

BUSINESS DEPARTMENT E-NEWS ALERT — FEBRUARY 25, 2003

New Regulations Under Sarbanes-Oxley Retirement Plan Blackout Periods: Trading Prohibition and Notice Requirements

On July 30, 2002, President Bush signed into law the *Public Company Accounting Reform and Investor Protection Act of 2002* (also referred to as the *Sarbanes-Oxley Act of 2002* and referred to herein as the “Act”). (Please refer to Preston Gates & Ellis Alert dated July 31, 2002 for a summary of the provisions of the Act.)

Two sets of rules were recently adopted pursuant to Section 306 of the Act that relate to “blackout” periods under qualified defined contribution retirement plans such as 401(k) plans. On January 23, 2003, the Securities Exchange Commission (“SEC”) issued final rules¹ and adopted Regulation BTR (Blackout Trading Restriction) to implement the Act’s prohibition on trading in company stock by certain insiders during qualified plan blackout periods. On January 24, the Department of Labor (“DOL”) published final regulations² governing notices that must be provided to plan participants in advance of various kinds of plan restrictions or suspensions. The SEC rules apply only to public companies, including foreign private issuers; the DOL notice requirements apply to non-public companies as well as public companies. Although the blackout trading prohibition and the new blackout period notice requirements both address situations where participants’ access to their retirement plan accounts is limited, the two sets of rules are based on different definitions of “blackout period.”

The blackout period that gives rise to the SEC blackout trading prohibition is narrowly defined, and the prohibition is generally only likely to apply in the event a fairly comprehensive administrative blackout period is imposed on a public company’s 401(k) Plan. No action is necessary with respect to the securities trading prohibition unless and until it is anticipated that such a blackout period will be imposed.

The definition of blackout period for purposes of the DOL participant notification requirements is fairly broad and may include various limitations on participants’ access to their accounts that do not rise to the level of a full administrative blackout. Companies should review administrative procedures under their 401(k) plans (and other retirement plans covered by these regulations) to determine whether any administrative restrictions that may occur from time to time under these plans may constitute a “blackout” for purposes of these new regulations, thereby requiring advance notice to participants. Additionally, companies should immediately educate their directors and officers on the new trading prohibition and update their written insider trading procedures and policies accordingly.

REGULATION BTR (BLACKOUT TRADING RESTRICTION)

The Act and Regulation BTR prohibit any director or executive officer from directly or indirectly purchasing, selling, or otherwise acquiring or transferring any equity security of the company during any

¹ Final Rule: Insider Trades During Pension Fund Blackout Periods (Release No. 34-47225). Available at: <http://www.sec.gov/rules/final/34-47225.htm>

² 29 CFR Section 2520.101-3.

blackout period if such director or officer acquires (or acquired) such security in connection with his or her service as a director or executive officer.

Definition of Blackout Period

A blackout period for purposes of the trading prohibition is a period of more than three consecutive business days during which at least 50% of the participants in the United States, under all of a company's "individual account plans" that permit participants to acquire or hold company stock, are restricted from purchasing, selling or otherwise transferring their company stock held in the plan.³ An individual account plan is a defined contribution retirement plan, such as a 401(k) plan, that provides for an individual account for each participant and in which benefits are based solely on the amounts contributed to each account and related earnings and losses. The applicable blackout periods typically occur when a plan is changing record keepers or investment choices under the plan.

The Trading Prohibition

During a qualifying blackout period, the company's directors and executive officers (those officers who are subject to Section 16 reporting requirements) are prohibited from trading in the company's stock, unless they can prove that the stock traded was not acquired in connection with their service as an officer or director. The trading prohibition extends to direct or indirect trades, so trades of family members or other trades in which the individual has a "pecuniary interest" will likely be prohibited during the period.

Certain automatic or prearranged transactions are not affected by the trading prohibition. For example, automatic dividend reinvestments, purchases or sales under a previously established trading arrangement (such as a 10b5-1 trading plan⁴), or regularly scheduled purchases through a qualified employee stock purchase plan are permitted to take place during an applicable blackout period.

Notice Requirements

In the event a director or executive officer will be subject to a trading prohibition in connection with a blackout period, companies must notify each affected individual, and the SEC on Form 8-K, of the blackout period. Regulation BTR describes the specific information that must be provided in the notice and sets forth requirements regarding the timing of notice.

Enforcement

In the event the trading prohibition is violated, the company may recover the profit realized by the individual on the trade. If the company does not take action to recover the profits within 60 days, any other stockholder of the company may take action on the company's behalf within two years after the violation.

ERISA BLACKOUT PERIOD NOTICE REQUIREMENTS

The Act also added a new subsection 101(i) to the Employee Retirement Income Security Act of 1974 (ERISA) that provides that the plan administrator of an individual account plan must provide notice to participants (and alternate payees or other beneficiaries benefiting under a plan) at least 30 days, but

³ The trading prohibition will only apply to foreign private issuers if the 50% test is satisfied and the number of affected plan participants located in the United States either exceeds 15% of the total number of the company's worldwide employees or 50,000 affected plan participants.

⁴ To qualify for this exemption, the trading plan may not be entered into or modified during a blackout period.

not more than 60 days, in advance of a blackout period. These provisions apply to all individual account plans, not just those that provide for employer stock as an investment alternative. The Final DOL regulations regarding the notice requirements apply to any blackout period beginning on or after January 26, 2003. For blackout periods beginning before February 25, 2003, the notice must be given as soon as possible.

Definition of Blackout Period

For purposes of the DOL notice requirements, blackout period means “any period for which any ability of participants or beneficiaries under the plan, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, to obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted, if such suspension, limitation, or restriction is for any period of more than 3 consecutive business days.” Note that this definition is not limited to restrictions affecting employer stock in a plan, and furthermore there is no condition here that 50% of participants must be affected by the blackout. This means that the notice requirement will apply to a much broader variety of situations than the insider trading restrictions outlined above. There may be restrictions that are standard procedure under a given plan which could constitute a blackout under the definition for purposes of this notice requirement.

The notice requirement does not apply to certain regularly scheduled suspensions, restrictions due to securities law requirements, or account holds relating to a qualified domestic relations order (QDRO), including a pending domestic relations order that has not yet been qualified. In the case of blackout periods with limited applicability, such as blackouts in connection with a merger or acquisition or other restrictions affecting only a limited number of individuals, the notice requirement only applies to those affected by the blackout period.

The Notification Requirement

The regulations describe the information that must be provided in the notice and include a model notice, a copy of which is attached to this Alert. The notice must be provided no later than 30 days before the last day on which participants may make changes or otherwise exercise rights that will be affected by the blackout period. In some cases this deadline may be earlier than 30 days before the blackout period actually begins, for example if the blackout affects an element of the plan that participants may access only periodically, or where a period of time is needed to implement a participant’s instructions before the blackout period begins.

In certain situations it may not be possible to provide the notice 30 days prior to the last day on which affected participants can exercise their rights under the plan. The notice may be provided less than 30 days in advance in the case of certain unforeseeable circumstances, in mergers and acquisitions, and where delaying the start of the blackout in order to meet the notice requirement would violate fiduciary responsibilities. In these situations, the notice must be provided as soon as is reasonably practicable.

The notice may be provided in the same manner as other materials required to be furnished to participants under ERISA, such as summary plan descriptions. The method used must be calculated to ensure actual receipt by affected individuals; posting at the employer’s worksite is not sufficient. It is permissible to provide the notice via electronic delivery in accordance with the final regulations issued by the DOL in 2002 regarding electronic delivery of plan communications. If the plan includes employer stock, the plan administrator must also notify the company so that the company may comply with SEC Regulation BTR.

Enforcement

The civil penalty that may be imposed by the DOL for failure to timely provide the notice is up to \$100 per participant per day.⁵ For example, in the event of a 30-day blackout period, the penalty could be imposed for a 60 day period. (That is, the 30-day advance period plus the 30-day blackout period itself.) The Act also increased the criminal penalties permitted for violation of ERISA's disclosure (and reporting) requirements, including this blackout notice requirement. The Act increased these criminal penalties to a fine of up to \$100,000 for an individual (from \$5,000) or \$500,000 for a person other than an individual (from \$100,000) and up to ten years in prison (from one year).⁶

For more information on this E-News Alert, please contact [Stephan Coonrod](#) (stephanc@prestongates.com) or any other attorney in the [Securities Group](#) at Preston Gates & Ellis LLP.

The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.

⁵ ERISA Section 502(c)(7); 29 CFR Section 2560.502c-7.

⁶ ERISA Section 501.