



FENWICK & WEST LLP

Corporate and Securities Law Alert

IMPORTANT: Section 16 Update

AUGUST 4, 2005

On August 3, 2005, the SEC adopted long awaited amendments to Rules 16b-3 and 16b-7 under Section 16(b) of the Securities Exchange Act of 1934. The amendments make it clear that the exemption under Rule 16b-3 is not limited to transactions with a compensatory purpose and that the Rule 16b-7 exemption applies to reclassifications in the same manner as it does to consolidations and mergers.

The final rules were adopted substantially as proposed and as they were urged to be adopted by the Federal Regulation of Securities Section of the American Bar Association. These final rules are critical to avoiding unintended applications of the Section 16 Rules to merger transactions and change the result with respect to the 2002 *Levy v. Sterling* decision in the 3rd Circuit that found Section 16 liability in a reclassification. A brief description of the amendments to the Rules follows below.

Rule 16b-3

In the amended Rule 16b-3, the SEC has made clear that the exemption under that Rule will be available to acquisitions and dispositions of issuer securities by an insider, including without limitation a grant or award to or from the issuer *whether or not intended for a compensatory purpose*, provided the other requirements of the Rule are satisfied. Prior to the amendment, the Rule was not explicit that the transaction need not be for a compensatory purpose.

Rule 16b-7

In the amended Rule 16b-7, the Rule now provides that transactions involving the acquisition or disposition of issuer securities by an insider pursuant to mergers, reclassifications and consolidations are exempt from Section 16, provided the other requirements of the Rule are satisfied. Prior to the amendment, the Rule did not make reference to reclassifications and it was unclear whether such corporate events were exempted from Section 16.

In order to preserve flexibility to apply the rule appropriately to evolving forms of transactions, the Rule does not define the term "reclassification." However, transactions that are exempt as reclassifications generally include transactions in which the terms of the entire class or series are changed, or securities of the entire class or series are replaced with securities of a different class or series of securities of the company, and all holders of the reclassified class or series are entitled to receive the same form and amount of consideration per share. Rule 16b-7 also applies in such transactions where shareholders have the right to receive cash instead of stock by exercising their dissenters' appraisal rights, or the option to surrender their shares for stock or for cash in certain circumstances.

Retroactivity

The revisions to Rule 16b-3 and 16b-7 described above are retroactive to August 15, 1996, the date these Rules became effective.

If you have any questions, please call Scott Spector at (650) 335-7251 or Dan Winnike at (650) 335-7657.

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