a national securities exchange exempt from the operation of Section 16 when trading in odd-lots, even though he may be an officer, director or 10 percent beneficial owner of the company whose securities are involved?

Answer: Yes. The specialist executes odd-lot orders in addition to his primary responsibility to maintain an orderly round lot market, and thus he is also considered to be an odd-lot dealer.

(45) *Question:* Can persons acting in their capacity as odd-lot dealers ever be subject to Section 16 when trading?

Answer: Yes. The exemption does not apply to transactions by an odd-lot dealer which involve his taking a position on the long or short side in excess of that necessary to transact his odd-lot business. An odd-lot dealer who takes a position not reasonably related to his odd-lot business may be subject to all the requirements of Section 16.

F. Rule 16a–6 [17 CFR 240.16a–6]

Rule 16a–6 requires the reporting of certain transactions occurring in connection with puts, calls, options and similar rights. However, the acquisition, expiration, surrender to the issuer, or cancellation of any non-transferable stock option or stock appreciation right issued under an employee benefit plan which meets the conditions of Rule 16b–3 is exempt from reporting by virtue of paragraph (c) of the rule. For purposes of this release, employee benefit plans which do not meet the conditions of Rule 16b–3 [61] may be termed "non-complying plans."

(46) *Question:* Are non-transferable options or rights granted to an employee under a plan which does not meet the conditions of Rule 16b–3 required to be reported pursuant to Section 16(a)?

Answer: Yes. Rule 16a–6 requires the reporting of the grant, acquisition, or disposition of any put, call, option or similar right on the ground that such a transaction involves a change in the beneficial ownership of the equity security to which the right relates.

The transferability or non-transferability of the right itself is unimportant in this context since the recipient acquires or disposes of the same beneficial interest in the underlying equity security in either case.

(47) *Question:* Should the award of a stock option granted in tandem with a SAR [62] under a non-complying plan be reported by an insider?

Answer: Yes. If currently exercisable the option and SAR shares should be reported within 10 days after the end of the month in which they are granted; both should be reported even if the SAR is exercisable only for cash. In the event they are not exercisable until sometime in the future, the award should be reported for the month in which they become exercisable. Of course, if the

[58] It should be emphasized that even after the twelve month grace period has elapsed, the executrix would be subject to the provisions of Section 16 only if the estate were a 10 percent beneficial owner of a class of equity security registered under Section 12. In such a situation ownership reports are required to be filed by the executrix.

[59] Imposition of the short-swing profit recovery provisions of Section 16(b) would be incongruous in this context, since the company would owe any profit to itself.

[60] That is, the odd-lot dealer must always buy when a customer wants to sell, and sell when a customer wants to buy, at the first possible opportunity following receipt of an order.

[61] Rule 16b–3 provides an exemption from the liability provisions of Section 16(b) of the Exchange Act for certain transactions involving acquisitions and dispositions of securities by participants under employee benefit plans which meet the conditions specified in the rule.

[62] See discussion of SARs in Question 22, *supra*.

plan meets the requirements of 16b-3, the acquisition of the option and SAR is exempt from the liability and reporting provisions of Section 16 by virtue of that rule and Rule 16a-6(c).

(48) *Question:* Under a non-complying plan, an insider receives an award of the right to acquire shares of his registered company, exercisable only at the time of his retirement. When must the employee report the award?

Answer: At the time the right becomes exercisable.

(49) *Question:* A registered company grants a stock bonus award to an insider. The bonus shares are subject to a repurchase option, exercisable only if the grantee's employment is terminated. Should the employee report the award on Form 4?

Answer: Yes. A Form 4 should be filed covering the stock granted to the insider. The reporting date for the transaction would be the date of the grant, and the transaction should be described as the receipt of a stock bonus. Pursuant to Rule 16a-6, Note 1, the company's repurchase option need not be reported by the insider until it is exercisable.

Upon termination of employment, the grantee should file a Form 4 reporting the company's repurchase option provided that other reportable changes in the insider's beneficial ownership occurred within the six months preceding such termination.[63] The termination of the company's repurchase option need not be reported if such option lapses without ever having been exercised.

(50) *Question:* Where an insider ("lender") loans equity securities of his registered company to a brokerage firm ("borrower"), which of the following events requires the lender to file a report on Form 4?

(a) The initial loan of the securities to the borrower;

(b) The transfer of record ownership of the securities from the lender to the borrower (or its nominee);

(c) A disposition of the borrowed securities, by loan or sale, by the borrower prior to the return of an equivalent amount of such securities to the lender; and

(d) A purchase by the lender of replacement securities in the event of a default by the borrower.

Answer: The lender is not required to report the actual loan of securities to the borrower, nor the transfer of record ownership.[64] Similarly, no report is required when there is a sale of such securities by the brokerage firm, so long as the loan is not in default; nor would a loan made by the borrower through failure to return the borrowed securities and the subsequent purchase by the lender of replacement securities would be reported on Form 4.

(51) *Question:* Is the right to acquire securities to be obtained in connection with a merger, a right to buy securities within the meaning of Rule 16a-6?

Answer: No.

Illustration: The shareholders of two otherwise unrelated companies agree to merge. Pursuant to the merger agreement, shares of common stock of the acquiring registered company are to be exchanged for the common stock of the other company. One person is a director and stockholder of both companies.

Interpretation: The common director need not report his right to acquire shares of the registered company in the merger. Of course, his acquisition of common stock upon completion of the merger must be reported.

(52) *Question:* "A" acquires a currently exercisable option to purchase 15 percent of the outstanding common stock of a registered company from "B". Must this transaction be reported under Section 16(a)?

Answer: "A" is required to report the acquisition of beneficial ownership of 15 percent of the outstanding common stock of the registered company. "B" is required to report the granting of the option as a change in his beneficial ownership. Both "A" and "B" have a sufficient interest in the securities to be considered beneficial owners under Section 16(a). If "A" is not already filing reports as an insider, his report will be filed on Form 3.

In the event the option expires or is cancelled, without "A" exercising his right to buy, both "A" and "B" would be required to report the expiration or cancellation of the option as a change in their beneficial ownership, and "A" would no longer be deemed a beneficial owner of the securities underlying the option. If the option were exercised, "A" would be required to report the purchase of the shares and "B" would report their sale on Form 4. "B" would no longer be deemed to be a beneficial owner of the securities.[65]

(53) *Question:* Is the acquisition of a currently exercisable right to purchase shares of a registered company for a 30 day period the "acquisition * * * of a presently exercisable * * * call, option or other right * * * to buy securities" which is reportable pursuant to Rule 16a-6?[66]

Answer: Yes. However, reporting would not be required if the provisions of paragraph (c) of Rule 16a-6 are satisfied.[67]

(54) *Question:* Is the acquisition of an exchange traded option or other type of put or call option by an insider exempt from reporting by virtue of Rule 16a-6(c)?

Answer: No. Rule 16a-6(c) is only available for non-transferable stock options and stock appreciation rights issued in connection with certain employee benefit plans that satisfy the conditions of Rule 16b-3.[68] Accordingly, an insider would be required to report the acquisition of the exchange traded or other type of option on Form 4.

(55) *Question:* Must an insider report the grant of performance units under a performance share plan[69] that meets the conditions of Rule 16b-3?

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[63] Letters re *Itel Corporation* dated May 16, 1978 and *Amdahl Corp.* dated January 19, 1977.

[64] The staff has long held the view that neither a bona fide pledge nor a loan of securities is a reportable event pursuant to the requirements of Section 16(a) of the Exchange Act. This position is grounded on the belief that the vast majority of such transactions are not subterfuges for sales, but rather straightforward commercial transactions which contemplate payment of the loan and the return of the pledged or borrowed securities to their owner, with no consequent change in his beneficial ownership for purposes of Section 16(a). Recently, the United States Supreme Court has ruled in *Rubin v. United States*, 49 U.S.L.W. 4103 (January 21, 1981), that the pledge of stock to a bank as collateral for a loan is an "offer" or "sale" of a security under Section 17(a) of the Securities Act of 1933. The staff has carefully examined the *Rubin* opinion in light of its administrative practice not to require the reporting of bona-fide pledges and loans of securities. In brief, the staff notes that *Rubin* deals essentially with issues arising largely under the Securities Act of 1933. *Rubin* does not address the impact of a pledge or loan in the context of the prohibition against insider trading found in Section 16(b) of the Exchange Act, nor does the opinion treat the effect of such arrangements with respect to the disclosure system established by Section 16(a). Given the different statutory objectives, the staff does not regard the *Rubin* decision as dispositive for reports filed under Section 16(a). Accordingly, the staff will adhere to its position that bona-fide pledges and loans of securities need not be reported as changes in beneficial ownership.

[65] Securities Exchange Act Release No. 9499 (February 23, 1972) (37 FR 4329).

[66] For consideration of the question whether the 30 day right to purchase shares is an "option, warrant, or right" within the meaning of Rule 16b-3, see the discussion of Rule 16b-3, *infra*.

[67] Rule 16a-6(c) provides that an ownership report need not be filed with respect to the acquisition, expiration, surrender to the issuer, or cancellation of any non-transferable stock option or stock appreciation right granted pursuant to a plan that meets the conditions of Rule 16b-3.

[68] Rule 16a-6(c), of course, exempts only transactions in the rights, or ancillary securities. Acquisitions of the underlying or principal securities must be reported under Section 16(a).

[69] In general, these plans call for the grant of accounting units or performance shares which entitle participants to payments contingent upon the attainment of pre-established employment performance objectives set over the award period typically three or more years. The payment value of each unit earned is equal to the current market

Continued

Answer: No. However, the acquisition of common stock in satisfaction of the performance units would be reportable under Section 16(a) even though exempted from Section 16(b) by Rule 16b-3.

Illustration: A registered company adopts a performance share plan. The plan provides for the granting of awards to participants in the form of performance units, but no payments will be made on account of such awards until after the end of a four-year award period. At the end of an award period, participants become entitled to receive, based on their performance units, payments in cash and/or common stock of the company, in amounts related to the average annual growth of the company's earnings per share during the award period.

Interpretation: Assuming that the plan satisfies all applicable provisions of Rule 16b-3, an insider need not report the acquisition of performance units by virtue of paragraph (c) of Rule 16a-6.

G. Rule 16a-7 [17 CFR 240.16a-7]

Rule 16a-7 provides that persons subject to the reporting requirements of both Section 16(a) of the Exchange Act as well as Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(f) of the Investment Company Act of 1940 may file a single ownership report which will be deemed to be filed under both Acts.

(56) *Question:* A director of a closed end investment company, which is registered under the Investment Company Act of 1940, purchases stock of his company which is listed on a national securities exchange. His purchase triggers reporting requirements under both the Exchange Act and the Investment Company Act. Must the director file two separate reports to satisfy these requirements?

Answer: No. The filing of a single ownership statement containing the required information will be deemed to satisfy the reporting obligation under both Acts.

H. Rule 16a-8 [17 CFR 240.16a-8]

Rule 16a-8 treats the filing of ownership reports with respect to situations where securities are held in trust.

(57) *Question:* For purposes of Rule 16a-8(a), in determining whether a person is part of the "immediate family" of the trustee, are factors such as age, marital status, and the sharing of a common household relevant?

Answer: No. Rule 16a-8(e) specifically defines the phrase "immediate family" [70] for purposes of the rule. The age, marital status and household of a particular person are not relevant to this determination.

Illustration: The trustee of an irrevocable personal trust is also a director of a registered company. The trust holds less than 10 percent of the common stock of that company. The sole beneficiary of the trust is the 35-year old married daughter of the trustee, who receives the income from the trust until age 45 and then is entitled to the corpus.

Interpretation: Since the beneficiary of the trust is the daughter of the trustee, she is considered part of his "immediate family," despite her maturity, marital status and presumed independence. Accordingly, the trustee must report trust transactions in the securities of the registered company as though they were his own.[71]

(58) *Question:* An officer of a registered company is the beneficiary of an irrevocable trust which holds shares of common stock of that company. The officer has the right to vote the trust shares but receives income from them only in the discretion of an independent trustee. Does the officer have a vested beneficial interest in the trust within the meaning of Rule 16a-8(a)(2)?

Answer: Yes. As already noted, the term "beneficial ownership" of securities has not been specifically defined by the Commission for purposes of Section 16. It is generally recognized, however, that among the hallmarks of beneficial ownership are the right to control voting and transfer; the right to receive or control the disposition of income; and the right to control disposition of proceeds upon liquidation. Not all of these characteristics need be present in order for beneficial ownership to exist. In this case, since the insider may receive income from the trust, and since he does have the right to vote the trust securities, it appears that he receives benefits sufficient to constitute him the beneficial owner of securities held in the trust.[72]

(59) *Question:* An insider establishes a trust whose assets consist of shares of his registered company. The sole beneficiary of the trust is a person not related to the insider, and the trustee is independent. The insider retains the power to remove the trustee without the consent of the beneficiary. Would the insider be deemed the beneficial owner of the trust shares?

Answer: Yes.[73]

(60) *Question:* Employee benefit plans of various types frequently provide for the accumulation of interests in registered company shares by participating employees, including officers and directors. Many such plans are based on a form of trust arrangement, often with an independent trustee, with the participants as beneficiaries. Where the beneficial interest in company common stock held by a plan trust for the accounts of officers and directors does not exceed, in the aggregate, 20 percent of the market value of all securities held by the trust, are officers and directors required to report: (1) participant and company contributions under the plan; (2) the purchase by the trustee of the common stock of the company for use in connection with the plan; (3) the allocation of company stock to their individual trust accounts; or (4) the periodic vesting of rights to acquire the common stock so allocated?[74]

Answer: No.[75] Such intra-plan transactions are exempt from the reporting requirements under Rule 16a-8(b). However, a plan participant who is required to report changes in beneficial ownership pursuant to Section 16(a) must continue to file reports on Form 4 to disclose any other changes in his beneficial ownership which occur outside the plan. Each such report should include, by footnote, a statement as to the number of shares vested for such individuals in the plan as shown by

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value of a share of company stock at the end of the award period, subject in some cases to a maximum payment ceiling. Payments are made at the end of the award period in cash, stock, or a combination of both, in the sole discretion of a disinterested committee which administers the plan. Performance shares are not transferable by a participant.

[70] Rule 16a-8(e) defines an immediate family member as:

1. a son or daughter of the trustee, or a descendant of either,
2. a stepson or stepdaughter of the trustee,
3. the father or mother of the trustee, or an ancestor of either,
4. a stepfather or stepmother of the trustee,
5. a spouse of the trustee.

For the purpose of determining whether any of the foregoing relations exists, a legally adopted child of a person shall be considered a child of such person by blood.

[71] Opinion of General Counsel, Securities Exchange Act Release No. 1965 (December 21, 1938) [11 FR 1091].

[72] Letter to *John R. Blake* dated June 30, 1971.

[73] See Rule 16a-8(a)(3). [17 CFR 240.16a-8(a)(3)].

[74] See letters re *The Pillsbury Company* dated June 17, 1981 and *Associated Madison Companies, Inc.* dated October 27, 1980.

[75] Where a trust holds more than one class of equity security of the same issuer, the aggregate value of all classes of equity securities of the issuer held by the trust should be taken into consideration when computing the 20 percent threshhold established in paragraph (b) of Rule 16a-8. Further, the exemption provided by Rule 16a-8(b) is not "acquired or lost solely as a result of changes in the value of the trust assets during any fiscal year or during any time when there is no transaction by the trust in the securities otherwise subject to the reporting requirements of Section 16(a)."

its latest annual report. The footnote should also indicate that the information reflected therein does not include securities which may have accured to his account since the filing of the plan's last report. Of course, actual distributions of plan securities to insider participants should be reported in accordance with Rule 16a–1. Finally, should the plan itself become a 10 percent beneficial owner, the plan would be required to file its own reports pursuant to Rule 16a–8(c).

(61) *Question:* Would the existence of a provision in an employee plan which permits participants to reallocate their contributions among the various funds in the plan at least once a year affect the availability of the 16a–8(b) exemption?

Answer: No. As long as the aggregate market value of reportable securities allocated to the accounts of officers and directors represents less than 20 percent of the market value of all securities held by the plan, Rule 16a–8(b) is available.

(62) *Question:* Assuming that a trust does not meet the 20 percent test of Rule 16a–8(b), is the second sentence of that rule available to provide an exemption from reporting for officer and director participants if the benefit plan provides that the company, in its sole discretion, can determine when distributions will be made except in the case of death, disability or termination of employment?

Answer: No. Rule 16a–8(b) does provide an additional exemption from reporting when the ownership, acquisition or disposition of the securities by a trust is made without the settlor's or beneficiary's prior approval.[76] Here, however, the company as settlor has full control over the disposition of the securities held by the trust and, accordingly, Rule 16a–8(b) is not available.[77]

(63) *Question:* Would the answer to Question (62) be different if the company did not have any discretion over distributions but the participant had the right to withdraw his interest in the trust after a period of 5 years from the time the shares were allocated to his account?

Answer: No. Here the beneficiary has some control over the disposition of securities made by the trust. Since the plan contemplates withdrawals by participants prior to actual termination of employment, the exemption provided by the second sentence of Rule 16a–8(b) would not appear to be available.[78]

(64) *Question:* Is there any provision under Rule 16a–8(b) which would exempt from reporting the actual distribution of securities to insider participants in a plan?

Answer: No. Actual distributions of company stock are not exempt from reporting and therefore such acquisitions must be reported within the time prescribed by Rule 16a–1.[79]

(65) *Question:* Must a trust, and its trustee, file separate reports pursuant to Section 16(a), if the trust holds 5 percent of the outstanding common stock of a registered company and the trustee is an insider of the same company?

Answer: No.[80]

(66) *Question:* Is it ever appropriate to file only one annual ownership report covering all officer and director participants in a benefit plan?

Answer: Yes. The staff recognizes that the assembling and reporting of transactions for individual insider participants as frequently as on a monthly basis may require burdensome and costly procedures. Accordingly, the staff has interpreted the provisions of Rule 16a–8(d) to provide partial relief from the reporting provisions of Section 16(a) for officers and directors who are participants in a plan.[81] Under this interpretation, the plan trustee may file a single annual report naming the insider participants, and showing the dates, amounts and average price per share of company securities attributable to each officer and director for the period.[82] If this procedure is followed, individual ownership reports reflecting interests accrued under the plan are not required.

(67) *Question:* Is Rule 16a–8(d) available to officer and director participants in benefit plans that do not provide for the establishment of a trust?

Answer: No. Rule 16a–8(d) permits deferred reporting only for plan securities held in trust.

Illustration: A registered company adopts an employee benefit plan which allows employees to make monthly purchases of company common stock on the open market, through a broker, by means of monthly payroll deductions. Each month, a participant immediately acquires full ownership of shares purchased for his or her account. Shares are held for the participant's account in the name of the broker until delivery is requested by the participant.

Interpretation: Since this plan does not provide for the establishment of a trust, Rule 16a–8(d) is not available, and officer and director participants must file a Form 4 for each month in which there is a change in beneficial ownership resulting from participation in the plan. Since the shares held by the plan are segregated in a brokerage account for the benefit of the participant, and since the participant can vote the shares and obtain physical possession of them, there is no basis for deferred reporting.[83]

(68) *Question:* As a matter of administrative convenience, may the committee administering a benefit plan file the Form 4 report on behalf of all participating officers and directors, instead of the trustee?

Answer: Yes.[84]

(69) *Question:* Under the terms of a retirement plan in use by a registered company, participants are allowed to reallocate contributions annually among various funds in the trust and they are entitled to vote the shares of company common stock credited to their accounts. However, participants are not entitled to receive such shares until their retirement, disability, death or other termination of employment. Is the reporting exemption provided by Rule 16a–8(g)(3) available to officer and director participants in the plan?[85]

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[76] The second sentence of Rule 16a–8(b) states, "[E]xemption is likewise accorded from section 16(a) with respect to any obligation which would otherwise be imposed solely by reason of ownership as settlor or beneficiary of securities held in trust, where the ownership, acquisition, or disposition of such securities by the trust is made without prior approval by the settlor or beneficiary."

[77] See letter re *Quaker Oats Company* dated April 12, 1973.

[78] See letter re *Dain, Kalman & Quail* dated November 29, 1973. It should be noted that in those situations where this exemption is applicable, that is, where the settlor or beneficiary has no control over the ownership, acquisition or disposition of the company's securities, participants who are otherwise required to report changes in beneficial ownership should include a notation, on any report filed, of the number of shares vested to their accounts under the plan as shown by its latest annual report, and an indication that such report does not include securities which may have been acquired since the last plan report.

[79] Letters re *Buckhorn, Inc.* dated April 30, 1981 and *Butler Manufacturing Company* dated February 5, 1981.

[80] Notwithstanding the fact that the definition of the term "person" in Section 3(a)(9) does not expressly include trusts, if the trust were a 10 percent beneficial owner, both it and the trustee would have to file separate ownership reports reflecting such transactions. Letter re *Caltron Systems, Inc.* dated September 6, 1973.

[81] Letters re *Royal Crown Cola Co.* dated July 31, 1974 and *General Tire and Rubber Company* dated January 5, 1973.

[82] It should be noted that a trust which is a 10 percent stockholder may not avail itself of this relief. Accordingly, if a trust owns more than 10 percent of a class of equity security of a registered company, both the trustee and the trust would have to report, on a regular basis, the transactions of the trust in the securities of the company. Letter re *The Bendix Corporation* dated August 10, 1972.

[83] Letters re *Northwest Energy Company* dated September 8, 1976; and *The Texstar Corporation* dated July 11, 1975.

[84] Letters re *North American Group Associates* dated January 24, 1979 and *Clarkson Industries, Inc.* dated December 13, 1973.

[85] As noted above, Rule 16a–8(b) may also be available to participants in the plan if the beneficial

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Answer: Yes. The mere pass-through of voting rights to participants in a pension or retirement plan, even when coupled with the power to reallocate contributions on an annual basis does not change the primary emphasis of the pension or retirement plan.[86] Since a participant's interest remains substantially indirect, Rule 16a-8(g)(3) is available.[87]

(70) *Question:* Would the existence of withdrawal provisions in a plan automatically destroy the availability of Rule 16a-8(g)(3)?

Answer: No. If limited withdrawal provisions are accompanied by the imposition of significant penalties on the participants, such provisions will not automatically disqualify the plan from being considered a "pension or retirement plan." [88] Significant penalties might consist of denying the participant the right to participate in the plan for at least a one-year period,[89] and/or requiring the forfeiture of a substantial portion of the participant's interest in the employer's contribution.[90]

(71) *Question:* Is the rule available where a participant can make withdrawals, without penalty, for emergency and educational purposes subject to the approval of the committee administering the plan?

Answer: No. Withdrawal provisions of any kind must be accompanied by corresponding penalties.

(72) *Question:* Would a voluntary, contributory employee benefit plan that requires the establishment of a trust, and allows the employee participant to choose from different investment media, be deemed a "business trust" within the meaning of Rule 16a-8(g)(4)?

Answer: No. The term "business trust" has been construed to mean a type of business organization formed along the lines of the common-law or "Massachusetts trust," and which is engaged in general commercial enterprise. An employee benefit plan would not normally be considered such an entity, and the exemption provided by Rule 16a-8(g)(4) would not be available.[91]

I. Rule 16a-9 [17 CFR 240.16a-9]

Rule 16a-9 provides a temporary exemption or, more accurately, deferred reporting for certain transactions in which the amounts involved are sufficiently small that there appears to be no public interest in requiring reports of the transactions as they occur.

(73) *Question:* is the exemption provided by Rule 16a-9 available to an insider who participates in a registered company's employee benefit plan?

Answer: The exemption provided by Rule 16a-9 would be available for acquisitions by an insider participating in the plan so long as the following two conditions are met: (1) all acquisitions and sales of securities of the same class effected by the insider during any six month period do not exceed $3,000 in aggregate market value; and (2) the insider does not sell securities of the same class within six months *after* an acquisition.[92] These limitations, however, do not apply to the acquisition or disposition of securities by gift in an amount not exceeding $3,000 in aggregate market value during any six month period. Thus, the rule provides a temporary exemption for up to $3,000 in acquisitions, otherwise than by gift, so long as the conditions of paragraph (a) of the rule are satisfied, and an additional $3,000 for acquisitions or dispositions by gift in accordance with the provisions of paragraph (b) of the rule.[93] It should be emphasized that any transaction involving a sale of securities is not exempt under Rule 16a-9.

Illustration: An insider, who has had no recent transactions in the securities of his registered company, acquires on January 1 registered common stock with a market value of $1,000 through the company's benefit plan. No Form 4 report need be filed in accordance with the exemption provided by paragraph (a)(2) of Rule 16a-9. On February 1, he acquires additional common stock, again in the amount of $1,000, and on the same day he donates $1,000 worth of stock to a charity. On May 1, the insider acquires common stock in the amount of $1,000 and makes a second donation of $2,000 worth of common stock to the same charity. The $3,000 in acquisitions and the $3,000 in dispositions by gift would be exempt from reporting under Section 16(a) by virtue of Rule 16a-9. However, if the insider made further donations of the common stock, or acquired additional shares of such stock within the relevant six month period, the exemption would be lost since he has exceeded the limits of the rule.[94] Under these circumstances, he must file a Form 4 reporting all transactions temporarily exempted by Rule 16a-9. See paragraph (c) of the rule.[95]

(74) *Question:* Would the exemption be available with respect to an insider's gifts of a company's registered equity security having a total market value of $10,000 during a six-month period?

Answer: No. Based on the specific language of Rule 16a-9(b), gifts of registered securities by an insider in

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interest in company common stock held by the trust for the account of statutory insiders does not exceed, in the aggregate, 20 percent of the market value of the securities having a readily ascertainable market value held by the trust.

Although Rule 16a-8(b) technically provides only an exemption from reporting changes in beneficial ownership of securities held in trust, and Rule 16a-8(g)(3) provides an exemption only for changes in an insider's indirect interest in portfolio securities held by certain types of plans, it is the staff's view that all intra-plan transactions are exempt from reporting if either of these two provisions is applicable.

[86] A "pension or retirement plan," within the meaning of the rule, is one in which participants generally are not entitled to receive a distribution until their retirement, death, or other termination of employment.

[87] For example, the staff is of the view that the following are two indications of direct ownership: (1) the ability to control or influence the timing and amount of purchase or sale of securities for the plan; and (2) the ability of a participant to withdraw his vested interest in the plan without substantial penalty.

[88] Even where the penalties are not significant, the reporting obligations may be deferred if the administrators of the plan file annually a single report pursuant to Rule 16a-8(d) which reflects the beneficial interests of officer and director participants in the company stock held by the plan. Individual ownership reports which are otherwise filed by participants should note their participation in the plan.

[89] Letter re *Santa Anita Realty Enterprises, Inc.* dated May 30, 1980. A lesser period of time is not sufficient: see letters re *United Bank Corporation of New York* dated March 5, 1981; *Newhall Land and Farming Company* dated September 29, 1980; *Western Gear Corp.* dated April 9, 1979; and *Heritage Communications, Inc.* dated September 14, 1978.

[90] While a 10 percent forfeiture is considered to be substantial, a lesser percentage would not; see letters re *Harris Bankcorp, Inc.* dated November 24, 1978 and *Ex-Cell-O Corporation* dated May 9, 1977.

[91] Letter to *Theodore C. Bolliger* dated December 16, 1970.

[92] The sale transactions referred to in (1) above must occur *prior* to an acquisition intended to be exempt from reporting under the sale since the exemption is lost pursuant to Rule 16a-9(a)(1) if sales occur within six months after the subject acquisitions.

[93] Rule 16a-9 provides:

(a) Any acquisition of securities shall be exempt from Section 16 where

(1) The person effecting the acquisition does not within six months thereafter effect any disposition, otherwise than by way of gift, of securities of the same class, and

(2) The person effecting such acquisition does not participate in acquisitions or in dispositions of securities of the same class having a total market value in excess of $3,000 for any six months' period during which the acquisition occurs.

(b) Any acquisition or disposition of securities by way of gift, where the total amount of such gifts does not exceed $3,000 in market value for any six months period, shall be exempt from section 16(a) and may be excluded from the computations prescribed in paragraph (a)(2).

(c) Any person exempted by paragraph (a) or (b) of this section shall include in the first report filed by him after a transaction within the exemption a statement showing his acquisitions and dispositions for each six months' period or portion thereof which has elapsed since his last filing.

[94] Similarly, if the insider sold securities of the same class during such period the protection of the rule would be forfeited.

[95] Letters re *Atlantic Richfield Thrift Plan* dated June 6, 1973 and *Washington National Corporation* dated August 11, 1975.

excess of $3,000 market value in any six-month period would not be entitled to the exemption provided by the rule.

(75) *Question:* In computing the $3,000 ceiling, can the value of the shares acquired through dividend reinvestment plans be excluded?

Answer: No. All acquisitions of securities of the same class should be included in calculating the $3,000 ceiling.[96]

J. Rule 16a-10 [17 CFR 240.16a-10]

Rule 16a-10 provides that any transaction which has been or shall be exempted by the Commission from the requirements of Section 16(a) shall, insofar as it is otherwise subject to the provisions of Section 16(b), be likewise exempted from section 16(b). The plain language of Rule 16a-10 needs no elaboration. The rule simply expresses the Commission's view that transactions which are exempt from the reporting requirements of Section 16(a) should not be subjected to the liability provisions of Section 16(b), and thus the rule exempts such transactions from the recovery provisions of the Exchange Act.[97] It might be noted that Rule 16a-10 was designed to be self-operative, and the Division will not express any view as to the applicability of the rule to a given fact situation.

K. Rule 16a-11 [17 CFR 240.16a-11]

Rule 16a-11 exempts from the liability and reporting requirements of Section 16 the acquisition of securities by insiders pursuant to dividend reinvestment plans.

(76) *Question:* Is the exemption provided by Rule 16a-11 available to insider participants in a dividend reinvestment plan which restricts plan participation to key employees of the issuer?

Answer: No. As stated in Securities Exchange Act Release No. 16806 (May 14, 1980) [45 FR 33957], the rule is available only to participants in dividend reinvestment plans which, by their terms, are available to all security holders of the class on which the dividend is being paid. It should be noted, however, that the staff has expressed the view that Rule 16a-11 is available for a dividend reinvestment feature of a profit sharing plan which was not available to all shareholders of the company's common stock, since the company did maintain a separate dividend reinvestment plan which was open to all of the company's shareholders.[98]

(77) *Question:* Assuming Rule 16a-11 is available, are acquisitions of securities pursuant to a dividend reinvestment plan forever exempt from reporting by an insider?

Answer: No. For reporting purposes, Rule 16a-11 means only that an insider is not required to file current reports of acquisitions of dividend securities within ten days of the close of the month in which such securities are acquired pursuant to a dividend reinvestment plan. The rule does not mean, however, that plan securities are forever insulated from the reporting requirements of Section 16(a), one purpose of which is to require a periodic public statement of the total amount of equity securities actually owned by each insider. Accordingly, the ownership of plan securities, as distinguished from their acquisition, should be reported on the next Form 4 report otherwise required to be filed. On that, and in subsequent reports, participation in the dividend reinvestment plan may be indicated by a footnote, which also shows the aggregate number of plan shares acquired to date. Specific dates of acquisitions are not necessary. This technique permits accurate reconciliation of reports by the Commission as well as the public.[99]

(78) *Question:* Many dividend reinvestment plans permit participants to make additional cash contributions toward the purchase of securities along with the reinvestment of dividends and interest. Are such cash contributions by insiders exempt under Rule 16a-11?

Answer: No. The rule exempts only the reinvestment of dividends or interest. Additional securities acquired through voluntary cash contributions which may be permitted under such plans are not covered by the rule and must be reported under Section 16(a).

(79) *Question:* When is a reporting person deemed to acquire beneficial ownership of securities purchased through additional cash contributions under a dividend reinvestment plan?

Answer: On that date which corresponds to the last day on which the participant is able to withdraw any uninvested cash held for his account, before becoming entitled only to a distribution of whole shares which have been or will be purchased for his account.[100]

(80) *Question:* Is a sale of securities which were acquired pursuant to a dividend reinvestment plan exempt from the liability and reporting provisions of Section 16?

Answer: No. Rule 16a-11 exempts only the acquisition of such securities, not their subsequent disposition.

III. Section 16(b)—The Liability Provision

A. Statutory Concept

In order to minimize any possible inclination on the part of statutory insiders to utilize non-public information to their own advantage in trading the equity securities of their companies, Congress enacted Section 16(b) of the Exchange Act as a complement to the disclosure requirements of Section 16(a). Section 16(b) provides, in pertinent part, that for the purpose of preventing the unfair use of information which may have been obtained by an insider by reason of the insider's relationship to the issuer any profit realized by the insider from any purchase and sale, or any sale and purchase, of any equity security of such issuer within any period of less than six months shall inure to and be recoverable by such issue.[101] As a general rule, the "profit realized" is calculated so as to produce the maximum recovery. Thus, in the simplest computation involving a single purchase and a single sale within six months, the profit realized (or the amount recoverable) is the difference between the insider's purchase price and his sale price. If, in fact, the matching of these transactions results in no profit, or a loss, then the recovery provisions of Section 16(b) are inapplicable even through transactions of purchase and sale occurred within six months. The calculation of profit, however, becomes more complex when there are multiple transactions since, among other things, it may be difficult to determine how the various transactions should be matched. The order in which the transactions occurred is not controlling, since Section 16(b) provides for recovery of profit in connection with "any purchase and sale or sale and purchase."[102]

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[96] This would be the result even if certain acquisitions were exempted under Rule 16a-11 or another exemptive provision. See, generally, letter re *Orange and Rockland Utilities, Inc.* dated August 12, 1977.

[97] Securities Exchange Act Release No. 4801 (February 20, 1953) [18 FR 1132].

[98] See letter re *The Girard Company* dated February 3, 1981.

[99] Letter to *Dorothy L. Roberts* dated August 15, 1980.

[100] Letter to *John W. Brocks, Jr.* dated January 12, 1973.

[101] Section 16(b) also provides that such profits may be recovered in an appropriate action by the corporation or, if the corporation fails to bring suit, by any security holder suing on its behalf. Such actions may not be brought more than two years after the date the profit was realized.

[102] See e.g., *Smolowe v. Delendo Corporation*, 136 F. 2d 231 (2d Cir), *cert. denied*, 320 U.S. 751 (1943), where the Court held that the only rule that would effectuate the Congressional purpose was one which would require the insider to disgorge all possible profit. The court accomplished this through

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The disclosure requirements of Section 16(a) and the liability provisons of Section 16(b), mesh to form a significant deterrent to short-swing trading by those whose close relationships with their companies may afford them access to information not generally known by the public or other shareholders. It must be emhasized that, while Sections 16(a) and 16(b) rest on the hypothesis that insiders are likely to possess inside information, the actual possession or use of such information is not a pre-condition to the operation of the recovery provisions of Section 16(b).

It is sometimes overlooked that Congress left the implementation of the recovery provisions of Section 16(b) of the Exchange Act to private parties exclusively, namely corporations and their security holders, who alone are authorized to bring actions to recover short-swing profits in courts of appropriate jurisdiction. Consequently, the Commission and its staff generally refrain from expressing any interpretive views as to the impact of that section on particular facts. Of course, the Commission does participate as amicus curiae in private litigation under Section 16(b), sometimes at the request of the parties or the court itself where the issues involved raise important questions of law or policy.

Finally, section 16(b) grants the Commission specific rulemaking authority to exempt from its provisions any transaction or transactions which the Commission determines as not comprehended within the purposes of the section.[103] Over the years, the Commission has made use of this authority, and has adopted rules exempting certain types of transactions as well as certain acquisitions and dispositions of equity securities from the recovery provisions of Section 16(b), in situations where it appeared that such exemptions were consistent with the statutory purposes.

B. Purchase and Sale

The threshold determination that must be made when considering the applicability of Section 16(b) is whether there has been a purchase and sale of equity securities within six months. The terms "purchase" and "sale" are broadly defined by the Exchange Act. Section 3(a)(13) provides that "The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire." Section 3(a)(14) of the Exchange Act defines the terms "sale" and "sell" to include "any contract to sell or otherwise dispose of." While the meaning of these terms is usually clear,[104] their application in certain special situations has given rise to difficult problems of construction. Thus, the courts have applied these terms somewhat differently to transactions of exchange involving conversions,[105] recapitalizations and reclassifications,[106] and mergers and consolidations.[107] Similar difficulty with the application of these terms has been encountered in certain employee compensation situations.[108]

In general, the rules adopted by the Commission under Section 16(b) do not address the problems of construction which arise from the application of that statutory provision. Rather, the rules are exemptive in nature and designed to alleviate the impact of the short-swing profit recovery provisions in situations where their mechanical application does not appear to effectuate the purpose of the statute. It should be noted that the exemptive rules under Section 16(b) do not provide any exemption from the reporting requirements of Section 16(a) of the Exchange Act.

The final portion of this release is devoted to the interpretation of the rules promulgated under Section 16(b).

IV. Interpretations Relating to the Commission's Rules Under Section 16(b)

A. Rule 16b–1 [17 CFR 240.16b–1]

Rule 16b–1 provides an exemption from Section 16(b) liability for transactions involving purchases and sales of securities by an investment company registered under the Investment Company Act of 1940, so long as such transactions have been exempted, by order of the Commission, from the provisions of Section 17(a) of the Investment Company Act.[109]

(81) *Question:* Is a formal order of the Commission under Section 17 of the Investment Company Act always a prerequisite to the availability of Rule 16b–1?

Answer: No. Rule 16b–1 would also be available to an investment company which could rely on an exemptive rule under Section 17(a) for both the purchase and sale. The exemption provided by Rule 16b–1 gives recognition to the fact that before it may grant an exemptive order pursuant to Section 17(b), the Commission is required by that Section to make an appropriate finding with respect to the fairness and reasonableness of the transactions concerned and the absence of overreaching. In a similar fashion, the Commission's adoption of exemptive rules pursuant to Section 17(a) reflects the Commission's determination that the classes of transactions satisfying the specified standards for exemption meet the requisite standards of Section 17(b) as to fairness, reasonableness, and absence of overreaching.

For example, Rule 17a–5 excludes from the terms "purchase" and "sale",

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the use of a formula which has become known as the "lowest price in highest price out" method. Under this method, profit is computed by matching the highest sale price with the lowest purchase price within six months, the next highest sale price with the next lowest purchase price within six months, and so on, until all shares have been included in the computation.

[103] Section 3(a)(12) of the Exchange Act exempts a limited number of securities from some or all of the provisions of the Exchange Act. These exempted securities are not subject to Sections 16(a) or 16(b).

[104] For example, a bona fide gift of securities is not considered to be a "sale" for purposes of Section 16(b). *Lewis v. Adler*, 331 F. Supp. 1258 (S.D.N.Y. 1971); *Truncale v. Blumberg*, 80 F. Supp. 387 (S.D.N.Y. 1948); *Shaw v. Dreyfus*, 79 F. Supp. 533 (S.D.N.Y. 1948), *aff'd*, 172 F. 2d 140 (2d Cir. 1949).

[105] *Park & Tilford, Inc. v. Schulte*, 160 F. 2d 984 (2d Cir.), *cert. denied*, 332 U.S. 761 (1947) (conversion of redeemable preferred stock held to be a purchase); *Heli-Coil Corp. v. Webster*, 352 F. 2d 156 (3rd Cir. 1965) (conversion of a convertible debenture deemed a sale of the debenture and a simultaneous purchase of the underlying common stock); *Ferraiolo v. Newman*, 259 F. 2d 342 (6th Cir. 1958), *cert. denied*, 359 U.S. 927 (1959) (conversion of preferred stock held not to be a purchase).

[106] *Blau v. Lehman*, 286 F. 2d 786 (2d Cir. 1960), *aff'd without consideration of this point*, 368 U.S. 403 (1962) (exchange of common stock for preferred stock was a purchase); *Roberts v. Eaton*, 212 F.2d 82 (2d Cir.), *cert. denied*, 348 U.S. 827 (1954) (exchange in connection with a reclassification not a purchase).

[107] In the area of mergers and other reorganizations, some courts have looked to the opportunity for abuse as the test for determining the applicability of Section 16(b). See *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (exchange of stock in a merger was not a sale since it did not present the possibility of speculative abuse of inside information); *American Standard, Inc. v. Crane Co.*, 510 F.2d 1043 (2d Cir 1974), *cert denied*, 421 U.S. 1000 (1975) (exchange in merger was neither a sale of stock of disappearing corporation nor a purchase of stock of the surviving corporation). Other courts have followed a more literal or objective approach and applied the statute without regard for actual abuse or the opportunity for such abuse. *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972); *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976).

[108] For example, one court has indicated that the cash settlement of a stock appreciation right involves a simultanaeous purchase and sale of the stock to which it relates. *Matas v. Siess*, 467 F.Supp. 217 (S.D.N.Y. 1979). Two other decisions in the same district, however, suggest that Section 16(b) liability does not attach solely because of the exercise of a stock appreciation or similar right, at least in the circumstances described in those cases. *Rosen v. Drisler*, 421 F. Supp. 1282 (S.D.N.Y. 1976) (cash payments in settlement of stock option rights); *Freedman v. Barrow*, 427 F. Supp. 1129 (S.D.N.Y. 1976) (Stock appreciation rights exercised for stock or cash). In *Freedman* at 1152, the court stated "The exercise of a stock appreciation right does not involve the sale of an equity security by the officer-director, and thus, there is no inherent or *per se* violation of Section 16(b) as a result of the simultaneous receipt of shares thereunder."

[109] Rule 16b–4 extends comparable relief to companies registered under the Public Utility Holding Company Act of 1935.

as used in Section 17(a), any pro-rata distribution in cash or in kind made by a company to its common stockholders, where the individual stockholder has no election as to the type of asset he will receive in the distribution. It is the Division's view that, for purposes of Rule 16b-1, the general exemption from the provisions of Section 17(a) embodied in an exemptive rule such as Rule 17a-5 is substantially equivalent to an exemptive order of the Commission issued under the Investment Company Act.

B. Rule 16b-2 [17 CFR 140.16b-2]

Rule 16b-2 recognizes that an underwriter engaged in the public distribution of securities of a registered company may also be an insider of that company for purposes of section 16(b). Accordingly, the rule exempts those transactions of purchase and sale which are essential in connection with the distribution as not comprehended within the purpose of Section 16(b), so long as the conditions specified in the rule are satisfied.

(82) *Question:* A registered company is making an underwritten distribution of its securities. A member of the underwriting firm is also a director of the registered company. Can the underwriting firm conduct customary stabilizing transactions during the distribution period without incurring Section 16(b) liability, assuming the conditions of Rule 16b-2 are satisfied?

Answer: Yes. Rule 16b-2 exempts transactions in the security being distributed, as well as such stabilizing transactions as may be considered necessary to effect the distribution.

Illustration: The same company proposes to make an offering of preferred stock which is convertible into shares of its common stock. The underwriter intends to stabilize during the distribution period by buying the preferred stock.

Interpretation: The stabilizing purchases are exempt from the recovery provisions of Section 16(b).

(83) *Question:* Is the exemption afforded by Rule 16b-2 available to the underwriter who enters into a standby agreement with an issuer in connection with the redemption of a class of convertible debt securities?

Answer: Yes.

Illustration: A registered company proposes to call its outstanding subordinated convertible debentures for redemption. The company does not wish to use its own cash for the redemption. Accordingly, it will enter into a standby agreement with a group of dealers represented by a managing dealer, one of whose partners is also a director of the company. The standby agreement provides that the dealers will undertake to purchase any debentures tendered for cash at a price slightly in excess of the redemption price. The dealers would then convert the debentures into common stock of the company and sell such common stock in the open market.

Interpretation: The exemption provided by Rule 16b-2 is available to the managing dealer for the purchase and sale transactions contemplated so long as the conditions of the rule are met.

(84) *Question:* Is Rule 16b-2 available to an underwriter whose participation exceeds 50 percent of the aggregate offering where a member of the underwriter is also a director of the issuer?

Answer: No. Since the aggregate participation of persons not subject to the provisions of Section 16(b) must be at least equal to the aggregate participation of those subject to that section, the exemption would not be available.[110]

(85) *Question:* An unaffiliated underwriter purchases 35% of a new offering of common stock in a firm commitment underwriting for a registered company. As a result of that purchase the underwriter becomes the owner of more than 10 percent of the company's outstanding common stock. Is the protection of Rule 16b-2 available to the underwriter in such a situation?

Answer: Yes. Rule 16b-2 will exempt purchases and sales of the security being distributed, as well as necessary stabilizing transactions.

C. Rule 16b-3 [17 CFR 240.16b-3]

(1) *Introduction.* Rule 16b-3 establishes exemptions from the liability provisions of Section 16(b) for certain securities transactions occurring under those employee benefit plans which meet the conditions specified in the rule.[111] First adopted in 1935, and amended numerous times, Rule 16b-3 has had a long and complex history largely because of rapidly developing techniques in employee compensation. From the beginning, however, the basic thrust of the rule was to provide statutory insiders with a measure of relief from the impact of Section 16(b) on their participation in various types of employee benefit plans. Essentially, Rule 16b-3 is applicable to two broad categories of employee plans: (1) those plans which provide for the acquisition of securities of the issuer through the individual exercise of a stock option or other right and thus involve some element of choice by the insider as to the timing of the acquisition of the stock; and (2) those plans which provide for the acquisition of securities of the issuer on a more or less mechanical basis, such as stock bonus, retirement, incentive, thrift, savings and similar plans, and involve virtually no individual decision on the part of the participant as to the timing of the acquisition of the stock.

The concept of volition, or the ability on the part of a participant to make an independent choice or decision affecting his actual receipt of securities under an employee benefit plan, is central to the application of Rule 16b-3 to the two major types of benefit plans which involve the distribution of employer securities to participants. The first type, plans providing for the acquisition of employer securities through the exercise of options, warrants or similar rights and generally covering a limited group of key employees, usually gives broad discretion to the participant with respect to the timing of the exercise of his options or rights. A participant may be able to exercise his options at any time or for substantial periods during their stated life, and this freedom permits him to acquire the securities underlying the options at points in time which are within his control. As a consequence, it may be possible for an insider participant to coordinate the exercise of his options with the possession of non-public or inside information and perhaps obtain the kind of economic benefit that Section 16(b) of the Exchange Act was designed to discourage. Accordingly, Rule 16b-3 recognizes the element of volitional control present in plans of the first type and does not provide an exemption from Section 16(b) for the securities acquired pursuant to the exercise of options, warrants or rights. The rule, however, does exempt from the recovery provisions of Section 16(b) the acquisition of options, warrants and rights themselves since they are essential to the operation of plans of this type. Rule 16b-3 requires that all such rights be non-transferable, and thus, in the context of an employee benefit plan, they are not effective vehicles for the abuse of inside information.

Employee benefit plans of the second type, stock bonus, retirement, thrift and similar plans, may cover most if not all of a company's employees. Unlike the option plans, they are generally structured to eliminate any meaningful volition or choice on the part of the participant. As a rule, the employee's basic choice is whether to participate in the plan or not. Once the employee

[110] See Rule 16b-2(a)(3) [17 CFR 240.16b-2(a)(3)].

[111] For purposes of this release, a benefit plan which complies with the conditions of Rule 16b-3 may be referred to as a "complying plan."

elects to participate, and depending upon the plan, he may have limited additional decisions to make such as the amount of his regular contribution to the plan and his selection of an investment vehicle within the plan, if more than one is available. But in plans of the second type the employee cannot control the moment in time when he will receive a distribution of securities of the employer as a result of his participation in the plan. Distributions are made in accordance with the terms of the plan, rather than any decision of an individual participant. The meaningful volition is absent from plans of the second type. The mechanical nature of such plans, coupled with the inability of a participant to influence allocations to his account or distributions to him under the plan tend to make plans of the second type ineffective for the abuse of inside information. Consequently, and in contrast to plans of the first type, Rule 16b–3 exempts the actual acquisition of securities issued to participants, although the rule does not exempt the subsequent disposition of such securities by participants under either type of plan. In addition, for plans of the second type, Rule 16b-3 exempts certain formal transactions which may be regarded as purchases and sales and which are necessary to the operation of these plans, such as the transfer of employer securities from the trustee to the plan, the allocation of such securities within the plan, and the crediting of securities to individual accounts.

Were it not for the exemptive provisions of Rule 16b-3, it would be extremely difficult for officers and directors of a registered company to participate in either type of plan because of the impact of Section 16(b). Stock options and similar rights may be considered equity securities within the meaning of the Exchange Act's definition. Thus, an insider who receives a stock option may be deemed to have acquired an equity security for purposes of Section 16(b); should he decide to exercise that option, he must dispose of one equity security, the option, in order to acquire another, the underlying common stock. This situation is further complicated if the insider participates in a stock bonus, retirement, incentive or similar plan, which usually entails the accumulation of the issuer's shares for his account at relatively frequent intervals. Under these circumstances, and absent Rule 16b-3, an insider might never be able to make a casual sale of his company's securities without facing the possibility of liability, since his casual sale could always be matched against a purchase under either or both plans. The Commission has long held the view that transactions such as these do not readily lend themselves to the abuse of inside information and should not automatically be subject to the recovery provisions of Section 16(b).[112] Accordingly, the Commission adopted Rule 16b-3 to exempt these and other limited types of related transactions from the operation of the statute in situations where the nature of the transaction, coupled with the conditions imposed by the rule, affords some real assurance against the likelihood of misuse of inside information.

Specifically, Rule 16b-3 exempts the following types of transactions:

(1) The acquisition of shares of stock pursuant to a plan, otherwise than upon the exercise of an option, warrant or right, as well as certain ministerial transactions essential to the operation of such a plan, such as the crediting of securities to a participant's account.

(2) The acquisition, expiration, cancellation or surrender of a stock option or stock appreciation right.

(3) The delivery to the issuer of shares of its own stock as payment for the exercise of a stock option.

(4) Upon the exercise of a stock option, the acquisition of a number of shares of the issuer's stock equal to the number delivered to the issuer in payment.

(86) *Question:* Is the sale of stock by an insider, which was received under an employee benefit plan, exempt from the reporting and liability provisions of Section 16 if the plan satisfies the conditions of Rule 16b-3?

Answer: No. Rule 16b-3 provides an exemption from the liability provisions of Section 16(b) for the acquisition of shares of stock only under a non-volitional complying plan. Except for one limited, technical provision,[113] the rule does not apply to the disposition or sale of stock.[114] Finally, Rule 16b-3 does not confer any exemption from the reporting requirements of Section 16(a).[115] (But see discussion of Rule 16a-6, *supra*, with respect to the reporting of options and rights.)

(87) *Question:* Rule 16b-3 exempts from Section 16(b) the acquisition of a stock option or stock appreciation right,[116] but not the acquisition of the underlying shares.[117] What is the reason for this distinction?

Answer: A principal justification for the exemption of options, warrants and rights under Rule 16b-3 is that the acquisition of such rights is an event not normally within the control of the recipient.[118] Since the insider generally has no choice as to when or even whether he will receive such an award, it is unlikely that any inside information he may possess will affect the granting of the right. This concept is reflected in paragraph (b) of the rule which states that the selection of those insiders who are to receive stock options or stock appreciation rights under complying plans will be made by "disinterested" persons. Once such rights are granted, however, the discretion of insiders to control the timing and amount of exercise is not generally restricted. Since that decision to exercise may be influenced by inside information, the rule does not create an exemption for the acquisition of the underlying stock.

Illustration: The employee benefit plan of a company provides that the administering committee shall have the authority to offer to optionees the opportunity, at such times and on such terms and conditions as the committee may prescribe, to surrender their options to the company for cancellation, and to receive upon such surrender a payment in common stock of the company in an amount determined by a set formula.

Interpretation: The surrender of options pursuant to the plan would be exempt from the operation of Section 16(b) by virtue of Rule 16b-3. However, the acquisition of common stock upon such surrender would not be exempt. By permitting participants to determine

[112] The exemption of the option transaction alone may be significant. As the Commission observed in Securities Exchange Act Release No. 6111 (November 5, 1959) [24 FR 9272], ". . . plans frequently provide that grants are to be made at regular intervals, often annually. In consequence, it may be impossible to sell stock, without having a 'purchase' occur within six months before or after the 'sale.' Accordingly, the exemption is particularly important to the continued usefulness of these methods of providing employee compensation and incentives."

[113] That is, the delivery of stock by an officer or director as payment for the exercise of an employee stock option.

[114] Letter re *Tele-Communications, Inc.* dated July 12, 1978.

[115] Letters re *American Quasar Petroleum Co.* dated February 8, 1978; and *Risdon Manufacturing Co.* dated January 6, 1978.

[116] See question 22, *supra*, for a discussion of stock appreciation rights.

[117] See *Keller Industries, Inc. v. Walden*, 462 F. 2d 388 (5th. Cir. 1972). See also letters re *Doyle, Dane Bernbach, Inc.* dated March 2, 1977 and *SmithKline Corporation* dated March 23, 1976.

[118] The other main justifications are that stockholders in approving the plan have expressly authorized the additional compensation, and that the plan contains set limits so that it is not easily abused. The purpose of Rule 16b-3 is to permit the functioning of plans which serve a legitimate corporate purpose by providing additional incentives to officers and directors, where the safeguards surrounding such plans minimize the possibility of abuse of inside information.

whether they will deliver their options for payment pursuant to the terms of the surrender or continue to hold such options, the company is, in effect, providing the participant with the opportunity to control the timing of the acquisition of the common stock, with the concurrent possibility of speculative abuse.[119] Accordingly, Rule 16b-3 does not exempt the acquisition of the underlying shares. But since the rule does exempt the acquisition and disposition of the option, it is possible for this plan, and many similar compensation plans, to achieve their basic purpose and still avoid the mechanical application of the short-swing liability provisions of Section 16(b).

(88) *Question:* Rule 16b-3 does not exempt the acquisition of shares of stock "acquired upon the exercise of an option, warrant or right."[120] In the following types of plans,[121] are the shares received acquired other than upon the exercise of an option, warrant or right and thus exempted by the rule?

(a) *Performance Share Plan.* The acquisition of stock received on the settlement of performance share units awarded by a disinterested committee. Performance share units, in effect, are accounting units which entitle the holder to payments contingent upon the attainment of pre-established employment and performance objectives set over a period of time, typically three or more years. The payment value of each unit earned is equal to the current market value of a share of company stock at the end of the award period, subject in some cases to a maximum payment ceiling. Participants have no discretion as to the time or manner in which the units will be settled or valued.

(b) *Stock Appreciation Right Plan.* The acquisition of stock received upon the exercise of a right which is directly related to a stock option, whereby an insider is entitled to receive the appreciation in market value of the shares covered by the related stock option (i.e., current market price less purchase price of option shares), in lieu of actually exercising the option.

(c) *Employee Stock Purchase Plan.* The acquisition of stock received upon the exercise of a non-transferable "option" under a plan which, by its terms, gives the holder 90 days to purchase at 85 percent of market value as many shares of stock as his employee contributions will allow. The "options" are automatically exercised on the last day of the 90 day period, unless the employee withdraws from participation in the plan before that time. The only discretion exercised by an employee is whether to participate in the plan.

(d) *Restricted Stock Plan.* The acquisition of restricted stock by grant from the company with no cash consideration required. If the participant leaves the company's employ before the end of the restricted period (usually three to five years), the shares are forfeited to the company.

(e) *Restricted Stock Purchase Plan.* The acquisition of stock from a company by purchase at a substantial discount from current market value, often for a nominal amount such as par value. Rights to execute such purchases are granted to employees on a periodic basis, with the right expiring within a short time period, often thirty to sixty days following the grant.

Answer: In determining whether an acquisition of stock is pursuant to the exercise of an "option, warrant or right," the staff examines the facts and circumstances of a given plan with a view to determining whether the participant can exert a meaningful degree of control as to the timing of his acquisition, and also whether there is an element of consideration involved in the exercise. Thus, the staff has determined that the acquisition of stock in situations (a), (c) and (d) would be exempt from the operation of Section 16(b) by virtue of Rule 16b-3. However, the acquisition of stock in situation (e) would be exempt only under the limited circumstances discussed below. The acquisition of stock in situation (b) would not be exempt under the rule.

Certain interpretive letters concerning the applicability of Rule 16b-3 to performance share plans such as the one described in situation (a) have reached different conclusions. In some instances, the staff found such plans to be "bonus plans," and so concluded that the acquisition of stock under the plans would be exempt from Section 16(b). In other instances, the rights conferred by these plans were deemed to be "tantamount to stock appreciation rights." Under that approach, the acquisition of stock pursuant to the rights would not be exempt under the rule, although cash settlements of the rights could be exempted upon compliance with the provisions of paragraph (e) of Rule 16b-3.[122] After review, the staff modified its position and determined that the settlement of performance share units in either common stock or cash is essentially non-volitional and would be exempt under Rule 16b-3, at least under a plan which places all volition as to the form of settlement of a performance share unit (i.e., stock or cash) with a disinterested committee.[123] Since the form of settlement of the performance share units in situation (a) is made by a disinterested committee, the acquisition of stock in settlement of such units would be exempt from the operation of Section 16(b) by virtue of Rule 16b-3.

Situation (c) illustrates a common type of employee stock purchase plan. The staff has regularly taken the position that such plans may be deemed to be "retirement, incentive, thrift, savings or similar plan(s)" within the meaning of Rule 16b-3, and that the acquisition of shares pursuant to such plans would be deemed to constitute an acquisition of shares of stock other than upon the exercise of an option, warrant or right.[124] Unlike stock options granted under traditional option plans, the options granted under this type of stock purchase plan are granted and deemed to be exercised at regular intervals. A participant has discretion only as to his participation in the plan and the extent of his contributions within the limits established by the plan. He has no control over the timing of the automatic option exercise, and there is little opportunity for the kind of speculative abuse that Section 16(b) was designed to prevent.

With respect to situation (d), which describes a restricted stock plan, the staff's position has been that such a plan would constitute a "bonus" or "incentive" plan, and that an award of common stock would be exempt from the operation of Section 16(b). These plans clearly do not involve the exercise of an option or right, and there is no

[119] Letter re *The Rouse Company* dated October 29, 1980.

[120] With one limited, but important, exception. Rule 16b-3 does exempt delivery by the participant of a number of shares to the issuer in payment of the exercise price of a stock option, as well as the acquisition by the participant of a like number of shares received upon exercise. See Question 91, *infra*.

[121] These descriptions are based in part upon those supplied by Frederick W. Cook & Co., Inc. in a letter to the Commission dated November 1, 1978. They are intended only to be helpful illustrations, not a comprehensive summary of plan provisions in this area.

[122] Letters re *Chemical New York Corporation* dated August 2, 1978 and *West Point Pepperell; Inc.* dated August 29, 1978.

[123] Letter to *Lawrence C. Bickford* dated November 22, 1978. It should be noted, however, that if a performance share plan gives participants discretion as to the time or manner in which the units granted thereunder will be settled or valued, the units may be treated as SAR's under the rule. Under these circumstances, the settlement of the units for stock would not be exempt, and cash settlements would be exempt only upon compliance with paragraph (e) of Rule 16b-3.

[124] Letters re *Plantronics, Inc.* dated September 28, 1979; *Tratec Incorporated* dated March 7, 1979; *Baker International Corporation* dated December 29, 1978; and *Four-Phase Systems, Inc.* dated September 6, 1978.

period of time during which a participant might abuse inside information.[125]

Situation (b) provides an example of stock acquired upon the exercise of a right. The introductory paragraph to Rule 16b–3 specifically excludes shares acquired upon the exercise of a right, and therefore the acquisition of stock in situation (b) is not exempted by the rule. In such situations, of course, the participant can control the timing of the exercise of the right.

Situation (e) typifies a restricted stock purchase plan. Since the participants under such plans may have control over the timing of the exercise of the right, if only for a relatively short period of time, there exists some potential for speculative abuse. Further, the requirement that participants pay some measure of consideration in order to acquire stock pursuant to the plan makes it difficult to view such plans as "bonus" plans within the meaning of the rule. Nonetheless, various arguments have been advanced in support of the view that acquisitions under such plans should be exempted by Rule 16b–3. These arguments, essentially, are as follows: (1) the restricted stock purchase plan does not present a real opportunity for speculative abuse due to the inability of a participant to "time" his acquisition in the long-term sense of conventional stock options; (2) the economic reality of the transaction is an "award" of stock in recognition (and upon condition) of employment service; and (3) the grantee of such a "right" exercises no true volition due to the nominal nature of the purchase price.

After a review of this area, the staff has concluded that these contentions have merit, and that the acquisition of shares pursuant to a restricted stock purchase plan such as that described in situation (e) should be exempt from Section 16(b) by virtue of Rule 16b–3 if certain conditions are met. In reaching this conclusion, the staff deems it essential that the plan provide: (1) that rights granted to participants under the plan expire within a period of no longer than sixty days; and (2) any nominal consideration required of a participant in connection with the exercise of a right must be required only in order to assure compliance with applicable state law, and must not exceed ten percent of the market value of the shares subject to the right at the time of exercise.[126]

(89) *Question:* Does the phrase "option, warrant, or right" include the right of a participant to elect to defer receipt of an award payable in stock or in cash?

Answer: If the provisions of the plan governing such an election otherwise conform to the requirements of Rule 16b–3(d)(2)(i),[127] the election would not be considered the acquisition of a security pursuant to an "option, warrant or right." In this regard it should be noted that a participant who has this right is really making a choice as to the timing and manner in which payments are made under the plan. Broad discretion as to timing and manner of payment would be susceptible to potential abuse.[128] However, where the election is made either prior to the making of the award or prior to the fulfillment of all conditions to the receipt of the award, and where the participant is obligated to take the award in the form he previously elected, it would appear that the opportunity for misuse of inside information is slight. In recognition of this fact, Rule 16b–3 was amended to except from the phrase "exercise of an option, warrant or right" certain events which may occur in the operation of a plan where the award is ordinarily made in cash, but where the plan allows the recipient to defer payment of the award and elect to receive the deferred award in stock rather than in cash.[129]

(90) *Question:* Are the exceptions provided by Rule 16b–3(d)(2) relevant in the following circumstances:

(a) The right to elect to participate in a plan;

(b) The right to defer receipt of vested stock already credited to a participant's account where there is no cash alternative;

(c) The election of a retiring participant to receive a distribution in kind of his interest in the company common stock fund, in lieu of receiving cash?

Answer: Although the circumstances described in (a) and (b) do not literally fall within paragraph (d)(2) of Rule 16b–3, they do not constitute the acquisition of shares of stock upon the exercise of an "option, warrant or right" within the meaning of the rule. Situation (a) does not involve a purchase or acquisition, and thus would not appear to need the protection of an exemption. In situation (b), the participant is really not exercising volition since his right to a specific number of shares is fixed, whether he receives the shares now or later. By permitting the participant in situation (c) to elect to receive payment in stock in lieu of cash, an immediate acquisition of stock can be said to have occurred pursuant to the exercise of an "option, warrant or right."[130] Therefore, the provisions of Rule 16b–3(d)(2) must be satisfied if the election is to be exempt from the operation of Section 16(b) by virtue of Rule 16b–3.

(91) *Question:* Rule 16b–3 provides a special exemption for transactions whereby an officer or director satisfies the exercise price of a stock option by delivering to the issuer shares of the same class of stock which he already owns. The rule exempts the insider's disposition of the number of shares surrendered in payment, as well as his acquisition of an equal number of shares upon exercise of the option. Shares received upon exercise, in excess of the number surrendered, are not exempted by the rule. Does this mean that an insider can exercise an option under this provision and then proceed to sell the exempted shares he acquires upon exercise without regard for the liability provisions of Section 16(b)?

Answer: No. When an insider exercises a stock option in this fashion,

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[125] It should be noted that Section 16(a) reports should be filed at the time when share certificates are issued in the recipient's name since, even though the shares are restricted, voting power and the right to receive dividends will usually vest at that time.

[126] See letter re *Western Gear Corporation* dated June 11, 1981. Issuers relying on prior interpretive letters, utilizing other standards, may continue to rely on such letters for the life of current plans.

[127] Rule 16b–3(d)(2) provides:

2. The term "exercise of an option, warrant or right" contained in the parenthetical clause of the first paragraph of this rule shall not include

(i) The making of an election to receive under any plan compensation in the form of stock of credits therefor, provided that such election is made either prior to the making of the award or prior to the fulfillment of all conditions to the receipt of the compensation and, provided further, that such election is irrevocable until at least six months after termination of employment;

(ii) The subsequent crediting of such stock;

(iii) The making of any election as to the time for delivery of such stock after termination of employment, provided that such election is made at least six months prior to any such delivery;

(iv) The acceptance of certificates for shares of such stock.

[128] An exemption for shares acquired pursuant to such an unlimited right would be contrary to the underlying theory of Rule 16b–3 as set forth in Securities Exchange Act Release No. 6111 (November 5, 1959) [24 FR 9272], to exempt only those acquisitions which are unrelated to the use of inside information, primarily because of a lack of volition or limitation of discretion on the part of the insider with respect to the amount and timing of such acquisitions.

[129] See Securities Exchange Act Release Nos. 7776 (December 23, 1965) [31 FR 86] and 8592 (May 1, 1969) [34 FR 7574]. See also letter re *PPG Industries* dated September 20, 1980.

[130] See *Greene v. Dietz*, 247 F.2d 689 (2d Cir. 1957), and *Perlman v. Timberlake*, 172 F.Supp. 246 (S.D.N.Y. 1959).

he routinely acquires more shares than he surrenders. By its terms, Section 16(b) is applicable to any purchase and sale occurring within six months. Since the insider would have purchased shares upon exercise of the option (to the extent that the shares received exceeded those delivered) and would have sold some or all of the shares received,[131] these transactions would be subject to the recovery provisions of Section 16(b).

Illustration: A director of a registered company holds an option for 200 shares of its common stock at an exercise price of $10 per share. On June 1, when the common stock is trading at $20 per share, he decides to exercise the option by delivering 100 shares already owned (with a value of $2,000) in payment for the 200 shares subject to the option. Thereafter, on August 1, he sells 150 shares at $25 per share. These are his only relevant transactions during the calendar year.

Interpretation: Since the only purchase that can be matched with the August sale is in the amount of 100 shares (the number of shares received upon exercise that exceeded the number delivered), the amount of the director's liability under Section 16(b) is limited to the profit realized on the sale of 100 of the 150 shares sold.

(92) *Question:* In delivering already owned shares to satisfy the exercise price of a stock option, can the optionee also use the shares received upon such exercise to satisfy the exercise price of additional options?

Answer: Yes. The optionee can use any shares of the same class that are in his possession. However, the so-called "pyramiding of shares" is not contemplated by Rule 16b-3. Under this technique, the optionee requests the issuer to automatically apply the shares received upon the exercise of a stock option to satisfy the exercise price for additional options. The effect of pyramiding, at least in theory, is to allow the optionee to deliver a relatively small number of shares in satisfaction of the exercise price of even the largest option.[132] In amending Rule 16b-3 to provide an exemption in connection with the exercise of stock options, the Commission did not intend that this relief would extend to the practice of pyramiding.

(93) *Question:* Since the fair market value of the already owned shares will seldom exactly equal the exercise price, does the rule also exempt the sale by an optionee of the fractional share interest that will result when the market value of the already owned shares is fractionally in excess of the purchase price of the option shares?

Answer: Yes. Although Release No. 34-17080 (August 28, 1980) [45 FR 57389], speaks in terms of exempting whole shares, the staff is of the view that the sale by an optionee of a fractional share interest in connection with the exercise of an option would be exempt from the operation of Section 16(b).

2. *Approval by Security Holders:* In order to be eligible for the exemptive relief afforded by Rule 16b-3, a plan must satisfy the relevant conditions specified in the rule. The first condition is that the plan must be approved by the affirmative vote or consent of the company's security holders, solicited in accordance with the rules and regulations in effect under Section 14(a) of the Exchange Act.

(94) *Question:* Can the shareholder approval requirement be satisfied if the original vote or consent was not solicited substantially in accordance with the rules and regulations in effect under Section 14(a), because such action was taken at a time when Section 14(a) was not applicable to the company?

Answer: Yes. Paragraph (a) of Rule 16b-3 recognizes that a plan may be approved by security holders prior to the registration of the company's equity securities under Section 12 of the Exchange Act and thus at a time when the Commission's proxy rules under Section 14(a) do not apply. In such cases, the approval requirement of Rule 16b-3 can be satisfied by the issuer furnishing in writing to its shareholders of record entitled to vote on the plan substantially the same information regarding the plan that would be required by the rules and regulations under Section 14(a).[133]

Illustration: The company's common stock was recently registered under Section 12(g). Employees of the company received stock options pursuant to a plan both before and after such registration. The plan has not been submitted to shareholders for approval in accordance with the rules and regulations under Section 14(a) of the Exchange Act.

Interpretation: The exemption afforded by Rule 16b-3 would not be available for options granted under the plan until such time as the company complies with the informational requirements of the rule.[134]

(95) *Question:* In order to rely on the exemption afforded by the rule, when must this alternate informational requirement be met?

Answer: Rule 16b-3(a)(2) provides that the written information is required to be furnished on or prior to the date of the first annual meeting of security holders held subsequent to the later of (a) the first registration of an equity security under Section 12 of the Exchange Act or (b) the acquisition of an equity security for which exemption is claimed by a officer or director.

(96) *Question:* Where a company is not subject to the Commission's proxy rules, must the alternate information be provided to all security holders, including benefical owners, and holders of securities not entitled to vote on the plan?

Answer: No. The information is required to be sent only to security holders of record who would be entitled to vote on approval of the plan at the time the information is sent.[135] This group may include holders of securities which are not registered under section 12 of the Exchange Act.[136]

(97) *Question:* Does shareholder approval of a plan adopted by a predecessor corporation carry over to a successor corporation?

Answer: Yes. In connection with a merger, reorganization, purchase of assets or similar transaction, approval of a plan by the shareholders of a predecessor corporation, in accordance with the provisions of paragraph (a) of Rule 16b-3, would carry over to the successor corporation provided, of course, that the plan was assumed by the successor.[137]

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[131] Of course, a sale of shares other than the option shares would have the same result.

[132] Theoretically, only one share is needed. For example, suppose an insider holds an option for 5,000 shares at an exercise price of $30. He decides to exercise the option when the stock is at $60 by delivering one share of stock. As a result, he received 2 shares which are automatically used to purchase 4 shares under the option, which in turn are used to purchase 8 shares, and so on until the maximum number of shares purchasable under the option pursuant to this technique are received.

[133] As a matter of policy, the staff will not express any opinion whether the approval of a company's shareholders was solicited substantially in accordance with the rules and regulations in effect under Section 14(a). Compliance with the proxy rules is a question of fact which can be determined best by the parties concerned and their counsel, in light of all relevant facts.

[134] It should be noted that, even assuming compliance with the informational requirement at the next annual meeting of security holders, the exemption provided by the rule would only be available with respect to those options granted since the preceding annual meeting. See Rule 16b-3(a)(2).

[135] The rule makes it clear that this requirement is met if the information is mailed to the last known addresses of persons who are record holders within 30 days prior to mailing.

[136] Four copies of the written information forwarded to security holders must be filed with, or mailed to, the Commission not later than the date on which it is first sent to security holders.

[137] Letter re *Combined International Corporation* dated August 15, 1980 and *Natomas Company* dated February 21, 1980.

(98) *Question:* Where a plan provides for the granting of awards, and such awards are granted before obtaining the approval of security holders required by Rule 16b–3, is the exemption provided by the rule still available?

Answer: Yes. So long as (1) the grant of the award is conditioned upon subsequent shareholder approval; (2) the recipient has no right to sell or transfer the award; and (3) the plan otherwise conforms to the requirements of Rule 16b–3. In these circumstances, it is the staff's view that the exemption provided by the rule would be available in connection with the acquisition of the awards and any vesting of shares which may occur under the plan, but only to the extent allowed by Rule 16b–3(a)(2) (i.e., for those awards granted and any shares vested since the preceding annual meeting).[138]

Illustration: The plan is a new part of the company's key employee stock incentive program and was created by the board of directors in order to provide for the issuance of shares as awards to officers who have a direct responsibility for a long-term growth of earnings. Although the plan has not been approved by shareholders, "conditional awards" have been granted since the last annual meeting, and the recipients of such awards have no right to sell, assign, transfer, pledge or place any encumbrance on the awards or the underlying shares. Ownership of the shares will not vest until the lapse of certain restrictions which govern the award. The plan otherwise meets the conditions of Rule 16b–3.

Interpretation: Assuming shareholder approval of the plan at the next annual meeting, the grant of the conditional awards, as well as any acquisitions of shares pursuant to such awards, will be exempt from the operation of Section 16(b) by virtue of Rule 16b–3.

(99) *Question:* Would the existence of a plan provision which allows the board of directors to amend or modify the plan, without necessarily seeking shareholder approval, automatically result in the loss of the exemption?

Answer: No. However, any amendment to the plan which (a) materially increases the number of shares which may be awarded under the plan, (b) materially increases the benefits accruing to participants in the plan, or (c) materially modifies the requirements for eligibility for participation in the plan, must be approved by the shareholders in order to insure the continued availability of Rule 16b–3.

(100) *Question:* Rule 16b–3(a)(2)(ii) also requires the approval of security holders for certain material amendments or modifications made to plans which have already received approval. Would the following amendments require approval under Rule 16b–3(a)(2)(ii):

(a) An amendment which would provide for the grant of stock appreciation rights [139] or limited rights;[140]

(b) An amendment increasing the number of shares of stock subject to exercise pursuant to a stock appreciation right;[141]

(c) An amendment permitting officers and directors to participate in the plan;

(d) An amendment waiving a two-year eligibility requirement for participation, which significantly increases the number of participants in the plan, including officers and directors;

(e) An amendment substantially increasing the number of shares that may be issued under the plan?

Answer: Yes. With respect to (a) and (b), the staff is of the view that SARs confer benefits upon participants that are material in nature. Accordingly, these two amendments would materially increase the benefits accruing to participants under the plan, and would require shareholder approval.[142]

Approval would also be required in connection with the adoption of amendments (c) and (d) since they materially modify the eligibility requirements for participation in the plan within the meaning of the rule.[143]

Finally, with respect to amendment (e), a significant increase in the number of shares issuable under the plan would ordinarily require the approval of security holders. In this situation, however, the determination of materiality is especially dependent upon the nature and scope of the particular plan, and decisions must be based on the specific facts of each case.

(101) *Question:* Of the following plan amendments, which ones would require shareholder approval in order to assure the continuing availability of Rule 16b–3?

(a) Extension of the period for the exercise of stock options from three months to three years following termination of employment, provided that such exercise is still within the original expiration date of such option;[144]

(b) Elimination of a restriction against participation in a plan for those employees who have reached age 65, in accordance with the provisions of the Employee Retirement Income Security Act;

(c) An increase in company contributions to at least 27 percent of the amount contributed by the participant, rather than at least 20 percent;

(d) A reduction in the amount of company contributions;[145]

(e) A provision for the acceptance of already owned stock in payment for the exercise price of a stock option;

(f) The use of plan contributions to buy company stock directly from the company instead of in the open market;[146]

(g) A revision which provides that cash instead of stock will be paid in settlement of SARS;[147]

(h) The elimination of a provision which requires an insider to select his contribution rate at least six months in advance of his enrollment in the plan;[148]

(i) The establishment of an additional fund in which a participant would have the option of directing all or a part of his contribution;

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[138] Letter re *Wickes Companies, Inc.* dated July 14, 1980; *Arkansas Louisiana Gas Co.* dated August 16, 1977; and *Burndy Corporation* dated December 9, 1975.

[139] See letter re *Anheuser-Busch Companies, Inc.* dated February 20, 1981.

[140] A "limited right" is essentially an SAR which may be exercised in the event of a tender or exchange offer by someone other than the issuer. See letter re *Hospital Corporation of America* dated May 23, 1980.

[141] For example, under many plans, SARs may not be exercised for more than 50 percent of the shares to which the related option is exercisable. Thus, if an option is exercisable for 100 shares, the optionee may only exercise the SAR as to 50 shares. If he exercises the SAR for the maximum 50 shares, the shares remaining under option are reduced by a corresponding amount. Amendment (b) would permit SARs to be exercised for a greater number of shares, e.g., 75 percent rather than 50 percent. A basic purpose of the SAR is to furnish a source of cash for the purchase of option shares to officers and directors of the company who are constrained by the operation of Section 16(b) from selling other shares in order to finance the exercise of an option.

[142] It should be noted, however, that an amendment establishing "limited rights" would not be considered material if the plan already provided for the grant of stock appreciation rights. Letter re *Champion International Corporation* dated August 13, 1979.

[143] The staff has taken the position that the waiver of an eligibility requirement designed to benefit only non-insider employees which does not materially increase the cost of the plan to the company need not be submitted to shareholders under pararaph (a)(2) of Rule 16b–3. See letter re *FMC Corporation* dated March 10, 1981.

[144] See letters re *NCR Corporation* dated June 16, 1980 and *The Carnation Company* dated March 5, 1980.

[145] See letter re *E. H. Crump Companies, Inc.* dated January 14, 1980.

[146] See letter re *Transcontinental Gas Pipe Line Corporation* dated November 5, 1975.

[147] See letter re *Crompton & Knowles Corporation* dated July 7, 1977.

[148] See letter re *Dean Witter & Co., Inc.* dated November 1, 1975.

(j) A provision giving participants the right to make contributions of up to 12 percent of their compensation instead of 6 percent, with company contributions limited to the 6 percent provided by the original plan;

(k) A provision allowing participants to transfer their interest in the plan from one fund to another fund; [149]

(l) A provision permitting participants who make partial withdrawals from a plan to continue their contributions to the plan without penalty; [150]

(m) A provision permitting a retiring participant to defer distribution for up to 5 years and then receive distribution in 15 annual installments; [151]

Answer: None of the foregoing amendments require shareholder approval. It is the staff's view that the amendments are not material for purposes of Rule 16b-3(a)(2) since they would not result in any additional remuneration for directors and officers not already contemplated by the plans, nor would they materially increase the number of eligible participants, or substantially increase the number of securities issuable under such plans.

(102) *Question:* Is shareholder approval required under Rule 16b-3(a) for amendments to a stock option plan and related stock option agreements, whose sole purpose is to permit options granted and to be granted under the plan to be treated as "incentive stock options" for federal tax purposes? The amendments would provide that: (1) the aggregate fair market value of the stock underlying the options granted to a participant may not exceed in any calendar year $100,000 plus certain carryovers; and (2) no incentive stock options may be exercised by a participant while any previously granted incentive stock options are outstanding.

Answer: No.[152] The adoption of such amendments may result in certain federal income tax benefits to plan participants and may have some adverse federal income tax consequences on the company. Historically, however, the staff has not considered the tax implications of employee benefit plans in determining the applicability of the shareholder approval requirement of Rule 16b-3(a). The staff does not generally regard such benefits or detriments to be controlling in assessing the need for shareholder approval under the rule. It is possible, of course, that under some circumstances benefits or detriments resulting from tax or other legislation might rise to a level of significance requiring shareholder approval.

3. *Disinterested Administrators:* Paragraph (b) of Rule 16b-3 sets forth a second condition for the availability of the rule with respect to the participation of officers and directors in various benifit plans. Paragraph (b) generally requires that the selection of any director or officer to whom stock may be allocated, or to whom stock options or stock appreciation rights may be granted, as well as the number of shares subject to such options or rights, must be determined by disinterested administrators. In the case of director participants, this discretion must be exercised by a disinterested board of directors or a disinterested committee as defined in the rule.[153] In the case of officers who are not directors, the award discretion must be in the hands of the board of directors or a committee of three or more directors.

(103) *Question:* Where a plan is open to all directors, officers and employees and the number of shares allocable to such participants is not left to the discretion of any person, is rule 16b-3(b) applicable?

Answer: No. The requirement for disinterested administrators is not applicable where the plan is open to all and no person has discretion as to the number of shares a participant will receive.[154]

Illustration: The purpose of the employee benefit plan of a company is to provide eligible employees a means of purchasing shares of company common stock in the open market, through regular payroll deductions of up to a maximum of 6 percent of bi-weekly compensation. The company will contribute an amount equal to 25 percent of each participating employee's actual payroll deduction. Participation in the plan is entirely voluntary, and all regular full time employees who have béen employed by the company for at least two years are eligible to participate.

Interpretation: This plan need not satisfy the requirements of Rule 16b-3(b) in order for participants to rely on the exemption provided by the rule, since participation is essentially open to all employees, and the number of shares allocable to participants is not within the discretion of any person.

(104) *Question:* Assume that the plan described in Question 103 is open only to key employees and does not satisfy the requirements of either 16b-3(b)(1)(i) or (b)(1)(ii)[155], would the exemption provided by the rule still be available if the plan permitted participants to select between investments (such as a choice of either company stock or government obligations) and to direct a percentage of their contribution according to that choice?

Answer: Yes. Rule 16b-3(1)(iii) exempts the acquisition of shares under a plan without the need for disinterested administrators, if the plan sets forth the maximum number of shares which directors may acquire pursuant to the plan, and the terms and times at which such stock may be acquired. In the instant question, although a participant may have discretion to determine how much to contribute to the plan and how much of his individual account shall be invested in the company's stock, the plan establishes fixed limitations upon his discretion by establishing a maximum percentage of compensation which he may contribute, i.e., 6 percent.[156] Thus, it would appear that that plan meets the provisions of Rule 16b-3(b)(1)(iii)(A).[157]

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[149] See letter re *TRW, Inc.* dated June 28, 1977.

[150] See letter re *InterNorth, Inc.* dated July 14, 1980.

[151] See letter re *General Foods Corporation* dated May 29, 1980.

[152] It should be noted that Rule 16b-3 does not exempt the "pyramiding" of shares under employee stock option plans. See discussion regarding pyramiding in the answer to Question 92, *supra*.

[153] Rule 16b-3(d)(3) defines "disinterested person," as used in paragraphs (b) and (e) of the rule, to mean "an administrator of a plan who is not at the time he exercises discretion in administering the plan eligible and has not at any time within one year prior thereto been eligible for selection as a person to whom stock may be allocated or to who stock options or stock appreciation rights may be granted pursuant to the plan or any other plan of the issuer or any of its affiliates entitling the participants therein to acquire stock, stock options or stock appreciation rights of the issuer or any of its affiliates."

[154] See letters re *Hexcel Corporation* dated July 3, 1980 and *Fed-Mart Corporation* dated December 8, 1972.

[155] Paragraphs (b)(1)(i) and (b)(1)(ii) of Rule 16b-3 relate to the requirement that a plan be administered by disinterested persons with respect to participation of directors in the plan.

[156] See, generally, letters re *ROCKCOR, Inc.* dated July 22, 1981; *Homestake Mining Company* dated June 20, 1974; and *Amerada Hess Corporation* dated March 30, 1972.

[157] Rule 16b-3(b)(1) provides:

(1) With respect to participation of directors:

(i) By the board of directors of the issuer, a majority of which board and a majority of the directors acting in the matter are disinterested persons;

(ii) By, or only in accordance with the recommendation of, a committee of three or more persons having full authority to act in the matter, all of the members of which committee are disinterested persons; or

(iii) Otherwise in accordance with the plan, if the plan:

(A) specifies the number or maximum number of shares of stock which directors may acquire or which may be subject to stock options or stock appreciation rights granted to directors pursuant to the plan and the terms upon which and the times at which, or the periods within which, such stock may be acquired or such options or rights may be acquired and exercised; or

Continued

(105) *Question:* If the selection of director participants who are to receive stock under a plan is made by a committee, one of whose members is not "disinterested" within the meaning of Rule 16b-3(d)(3), would this fact destroy the availability of the exemption?

Answer: Yes. Subparagraph (b)(1)(ii) of the rule requires that if discretion with respect to participation by directors is exercised by a committee, then all the members of such committee must be disinterested persons.[158]

Illustration: An award plan, a written document which meets the definition of a plan as stated in Rule 16b-3(d), was approved by a majority of the stockholders of the company. The plan is administered by a committee of four persons, all of whom are directors. Three of the committee members are disinterested persons as that term is defined by Rule 16b-3(d)(3). However, the fourth member of the committee has been granted awards under the plan.

Interpretation: Inasmuch as one of the members of the committee does not appear to be a disinterested person, the plan does not meet the conditions of the rule and, therefore, the exemption provided by the rule is not available.

(106) *Question:* Where Rule 16b-3(b) is applicable, would a committee member be considered "disinterested" in the following circumstances?

(a) He participates in another employee benefit plan of the issuer which is open to all and whose eligibility and allocation criteria are fixed and uniform for all employees;

(b) He participates in another plan of the issuer under which the selection of persons who will receive awards is within the discretion of others;

(c) He is granted options, independent of any plan, but subject to approval of shareholders.

Answer: The committee member would be deemed "disinterested" in situations (a) and (c), but not in situation (b). In this regard, it should be noted that a disinterested person under the rule must not have "been eligible for selection as a person to whom stock may be allocated or to whom stock options or stock appreciation rights may be granted pursuant to the plan or any other plan of the issuer * * *". In situation (a), the other plan does not involve any selection or allocation which is subject to the discretion of any person, and thus participation in such plan by the committee member would not disqualify him from serving as an administrator under any other plan. Similarly, since the options in situation (c) are granted outside of any plan, and are subject to shareholder approval, the grant of such options to the committee member will not affect his status as a disinterested person within the meaning of Rule 16b-3(b).

With respect to situation (b), the committee member is not disinterested since he is eligible for selection to receive stock pursuant to another plan.

Illustration (1): The various stock option plans of the company are administered by a stock option committee composed of three directors, none of whom is eligible to participate in such plans. Two of the committee members, however, are eligible and do participate in the company's employee stock ownership plan.

The stock ownership plan provides for the inclusion of all employees with one year of service who have reached the age of 21. Contributions to the plan are used to purchase the company stock. Allocations of employee contributions under the plan are based upon a participant's percentage of the total compensation received by all participants. However, the amount contributed to a participant's account is limited to the lesser of 25 percent of his compensation or a specified dollar amount which varies with the cost of living. Both committee members are restricted by this dollar amount limitation.

Interpretation: Since the eligibility and allocation criteria under the stock ownership plan are fixed and uniform for all employees, and since all employees are able to participate in the plan under those criteria, the participation by the two committee members does not disqualify them under Rule 16b-3(d)(3) from serving as administrators of the company's various stock option plans.[159]

Illustration (2): The option plan of a company provides for the granting of non-transferable stock options. Persons chosen to receive options are designated by an option plan committee composed of three persons selected by the board of directors to administer the plan. The committee members are ineligible to receive options under the plan.

The company also has a stock purchase plan for certain, but not all, full-time salaried employees, including the three persons who serve on the option plan committee. The stock purchase plan permits the regular acquisition of company shares through employer-employee contributions in fixed amounts. The stock purchase plan is administered by a separate committee of three persons, other than those who administer the option plan, who are selected by board. The stock purchase plan committee has the power to determine which groups of employees are eligible to participate.

Interpretation. Because the purchase plan gives its own administrative committee the power to select certain groups for participation in the plan, the members of the option plan committee would not be disinterested administrators within the meaning of Rule 16b-3.[160]

(107) *Question:* Is paragraph (b)(2)(i) of the rule [161] satisfied even if one or more members of a committee of three directors is not a disinterested person?

Answer: Yes.[162]

(108) *Question:* Prior to registration under Section 12 of the Exchange Act, a company adopts an employee stock option plan which does not meet the disinterested administrator standard of paragraph (b) of Rule 16b-3. The company grants options pursuant to the plan, and shortly thereafter registers its common stock under the Exchange Act. The stock option plan is then conformed to Rule 16b-3. Is the rule available for those persons who received options under the non-complying plan?

(B) sets forth, by formula or otherwise, effective and determinable limitations with respect to the foregoing based upon earnings of the issuer, dividends paid, compensation received by participants, option prices, market value of shares, outstanding shares or percentages thereof outstanding from time-to-time or similar factors.

[158] This answer assumes that the plan does not satisfy the alternative provisions of Rule 16b-3(b)(1)(iii).

[159] Letter re *American Financial Corporation* dated June 23, 1977.

[160] Letter re *R. B. Jones Corporation* dated July 26, 1972.

[161] Rule 16b-3(b)(2) provides:

2. With respect to the participation of officers who are not directors:

(i) By the board of directors of the issuer or a committee of three or more directors;

(ii) By, or only in accordance with the recommendation, of a committee of three or more persons having full authority to act in the matter, all of the members of which committee are disinterested persons; or

(iii) otherwise in accordance with the plan, if the plan

(A) specifies the number or maximum number of shares of stock which officers may acquire or which may be subject to stock options or stock appreciation rights granted to officers pursuant to the plan and the terms upon which, and the times at which, or the period within which, such stock may be acquired or such options or rights may be acquired and exercised; or

(B) sets forth, by formula or otherwise, effective and determinable limitations with respect to the foregoing based upon earnings of the issuer, dividends paid, compensation received by participants, option prices, market values of shares, outstanding shares or percentages thereof outstanding from time-to-time or similar factors.

[162] Letters re *Faberge, Inc.* dated December 8, 1972 and *National Medical Enterprises, Inc.* dated October 22, 1980.

Answer: Yes. The Commission, in Release No. 34–7559 (March 22, 1965) [30 FR 4127], added a new subparagraph to the rule which provided that the disinterested administrator requirements of Rule 16b–3(b) would not apply with respect to any option granted or any other equity security acquired prior to the date of the first registration of an equity security.[163]

4. *Plan Limitations.* Paragraph (c) of Rule 16b-3 requires that a plan limit the amount of stock which may be issued thereunder or the dollar amount of such stock.

(109) *Question:* Would a plan be deemed to meet the requirements of paragraph (c) if it requires that both participant and employer contributions be limited to a fixed percentage of annual compensation?

Answer: Yes. The language of Rule 16b–3(c) indicates that the plan will qualify under this provision if it limits the maximum number of shares which may be allocated under the plan, or the aggregate dollar amount of such shares. These limitations may be set in terms of fixed dollar amounts, maximum number of shares, or by formulas based upon earnings, dividends, compensation received by participants, or similar factors.

Illustration: The employee benefit plan of a company provides that any salaried employee is eligible to participate, except those employees subject to certain collective bargaining agreements. A participating employee may contribute up to 12 percent of his basic salary by regular payroll deductions, of which up to 6 percent will be matched by company contributions of 50 percent. A participant may direct the trustee to invest his contributions in one of two investment alternatives.

Interpretation: Because of the 6 percent ceiling on company contributions, the plan effectively limits the aggregate dollar amount and the aggregate number of shares that may be acquired by a participant, and therefore the plan meets the requirement of Rule 16b–3(c).[164]

5. *Definition of Plan.* Paragraph (d) of Rule 16b–3 defines three terms that are used repeatedly throughout the rule, "plan," "exercise of an option, warrant or right" and "disinterested person." The last two terms have already been considered in connection with the discussion of the introductory paragraph, and paragraph (b) of the rule. The definition of the term "plan" will be considered here.

(110) *Question:* The definition of the term "plan" seems to include a broad spectrum of remunerative arrangements. Does the term include a bonus share provision in a personal employment agreement that has been approved by a company's board of directors as well as its shareholders?

Answer: No. Although the definition of the term "plan," as set forth in paragraph (d)(1) of the rule, is very broad, it is basically intended to include only those plans which apply uniformly to a class of persons. Since a bonus share provision in a personal employment contract is negotiated between the company and the employee individually, it would not be considered a "plan" within the meaning of Rule 16b–3.

(111) *Question:* Is an employee stock purchase plan which otherwise satisfies the requirements of Rule 16b–3(d)(1), although not specifically mentioned therein, deemed to be a "plan" within the meaning of that provision?

Answer: Yes.

(112) *Question:* Are the provisions of Rule 16b–3(d)(1)(i), which require that a plan set forth either the price or the method used for determining the price at which securities may be offered to participants, satisfied in the following circumstances:

(a) The plan provides that the price shall be determined by the board of directors and "may be less than, equal to, or greater than the fair market value of the common stock on the date the option is granted."

(b) The plan provides that the price shall be determined by the board of directors but that it will "not be less than 50 percent of the fair market value of the underlying shares of common stock on the date the option is granted."

(c) The plan provides that bonus stock issued thereunder shall be subject to "such conditions and restrictions as the board in its discretion may provide, except that bonus stock will be issued for no consideration."

(d) The plan provides that "shares of common stock issued under the plan may be issued for any lawful consideration as determined by the board."

(e) The plan provides that the "option price for the common stock to be issued under the plan shall be a price to be determined by the board upon the date of the grant, not less, however, than a price equal to the $1 par value of the stock?"

Answer: Although the price or the method for determining the price is not specifically set forth in any of the foregoing situations, it is the Division's view that the provisions in situations (b) and (c) would be deemed to satisfy Rule 16b–3(d)(1)(i).

Situation (b) utilizes a general, but meaningful guide which is not likely to be abused. Situation (c) simply indicates, in the case of a bonus stock award, that no price or additional consideration will be demanded of the participant. Situations (a), (d) and (e) are different, however. In those examples, the provisions for determining the price are so vague as to be uninformative. Since they do not set forth the offering price of the securities to participants, or a reasonably specific method by which the price may be determined, the staff believes that these provisions do not meet the standard of Rule 16b–3(d)(1)(i).[165]

(113) *Question:* Is the exemption provided by Rule 16b–3 available under a plan which permits options to be transferred?

Answer: No. As specifically stated in paragraph (d)(1)(ii) of the rule, any option issued under the plan must not be transferrable other than by will or inheritance.

6. *Cash Settlements of Stock Appreciation Rights:* Paragraph (e) of Rule 16b–3 exempts any transaction involving the receipt of cash in complete or partial settlement of a stock appreciation right from the operation of Section 16(b), if all of the conditions of paragraph (e) have been satisfied.[166]

(114) *Question:* Is stock received in full or partial settlement of a stock appreciation right exempt from Section 16(b) liability by virtue of Rule 16b–3?

Answer: No. Rule 16b–3 does not provide any exemption for stock received in settlement of a stock

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[163] The effect of this exclusion from the requirements of paragraph (b) of Rule 16b–3, assuming the other relevant conditions of the rule are satisfied, is to make the protection of the rule available for certain acquisitions occurring under a plan, prior to Section 12 registration, to the extent that such acquisitions might be deemed purchases for purposes of Section 16(b). See *Adler v. Klawans, supra; Blau v. Allen, supra;* and *Feder v. Martin Marietta Corp., supra.*

[164] Letters re *Kennecott Paper Corporation* dated October 16, 1978 and *Gifford-Hill & Company, Inc.* dated October 1, 1975.

[165] Many plans provide a form of price range as to the formula for determining the price to participants. The suitability of such a formula in terms of the requirement of Rule 16b–3(d)(1)(i) must be established by an examination of the particular facts. In general, if the plan provision establishes a minimum price which is less than 50 percent of the market value of the security, the Division takes the position that such a formula is too vague to satisfy the standard of the rule.

[166] That is, the settlement of a stock appreciation right for cash will not be deemed to involve a simultaneous purchase and sale of the related stock. See footnote 108, *supra.* In addition, as stated in the introductory paragraph of Rule 16b–3 "* * * the acquisition, expiration, cancellation or surrender to the issuer of a * * * stock appreciation right * * *" is also exempt if the plan meets the conditions of the rule.

appreciation right, just as it does not exempt stock acquired upon the exercise of a stock option.[167]

(115) *Question:* A company has in effect a stock option—stock appreciation rights plan which satisfies the conditions of Rule 16b-3, except for paragraph (e) of the rule relating to cash settlement of stock appreciation rights. Would the following types of settlement under the plan be exempt from the operation of Section 16(b) by the rule?

(a) The plan provides that, should a participant be entitled to receive a fractional share, a cash payment will be made in lieu thereof;

(b) The plan provides that, upon exercise of an option and receipt of the appropriate number of shares, the company will pay to the optionee in cash an amount which approximates the federal income tax incurred;

(c) The plan provides that, upon the exercise of an SAR for stock, the appreciated value of the shares subject to the right will be reduced by the amount of tax incurred by the participant—the company would then pay such amount to the appropriate tax authorities for the account of the participant;

(d) The plan permits grants in the form of "equity units" which are essentially the equivalent of stock appreciation rights, except that increases in book value rather than market value determine the amount of cash the participant will receive;

(e) The plan permits a disinterested committee, in its sole discretion, upon or without the request of a holder, to cancel all or a portion of an option then subject to exercise by the holder, and either pay the holder in cash or issue stock. The committee authorizes full payment in cash upon exercise of a stock option;

(f) The cash settlement of a stock appreciation right.

Answer: All of the above cash payments would have to comply with the provisions of Rule 16b-3(e) in order for the exemption to be available for such cash payments. However, while paragraph (e) of Rule 16b-3 is intended to provide a safe harbor for cash settlements of stock appreciation rights, compliance with the provisions of paragraph (e) is optional on the part of the issuer, and a decision not to comply with the requirements of paragraph (e) would mean only that cash received by participants in full or partial settlement of a stock appreciation right would not be exempted from the operation of Section 16(b) by virtue of Rule 16b-3. Non-compliance with paragraph (e) would have no effect on settlements of stock appreciation rights in stock, nor would it affect the availability of the exemptive relief offered by any other provision of Rule 16b-3 for securities acquired pursuant to a plan that otherwise meets the conditions of the rule.

(116) *Question:* Are cash payments to a director in settlement of a stock appreciation right still exempt if the issuer has failed to meet certain of its periodic reporting obligations under Section 13 of the Exchange Act?

Answer: No. Under paragraph (e)(1) of the rule, the issuer must have filed all reports required under Section 13 for at least one year immediately prior to the settlement of a stock appreciation right. In addition, the issuer must regularly release, on a quarterly and annual basis, summary statements of sales and earnings. These two conditions are intended to provide some degree of assurance that comprehensive information about the issuer will be published and available on a regular basis.

(117) *Question:* Paragraph (e)(2) of rule 16b-3 prohibits the exercise of a stock appreciation right or any related stock option during the first six months of their respective terms. An officer receives a stock option and related stock appreciation rights and he exercises the first installment of the option in less than six months, which results in the surrender and cancellation of those stock appreciation rights relating to that portion of the option exercised. Does this destroy the exemption for cash exercises of the remaining stock appreciation rights?

Answer: No. This situation does not conflict with the requirements of paragraph (e)(2) of Rule 16b-3, insofar as the unexercised stock appreciation rights remaining. The reference to a "related stock option" means the particular share option to which an SAR relates, and not to any other options, whether or not exercised, which may have been a part of the same grant or award.[168]

(118) *Question:* Are the requirements of paragraph (e)(2) satisfied where stock appreciation rights are subsequently granted to holders of long-term stock options and then such rights are exercised within 6 months of the grant?

Answer: No. A basic purpose of this provision is to deter the use of inside information by requiring a six month hiatus between the date of grant and the date of exercise. Accordingly, both the stock appreciation rights and the options must be outstanding for at least six months prior to exercise in order to meet the requirement of Rule 16b-3(e)(2).[169]

(119) *Question:* If a plan provides that stock appreciation rights are exercisable within six months of grant, would this feature automatically destroy reliance upon Rule 16b-3(e)?

Answer: No. In Securities Exchange Act Release 34-13659 (June 22, 1977) [42 FR 33283] the Commission stated that it had revised subparagraph (e)(2) of the rule to provide that neither the stock appreciation right nor any related stock option *"shall have been exercised* during the first six months of their respective terms * * *" Thus, so long as the rights have not actually been exercised during the first six months of their term, the condition set forth in Rule 16b-3(e)(2) will have been satisfied.

(120) *Question:* When stock appreciation rights are granted conditioned upon subsequent shareholder approval, does the six month term of Rule 16b-3(e)(2) commence upon the date of the conditional grant or upon the date of shareholder approval?

Answer: The term of the stock appreciation rights would begin immediately upon their grant, assuming that shareholders in fact approve the plan.[170]

(121) *Question:* Assume that a plan does not meet the administration requirements of Rule 16b-3(e)(3) at the time stock appreciation rights are granted. The company then forms a disinterested committee to administer the plan. The committee proceeds, in its discretion, to confirm the earlier grants

[167] See Rule 16b-3(e)(5). In general, the granting of stock options and stock appreciation rights under a complying plan will have the following ramifications for the insider:

(1) The acquisition of both stock appreciation rights and related stock options is exempt under Rule 16b-3, as is the acquisition of independent stock options;

(2) The acquisition of stock upon exercise of a stock appreciation right or a stock option is a purchase not exempt under Rule 16b-3;

(3) The complete or partial cash settlement of a stock appreciation right is exempt under Rule 16b-3; and

(4) The acquisition of immediately exercisable stock appreciation rights, related stock options and independent stock options is not reportable under Section 16(a) by reason of Rule 16a-6. However, the acquisition of stock upon the exercise of such rights and options is reportable.

[168] See letter re *General Electric Company* dated February 3, 1978.

[169] It should be noted, however, that subsequent amendments to a plan to provide for the settlement of stock appreciation rights in cash would not start a new six month period. That is, the term of the stock appreciation right would still be deemed to have commenced on the date it was originally granted. Letter re *Savin Business Machines Corp.* dated January 6, 1978.

[170] Letters re *R. R. Donnelly & Sons Co.* dated December 12, 1979 and *Columbia Pictures Industries, Inc.* dated August 4, 1977.

of stock appreciation rights and advises holders not to exercise such rights or the related options for six months following committee confirmation. Does this form of compliance satisfy the requirements of paragraph (e)(3) of the rule in this situation?

Answer: Yes.[171]

(122) *Question:* Is the requirement of Rule 16b-3(e)(3)(i), that the plan be "administered by * * * a committee of three or more persons, all of whom are disinterested persons" satisfied, if the disinterested committee does not have the authority to select all of the persons who may participate but does have the sole authority to approve the form in which all stock appreciation rights granted under the plan will be paid?

Answer: No. Since the disinterested committee does not have full authority with respect to one of the fundamental powers of administration, i.e., the right to select all participants, the staff does not believe that the requirement of Rule 16b-3(e)(3)(i) has been satisfied.[172]

(123) *Question:* Where the board of directors or committee administering the plan has sole discretion to determine the form in which payment is to be made upon exercise of a stock appreciation right, has such board or committee acted in accordance with the provisions of Rule 16b-3(e)(3)(ii) in the following situations:

(a) The committee has adopted a general determination that all payments upon the exercise of a stock appreciation right are to be made 50 percent in the form of shares of company stock and the balance in the form of cash;

(b) The committee has amended the plan to provide that holders of stock appreciation rights will receive upon exercise (i) payment only in shares of common stock where such rights are exercised outside of the window period,[173] and (ii) payment only in cash where such rights are exercised during the window period;

(c) The committee has adopted a general determination that payments upon the exercise of stock appreciation rights are to be made entirely in the form of cash, if such exercise is made in conjunction with the exercise of a stock option, in accordance with a formula prescribed by the committee;

(d) The committee has adopted a general determination that it will approve any election made by a participant?

Answer: The board or committee has satisfied its responsibilities in situations (a), (b) and (c) but not in situation (d). The purpose of this provision is to insure that the disinterested administrators will have final authority and control over the form in which payment of the stock appreciation right will be made. Situation (d) represents an abdication of this authority which is inconsistent with the requirements of Rule 16b-3(e)(3)(ii).

(124) *Question:* If a plan provides that stock appreciation rights are exercisable only for cash, must the board or committee administering the plan approve the payment of such cash?

Answer: No.

(125) *Question:* Assuming that the exception[174] to the window period provision of Rule 16b-3(e)(3)(iii) is not applicable, does the window period restriction apply where (1) the form of settlement of a stock appreciation right is within the complete discretion of the committee administering the plan; and (2) the participant has the option to elect cash in lieu of the stock to which he would otherwise be entitled?

Answer: Yes, in both situations. The purpose of Rule 16b-3(e)(3)(iii) is to make clear that, in those circumstances where reliance is to be placed on the safe harbor provided by Rule 16b-3(e), the window period requirement is applicable not only to any *election* by a plan participant as to the form of payment of a stock appreciation right which may involve cash, but also to any *exercise* by a participant of a stock appreciation right for cash. Thus, as in situation (1), even though a participant may have no *election* as to the form of payment of a stock appreciation right, the window period requirement would still be applicable to any *exercise* of such right by a participant for cash.[175]

With respect to situation (2), by permitting participants to determine whether they will accept cash in lieu of stock in settlement of a stock appreciation right, the company is in effect providing such participant with an election as to the form of payment. Viewed in this light, the determination must be made in accordance with paragraph (e)(3) of the rule and the window period requirement applies.[176]

(126) *Question:* Must the plan administrator's decision to consent to or disapprove the election of a participant be made during the ten day window period?

Answer: No. This decision can be made at any time after the participant's election.

(127) *Question:* In order to eliminate differences in compensation for officers and directors who exercise stock appreciation rights for cash at different times during the same window period, a plan provides that the highest market price of the company's common stock during any particular window period shall be the cash settlement price for that window period. Does such a provision meet the requirements of Rule 16b-3(e)(3)(iii)?

Answer: Yes.[177]

(128) *Question:* Is the window period requirement of Rule 16b-3(e)(3)(iii) applicable to the automatic exercise of SARs?

Answer: No. The exception to the window period requirement provides that exercises of SARs which occur on fixed or automatic maturity dates shall not be subject to the requirements of Rule 16b-3(e)(3)(iii), if the date of exercise is at least six months beyond the date of grant of the SAR and is outside the control of the participant. Under these circumstances the insider has no volition, and the automatic exercise does not provide real opportunity for the misuse of confidential information.

Illustration: Under the terms of a plan, SARs are granted to participants concurrently with the grant of stock options. Recipients are permitted to exercise the SARs only during a widow period, as defined in Rule 16b-3(e)(3)(iii). The plan also provides that the SARs will be automatically exercised upon the expiration of the related option.

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[171] Letter re *Standard Oil Company (Indiana)* dated February 19, 1981.

[172] Although interested directors can administer a benefit plan without jeopardizing the availability of Rule 16b-3 as long as the plan meets the requirements of paragraph (b)(1)(iii) of the rule, the specific exemption for cash settlements of SARs is dependent upon disinterested administrators. See letter re *Exxon Corporation* dated December 1, 1977.

[173] The term "window period" is used to describe the period of 10 business days in each quarter during which elections for cash settlement of stock appreciation rights must be made by participants. Under Rule 16b-3(e)(3)(iii), the window period commences on the third business day following the date of release of the specified quarterly and annual financial information and ends on the twelfth business day following such release.

[174] The window period provisions of Rule 16b-3(e)(3)(iii) do not apply to any exercise where the date of the exercise (1) is automatic or fixed in advance under the plan; (2) is at least six months beyond the date of grant of the stock appreciation right; and (3) is outside the control of the participant.

[175] In Securities Exchange Act Release No. 13659 (June 22, 1977) [42 FR 33283] the Commission stated "Henceforth, the exemption provided by the rule for cash settlements of stock appreciation rights will not be available unless all exercises of such rights for cash (other than those occurring on certain fixed or automatic majority dates) are made during a specified ten-day period each quarter following the release of financial information by the issuer."

[176] See letters re *Houdaille Industries, Inc.* dated May 8, 1978 and *Crompton & Knowles Corporation* dated July 7, 1977.

[177] See letter re *Texasgulf, Inc.* dated March 30, 1981.

Interpretation: Assuming the three provisions of the exception to Rule 16b-3(e)(3)(iii) are satisfied, the window period requirement would not be applicable to the automatic exercise of SARs.[178]

(129) *Question:* Must the exercise of "limited rights"[179] take place during a window period?

Answer: No. Since the period for exercise of limited rights is fixed in advance, and since such rights can only be exercised in very special circumstances which are beyond the control of the participant, their exercise comes within the exception provided by Rule 16b-3(e)(3)(iii), and the window period restriction is not applicable.

(130) *Question:* Pursuant to the provisions of a plan, SARs may be exercised for cash within a specified short period of time after the company enters into a definitive agreement for the merger, consolidation or sale of its assets. Should such exercises take place during a window period in order for the insider to properly rely on Rule 16b-3(e)?

Answer: Yes. Unlike "limited rights," mergers and other types of reorganizations as well as the transfer of company assets are not outside the control of directors and officers since such persons might be included in the negotiation and approval of the transaction. Thus, the exception to Rule 16b-3(e)(3)(iii) is not applicable.[180]

(131) *Question:* Assume that the date of exercise of a stock appreciation right meets the conditions of subparagraphs (e)(3)(iii) (A), (B) and (C). Must an election by the holder to receive cash in settlement of the right be made during a window period?

Answer: Yes. Rule 16b-3(e)(3)(iii) makes it clear that, where a participant has the right to elect cash as the form of payment of an SAR, such election must be made during a window period. Although the window period requirements of paragraph (e)(3)(iii) do not apply with respect to the *exercise* by the participant of a stock appreciation right for cash where the date of exercise meets the conditions of subparagraphs (A), (B) and (C), there is no parallel exception for an *election* by the participant to receive cash in payment of a stock appreciation right.[181]

[178] See letter re *The May Department Stores Company* dates April 10, 1978.

[179] See footnote 140, *supra*, for a general definition of "limited rights."

[180] See letter re *Garfinckle, Brooks Brothers, Miller & Rhoads, Inc.* dated June 19, 1981.

[181] See letter re *Intertherm, Inc.* dated July 16, 1979.

D. Rule 16b-4 [17 CFR 240.16b-4]

Rule 16b-4 exempts from Section 16(b) any transaction of purchase and sale of a security made by a holding company registered under the Public Utility Holding Company Act of 1935, or by any subsidiary of such company, where both the purchase and the sale have been approved or permitted by the Commission under the Holding Company Act.

(132) *Question:* Is a formal order of the Commission required to assure the availability of Rule 16b-4?

Answer: No. The intent of the rule is simply to provide relief from the operation of Section 16(b) for those transactions by registered public utility holding companies which have been approved or permitted by the Commission pursuant to the applicable provisions of the Holding Company Act and the rules and regulations thereunder.

E. Rule 16b-5 [17 CFR 240-16b-5]

Rule 16b-5 exempts from the operation of Section 16(b) certain highly specialized transactions involving the acquisition of an equity security of an issuer through the redemption of a security of another issuer.

(133) *Question:* Are all acquisitions resulting from redemption exempt from section 16(b) of the Exchange Act pursuant to the provisions of this rule?

Answer: No. The rule is inapplicable to the acquisition of convertible securities or rights. Further, the application of the rule is severely limited by its terms to redemption transactions which consist exclusively of the exchange of one security for another, where both the old and the new security are substantially and in practical effects equivalents, and the redemption does not involve the payment of any additional consideration for the new security. Such a redemption does not result in any real change in the rights of the beneficial owner of the old security, although it does change the form of his holdings.[182]

Illustration: An issuer decides to establish a stock bonus type of employee benefit plan. For various reasons, it organizes an affiliated holding company to implement the plan. The assets of the holding company consist solely of stock of the issuer contributed to fund the plan. The stock bonus awards to participants are made using holding company stock, which is redeemable at any time for stock of the issuer on the basis of a predetermined ratio.

[182] As a result, the beneficial owner must file the report required by Section 16(a) when the redemption takes place.

Interpretation: Rule 16b-5 exempts from Section 16(b) of the Exchange Act the acquisition of shares of the issuer received by a participant in such a redemption, so long as the participant has made no purchases of the same class of issuer security within six months before or after the redemption transaction.[183]

(134) *Question:* Does Rule 16b-5 exempt the purchase and sale of securities of the same classes as those involved in the redemption, when such transactions occur immediately before and after the redemption?

Answer: No. As stated in Securities Exchange Act Release No. 4495 (September 19, 1950) [15 FR 6477], proposing the rule for comment, Rule 16b-5 does not exempt any transaction other than the redemption. Thus, if there should be a separate purchase and sale (or sale and purchase) of either the old or the new security within any six month period, or if there should be a purchase of one and a sale of the other (or a sale of one and a purchase of the other), within any six month period, the insider would be subject to recovery under Section 16(b). Paragraph (c) of the rule is simply designed to facilitate the recovery of profit, by requiring an issuer to recognize formally the similarity between the two securities through appropriate corporate action, such as the adoption of a by-law or a resolution of the board of directors.

F. Rule 16b-6 [17 CFR 240.16b-6]

Paragraphs (a) and (b) of Rule 16b-6 recognize that where securities are acquired through the exercise of a long-term option (one held more than six months), not all of the gain inherent in the exercise of the long-term option need be attributed to the insider for purposes of computing the profit recoverable under Section 16(b), since at least a portion of such profit may derive from appreciation which occured prior to the relevant six month period. The rule establishes this apportionment of short and long-term profit to maintain the basic policy of Section 16(b) against short-swing trading by insiders and, at the same time, to avoid recapture of the long-term gain inherent in the exercise of the option as not comprehended within the purposes of the section. Accordingly, when gain is being calculated under Section 16(b) with respect to a purchase resulting from the exercise of a long-term option and a sale

[183] See 2 L. Loss, Securities Regulation 1118 (2d ed. 1961).

within six months, the rule limits the issuer's recovery to the difference between the proceeds of the sale and the lowest market price of the security within six months before or after the date of the sale. In addition, paragraph (c) of Rule 16b–6 provides a complete exemption from Section 16(b) for the disposition of securities purchased in a transaction specified in paragraph (a) of the rule, provided such disposition is made in connection with a plan or agreement for a merger, consolidation, reclassification or sale of assets. It must be emphasized that paragraphs (a) and (b) simply limit the extent of Section 16(b) liability; paragraph (c), where applicable, actually exempts the transaction of disposition.

(135) *Question:* In computing the amount of profit that will inure to the issuer in a transaction which falls under Rule 16b–6(a), is the option exercise price considered the cost of the purchase, to be matched against the price received on a sale within six months of that purchase? [184]

Answer: No. The use of the option exercise price as the purchase cost would effectively deprive the insider of the long term appreciation in the value of his option, represented by the long-term increase in the value of the underlying stock. The Commission believes that the capture of this unrelated long-term profit is not comprehended within the purposes of Section 16(b). Consequently, in 1950, the Commission promulgated Rule 16b–6 [185] to preserve for the insider the gain attributable to the long-term portion of the option and still permit recovery of the profit surrounding the short-swing transaction itself. [186]

Illustration: On October 1, 1976, C, an insider of XYZ Corporation, is granted an option to buy XYZ common stock at $10.00 per share, the market value on the date of grant. On June 1, 1977, C exercises his option to buy XYZ at $10.00 per share. The market value of XYZ on the date of exercise is $15.00 per share. On September 1, 1977, C sells XYZ stock at $20.00 per share. Absent Rule 16b–6, C may be required to surrender the difference between the purchase price and the sale price: $20.00—$10.00, or $10.00 per share. Assume that the market price for XYZ common stock from March 1, 1977 to March 1, 1978 ranged as follows:

March 1, 1977	$13.50
April 1, 1977	14.00
May 1, 1977	14.00
June 1, 1977	15.00
July 1, 1977	16.00
August 1, 1977	17.00
September 1, 1977	20.00
October 1, 1977	20.00
November 1, 1977	19.00
December 1, 1977	19.50
January 1, 1978	18.00
February 1, 1978	15.00
March 1, 1978	16.00

Under Rule 16b–6, C would be required to surrender the difference between the sale price, $20.00, and the lowest price at which XYZ traded within six months before or after the sale which would be the price on March 1, 1977, or $13.50 per share. Thus, the recoverable profit computed with the benefit of the rule would be only $6.50 per share.

The same result obtains under Rule 16b–6 where the option to buy is exercised by an insider within six months after a sale of an equity security. [187] The maximum recovery based on matching the purchase upon exercise of the option, with a prior sale occurring within six months of such exercise, would be the difference between the sale price and the lowest price at which the stock traded within six months before or after the sale.

(136) *Question:* Where an insider purchases stock through the exercise of a long-term option and immediately sells such stock within six months at a price below the exercise price, is Rule 16b–6 applicable?

Answer: No. Since the insider did not realize any profit on the transaction, he has no liability under Section 16(b).

(137) *Question:* Is the exercise of a warrant or stock incentive right the exercise of a "similar right" within the meaning of Rule 16b–6?

Answer: Yes.

Illustration: An insider of a company exercises warrants granted to him by the company over two years ago. Within six months of the exercise, the insider exchanges all his shares of the company for shares of its parent pursuant to the terms of a reorganization agreement. [188] The exercise of the warrants for common stock and the subsequent exchange of the shares received upon such exercise would appear to involve a purchase and sale subject to Section 16(b).

Interpretation: While there would be a purchase and a sale for purposes of Section 16(b), Rule 16b–6(c) would appear to be applicable. As a consequence, the disposition of the securities in accordance with the terms of the reorganization would be exempt from the operation of Section 16(b). [189]

(138) *Question:* Is Rule 16b–6(c) applicable to mergers in which shareholders receive cash or a combination of cash and securities?

Answer: Yes. Rule 16b–6(c) provides insiders an exemption from the operation of Section 16(b) for the disposition of an insider's securities, purchased pursuant to a long-term option or right, or acquired pursuant to a long-term employment contract, as specified in paragraph (a) of the rule, provided that the disposition is pursuant to a plan or agreement for a merger, consolidation, reclassification or sale of assets. The exemption is not lost if cash is paid in lieu of securities, or in combination with securities. [190]

Illustration: Company A has entered into an agreement and plan of merger whereby it will merge into a wholly-owned subsidiary of Company B. On the effective date of the merger, each outstanding share of common stock of Company A will be converted into the right to receive $50 in cash, and Company A will become a wholly-owned subsidiary of Company B. An executive officer of Company A intends to exercise options which he has held for more than six months and then surrender the Company A shares received upon exercise for the $50 per share cash payment.

Interpretation: Rule 16b–6(c) exempts the disposition of the option shares from the operation of Section 16(b).

(139) *Question:* An officer owns shares of his company, as well as options to acquire additional shares. Both his shares and options have been held for more than six months. In connection with a merger, or one of the other transactions described in

[184] *Smolowe v. Delendo Corporation, supra.*

[185] Securities Exchange Act Release No. 4509 (October 24, 1950) [15 FR 7357].

[186] Letter re *New England Nuclear Corporation* dated September 18, 1972.

[187] Rule 16b–6 does not extend to options to *sell* securities.

[188] It should be noted that if an insider desires to realize the long term appreciation in the value of his option (or similar right) without risk of controversy concerning his liability to surrender profits under Section 16(b), his safe course is to exercise the option and hold for at least six months the security thereby acquired. Where this is done the insider will not be affected by the method in which the Commission and the courts may compute realized profit, since the transaction in question would fall outside the scope of Section 16(b). Nevertheless, *the insider who does sell within six months after acquiring a security pursuant to an option (or similar right) is not acting unlawfully;* Congress did not intend to impose such a drastic sanction in the event of such a sale, but merely to remove the profit incentive to entering into short-swing trading transactions. (Emphasis added) Securities Exchange Act Release No. 4509 (October 24, 1950) [15 FR 7357]. Of course, trading on the basis of inside information may be a violation of other provisions of the federal securities laws.

[189] Letter re *Spectronics, Inc.* dated August 18, 1978.

[190] See letter re *American Credit Corporation* dated November 24, 1978 and letter to *Gary A. Herman* dated May 18, 1976.

paragraph (c) of Rule 16b–6, the officer exercises his options and surrenders the newly acquired option shares together with his previously held shares. Will the acquisition of the option shares be matched against the disposition of his other shares in the merger, resulting in potential Section 16(b) liability, despite the exemption provided by Rule 16b–6?

Answer: No. There has been concern that insiders in such a situation are confronted with a dilemma, since the purchase of shares under the option could in theory be matched with the sale of already owned shares in the merger giving rise to liability under Section 16(b).[191] The staff believes that this approach would unfairly penalize holders of long-term options and frustrate the purpose of paragraph (c) of the rule. Accordingly, in light of the rationale underlying paragraph (c), the staff is of the view that the acquisition of shares pursuant to the exercise of a long-term option just prior to a merger need not be matched against the disposition of other shares in the merger.

(140) *Question:* Are the provisions of Rule 16b–6 available where a company extends the life of its outstanding options prior to entering into a merger or other transaction of the type described in paragraph (c) of the rule?

Answer: Yes. The extension of an option does not commence a new six month holding period for purposes of Rule 16b–6.

Illustration: On May 1, Company X extends for one year the expiration date of employee stock options held by certain of its executive officers, some of which had been held for only five months at the time of the extension. On May 30, Company X begins merger discussions with Company Z, and on June 30 an agreement in principle is reached. The merger takes place on July 14.

Interpretation: Rule 16b–6 would be available to the officers of Company X with respect to all options held for more than six months at the time of the merger.

(141) *Question:* Would the exemption provided by Rule 16b–6(c) be available for the purchase of unexercised stock options in connection with a cash merger? In connection with a sale of assets for cash and securities?

Answer: Yes, assuming all the provisions of the rule are satisfied.

Illustration (1): Company A proposes a complete liquidation and dissolution. Pursuant to the plan, Company A will sell all of its assets to Company B in exchange for cash and securities in an amount equal to $26 per outstanding share of Company A. In accordance with the terms of the applicable agreements, Company A has the right to purchase those stock options which have been held by its officers and directors for more than six months, but have not been exercised, for a cash price equal to the difference between $26 and the option exercise price.

Interpretation: Rule 16b–6(c) is applicable to the purchase of these stock options.[192]

Illustration (2): Following a successful tender offer, the purchaser informs the issuer that it proposes to merge the issuer with a wholly-owned subsidiary of the purchaser, on terms providing that each remaining share of the issuer's common stock will be entitled to a cash payment per share in an amount equal to the tender offer price. The merger will bind all stockholders of the issuer except for the exercise of appraisal rights by dissenting shareholders. The issuer has stock options outstanding under several employee benefit plans. The applicable agreements provide for the cancellation of the exercisable options on the date of the merger and a cash payment to the optionees of the option spread.

Interpretation: The cash settlement of the stock options in this manner is eligible for the protection afforded by Rule 16b–6(c).[193]

G. Rule 16b–7 [17 CFR 240.16b–7]

Rule 16b–7 exempts from the operation of Section 16(b) the acquisition and disposition of securities in certain specified types of mergers and consolidations.[194]

In Securities Exchange Act Release No. 4696 (April 3, 1952) [17 FR 3177], the Commission emphasized the danger of the possibility of misuse of inside information in connection with mergers and consolidations.

> The policy of Section 16(b) to discourage short-swing trading by insiders seems highly relevant to purchases or sales within six months of a merger if the merger involves a significant change in the character of the enterprise carried on by an issuer which is subject to Section 16(b). Thus a purchase on the eve of the merger may well be motivated by advance information and the receipt by merger of a new security having different economic characteristics from that purchased involves elements of realization of a short term profit. In addition to preventing abuse of inside information, requiring an insider to surrender any profit resulting from a purchase or sale within six months of a merger is related to the policy of Section 16(b) to eliminate motives for manipulative activity. The significance of a merger may be greatly exaggerated by rumor, particularly in periods of unusual speculative activity in the security markets. If insiders were free to take advantage of such a situation to unload at temporarily inflated prices securities received in the merger, the opportunity and motive for manipulative activity might well be greater than the ordinary short-swing purchases and sales where both are cash transactions.[195]

The Commission recognized, however, that not every transaction of this nature involves a serious potential for the abuse of inside information. As a consequence, Rule 16b–7 was adopted to exempt transactions of exchange involved in the merger or consolidation of companies where 85 percent or more of all of the assets or securities of one of the companies involved is owned by the other company. As Release No. 34–4996 points out, the exemption is based on the premise that such transactions are of relatively minor importance to the stockholders of a particular company and do not present significant opportunities to insiders to profit by advance information concerning the merger. Indeed, they do not significantly alter in an economic sense the type of security which the insider held prior to the transaction.[196]

(142) *Question:* Although not specifically mentioned, does Rule 16b–7 apply to transactions structured as (1)

[191] Letters re *The Flintkote Company* dated February 7, 1980 and *Investors Diversified Services, Inc.* dated March 21, 1979.

[192] Letter re *National Liberty Corporation* dated December 12, 1980.

[193] Letter to *Melvin L. Bedrick* dated September 20, 1979.

[194] While Rule 16b–6(c) provides an exemption from the operation of Section 16(b) only for the disposition of certain securities pursuant to a plan or agreement for merger, consolidation, reclassification or sale of assets, Rule 16b–7, on the other hand, exempts transactions of acquisition and disposition in connection with specified types of mergers and consolidations.

[195] See also Securities Exchange Act Release No. 4717 (June 9, 1952) [17 FR 5501], and Brief for SEC as *amicus curiae*, page 8, *Blau v. Hodgkinson*, 100 F. Supp. 361 (S.D.N.Y. 1951).

[196] The rule is typically relied upon in situations where a company is reincorporating in a different state or reorganizing its corporate structure. For example, Company T, a Texas insurance company, seeks to become a general business corporation. To accomplish this in conformity with Texas law, Company T proposes to transfer all of its assets and liabilities to New T, a Texas general business corporation, to be organized as a wholly-owned subsidiary of Company T, and then merge into an insurance subsidiary of New T. Pursuant to the merger, each share of T common will be exchanged on a share-for-share basis for equivalent New T securities, with the result being that the present T shareholders will become New T shareholders. The proposed transaction will have no effect on the consolidated financial statements, the present composition of management, nor will it affect the rights of present shareholders and, accordingly, Rule 16b–7 is available. Letters re *American General Insurance Company* dated March 11, 1980; *Anheuser-Busch, Incorporated* dated March 16, 1979. See also letters to *Eugene R. Sullivan* dated October 10 and December 11, 1978.

statutory exchanges; (2) liquidations; or (3) reclassifications?

Answer: The staff is of the view that, for purposes of Rule 16b-7, a statutory exchange may be the substantive equivalent of a merger, consolidation or sale of assets. Therefore, the acquisition and disposition of stock in a statutory exchange would be exempt under Rule 16b-7, assuming all of the conditions of the rule are satisfied.[197] A liquidation, on the other hand, is not covered by Rule 16b-7, since the liquidation in substance and purpose bears little resemblance to the types of transactions specified in the rule.[198] Rule 16b-7 does not require that the security received in exchange be similar to that surrendered, and the rule can apply to transactions involving reclassifications.

Illustration (1): Company B is a savings and loan association organized in the State of Virginia. Company A, a wholly-owned subsidiary of Company B, was incorporated under the laws of Virginia for the sole purpose of acquiring all the outstanding shares of capital stock of Company B. The purpose was to create a holding company which would be able to acquire other savings and loan institutions in Virginia. Under Virginia law, Company B is not permitted to acquire stock of other savings and loan associations. As a result of the exchange, Company B became a wholly-owned subsidiary of Company A, and the former Company B shareholders became the owners of all the outstanding shares of Company A. This transaction was implemented pursuant to statutory procedures under Virginia law.

Interpretation: The acquisition by Company B stockholders of common stock of Company A and the corresponding disposition of the Company B stock in exchange fall within the terms of Rule 16b-7.

Illustration (2): Company X is a holding company whose principal asset is 100,000 shares of Company Y common stock, roughly 6 percent of the total number of shares of such stock issued and outstanding. Company X proposes to liquidate so that its shareholders will hold the stock of Company Y directly. Pursuant to the liquidation plan, shareholders of Company X will exchange their shares of Company X for those of Company Y on a pro rata basis.

Interpretation: The acquisition and disposition of such shares is not exempt under Rule 16b-7. This transaction is not substantially similar to a merger or consolidation, nor does it meet the standards of paragraph (a) of the rule which provides that the acquisition and disposition of securities in connection with a merger or consolidation is exempt from Section 16(b) where 85 percent or more of the assets or securities of all other companies involved in the transaction is owned by another party to the transaction.

(143) *Question:* Does the 85 percent ownership requirement of the rule apply to indirect as well as to direct ownership of the companies involved in a transaction?

Answer: Yes. It is the staff's view that the rule does encompass indirect ownership, so long as the transaction in question does not result in a significant change in the character or structure of the company.[199]

Illustration: Company A proposes to enter into a transaction with its wholly-owned subsidiary, Company B, whereby Company B would become the parent of Company A through a tax free exchange of shares. The tax free exchange would be accomplished by a statutory merger of a wholly-owned shell subsidiary of Company B into Company A, with Company A the surviving corporation. Prior to the merger, Company A will own 100 percent of the equity securities of the shell subsidiary which will be merged into Company A. Thus, Rule 16b-7 would be available only if the 85 percent requirement was interpreted to include indirect as well as direct ownership, since Company A will merge into a wholly-owned subsidiary of Company B rather than Company B itself.

Interpretation: Rule 16b-7 would be applicable because Company B, on a consolidated basis, will represent the same business entity as the present Company A, will be managed by the same officers and directors, and will have the same charter and by-laws as Company A. Accordingly, the merger will not result in "any significant change in the character or structure of the company."[200]

(144) *Question:* Would the purchase and sale of securities of any company involved in a merger which met the requirements of Rule 16b-7, within six months of such merger, destroy the exemption otherwise afforded by the rule?

Answer: If the non-merger transactions are exempt under any other rule adopted under Section 16(b), the exemption provided by Rule 16b-7 could still be relied upon. However, as stated in paragraph (c) of the rule, if an insider has made additional non-exempt purchases and sales within six months of the merger or consolidation, the exemption shall be unavailable to the extent of such purchases and sales.

Illustration: An officer purchases 100 shares of his company's common stock in the open market on June 1 and sells 100 shares on August 1. No exemption from Section 16(b) is available for these transactions. During the interim, the company reincorporates by merger. Although Rule 16b-7 is available for the officer's participation in the merger transaction, paragraph (c) of the rule diminishes his protection to the extent of his non-exempt purchase and sale.

H. Rule 16b-8 [17 CFR 240.16b-8]

Rule 16b-8 exempts from the operation of Section 16(b) any acquisition or disposition of an equity security involved in the deposit or withdrawal of such security under a voting trust or deposit agreement.

(145) *Question:* Is the exemption provided by Rule 16b-8 available to an insider who purchases securities of the class deposited and, within six months thereafter, sells certificates of deposit representing such securities?

Answer: The rule provides that the exemption is not available to the extent that there has been a purchase or sale of securities of the class deposited and a sale or purchase of certificates representing such securities within a period of less than six months. The intent of this provision is to exempt only transactions of withdrawal or deposit in the voting trust itself. The protection afforded by the rule is diminished and, perhaps, lost to the extent that the insider also has transactions of purchase and sale, or sale and purchase, in either the certificates of deposit or the underlying equity security within six months of the date of the deposit or withdrawal in the voting trust.

I. Rule 16b-9 [17 CFR 240.16b-9]

Rule 16b-9 generally provides that the conversion of one equity security into another equity security shall not constitute either a sale of the security converted or a purchase of the security acquired upon conversion for purposes of Section 16(b).

(146) *Question:* Would the fact that the security received upon conversion does not have substantially the same rights and privileges as the convertible security affect the availability of the exemption?

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[197] Letter re *Heritage Financial Corp.* dated September 19, 1978.

[198] Letter re *Petro-Lewis Corporation* dated July 9, 1979.

[199] Letter re *Southern Natural Gas Company* dated May 11, 1973; letter to *Ed Kaufman* dated May 25, 1973.

[200] Securities Exchange Act Release No. 4717 (June 9, 1952) [17 FR 5501].

Answer: No.

(147) *Question:* An insider holds convertible debentures for more than six months. He then converts the debentures into common stock and immediately sells some additional shares of common stock. Assuming he has no other relevant transactions, is rule 16b-9 available for his conversion?

Answer: Yes. The proviso to the rule states that the rule is not available to the extent that there are independent purchases and sales of the securities concerned within a period of less than six months, which period includes the date of conversion. Since the insider did not engage in any other relevant transactions within the six month period, the exemption is available.

Illustration: An insider of Company X acquires notes convertible into Company X common stock in a private placement. He intends to convert these notes one year later. The conversion will be effected at a time when he will not have purchased or sold any other equity securities of the company within the preceding six months. However, he intends to sell Company X common stock immediately after the conversion.

Interpretation: Rule 16b-9 is available, hence the acquisition of the common stock upon the conversion of the notes would not be deemed a purchase for purposes of Section 16(b).[201]

(148) *Question:* Is Rule 16b-9 available if, pursuant to the terms of the conversion right, the holder must make an additional cash payment in order to receive the new security?

Answer: Usually. In connection with the exercise of a conversion right, it is sometimes necessary to make a payment in addition to the surrender of the convertible security or, alternatively, surrender of the convertible security may result in the delivery of cash or other property in addition to the security received on conversion. Where such extra payments or receipts are not substantial in relation to the value of the securities involved, they do not affect the availability of the exemption. Thus, the exemption would still be available so long as not more than 15 percent of the value of the security received in exchange consisted of cash or property other than the convertible security.[202]

(149) *Question:* Would the application of anti-dilution provisions which might affect the conversion price of a convertible security, be considered a change in the conversion privilege for purposes of Rule 16b-9(a)(1)?

Answer: No.

Illustration: In accordance with a loan agreement, Company A issued and sold to Company B a $2,000,000 principal amount, convertible subordinated note. The note is convertible into shares of Company A common stock. The agreement requires Company A to make periodic pre-payments on the principal amount of the note. The agreement also provides for the adjustment of the conversion price of the note to prevent dilution of the conversion privilege and protect the proportional equity interest of the note holder. Any changes in the conversion price resulting from the operation of the anti-dilution provisions would occur solely because of actions taken by Company A and would not involve any further actions by, or negotiations with, the note holder.

Interpretation: Any change in the conversion price of the note, by operation of the anti-dilution provisions, would not be considered a change in the conversion privilege of the note for purposes of clause (1) of the proviso to paragraph (a) of Rule 16b-9.[203]

J. Rule 16b-10 [17 CFR 240.16b-10]

Rule 16b-10 exempts from Section 16(b) of the Exchange Act certain acquisitions of securities from an issuer received in exchanges made pursuant to the provisions of the Interstate Commerce Act. In order for the exemption to be available, the person acquiring the new security must be subject to one or more of the provisions of Part I of the Interstate Commerce Act and meet the other conditions set forth in the rule. The exemption was intended to provide a measure of protection for mandatory exchange transactions in connection with the reorganization of railroads and other carriers.

(150) *Question:* Is Rule 16b-10 available for the disposition of stock made in accordance with an order or condition imposed by the Interstate Commerce Commission?

Answer: No. The exemption covers only the acquisition of securities received in the mandatory exchange.

K. Rule 16b-11 [17 CFR 240.16b-11]

Rule 16b-11 exempts from Section 16(b) certain transactions involving the sale of short-term subscription rights distributed *pro rata* by an issuer to its security holders.

(151) *Question:* Does Rule 16b-11 exempt: (1) purchases of subscription rights for cash or other consideration; (2) sales of subscription rights which were purchased for cash or other consideration; or (3) the purchase of securities upon the exercise of subscription rights?

Answer: No. By its terms, the exemption is only available for the sale of subscription rights which were acquired from the issuer without the payment of consideration.

Illustration: A company proposes to file a registration statement under the Securities Act of 1933, pursuant to which it will offer to the holders of its common stock the right to subscribe for additional shares of common stock. The rights will be evidenced by transferable subscription warrants which will be distributed to stockholders *pro rata*, without the payment of any consideration, and will expire 30 days after issuance.

Interpretation: The sale of such rights by an insider would be exempt under Rule 16b-11.[204]

By the Commission.

George A. Fitzsimmons,

Secretary.

September 23, 1981.

[FR Doc. 81-28620 Filed 9-30-81; 8:45 am]

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[201] Letter re *Oxoco* dated September 15, 1977.

[202] It should be noted that this exemption is construed to exclude the exercise of options, warrants or rights. See *Brenner v. Johnson*, 328 F.Supp. 149 (E.D. Wis. 1971), *mod.*, 467 F.2d 1080 (7th Cir. 1972).

[203] Letter re *Portec, Inc.* dated June 14, 1976.

[204] The exemption does not apply to the sale of subscription rights by a person who has purchased subscription rights for cash or other consideration, within the six-month period preceding or following such sale, to the extent of any such purchase. See paragraph (c) of Rule 16b-11.

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17 CFR Parts 285, 286 and 287

[Release Nos. 33-6347, 34-18116, BWA-4, IAD-3; AD-3]

Primary Offerings by Multinational Banks

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Commission is amending three virtually identical exemptive regulations for primary distribution of securities issued by the International Bank for Reconstruction and Development, the Inter-American Development Bank, and the Asian Development Bank. The amendments permit these banks to sell their securities immediately upon filing certain information with the Commission instead of waiting a period of seven days.

EFFECTIVE DATE: October 1, 1981.

FOR FURTHER INFORMATION CONTACT: