



DIVISION OF
CORPORATION FINANCE

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

December 20, 1996

Peter J. Romeo, Chairman
American Bar Association
750 North Lake Shore Drive
Chicago, Illinois 60611

Re: American Bar Association

Dear Mr. Romeo:

In regard to your letter of December 11, 1996 our response thereto is attached to the enclosed photocopy of your correspondence. By doing this, we avoid having to recite or summarize the facts set forth in your letter.

Sincerely,

A handwritten signature in cursive script that reads "Martin P. Dunn".

Martin P. Dunn
Chief Counsel



AMERICAN BAR ASSOCIATION

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December 11, 1996

SECTION 19 (11/11/96)

Martin P. Dunn, Esq.
Chief Counsel
Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Section 16 of the Securities Exchange Act of 1934

Dear Mr. Dunn:

On behalf of the Task Force on Section 16 Developments of the American Bar Association Section of Business Law's Federal Regulation of Securities Committee, we are writing to request the Staff's views on several questions of general applicability relating to the new rules under Section 16 of the Securities Exchange Act of 1934.

1. Non-Employee Directors

Rule 16b-3(b)(3) defines a non-employee director as, in addition to certain other requirements, a director (i) who does not receive for services in any capacity other than as a director compensation in excess of the dollar amount for which disclosure would be required under Item 404(a) of Regulation S-K and (ii) who does not possess an interest in any transaction and is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(a) or 404(b) of Regulation S-K. The test under Item 404 is whether any of the described transactions or relationships have occurred since the beginning of the last fiscal year or are currently proposed. By contrast, the language of Rule 16b-3(b)(3) speaks only in the present tense.

Rule 16b-3(b)(3) raises two concerns. First, at the time a director takes action it may be impossible to know whether a relationship will ultimately become one that is disclosable under Item 404. Suppose, for example, a non-employee director is an executive officer of an entity that is doing business with the issuer but at the time the action is taken it is not known whether the 5% threshold in Item 404(b) has already been met or whether it will be met during the current fiscal year. Second, a director who has had a disclosable relationship during the prior year may have terminated it and it is not entirely clear that he or she would qualify as a non-employee director following such termination. The resulting uncertainty makes it difficult for companies to administer their benefit plans.

As to the first concern, we would prefer an interpretive position that tested non-employee status by looking to the last day of the fiscal year immediately prior to the time the action is being taken. If the staff is unable to concur in that approach, however, we believe that an appropriate interpretive approach is to treat a director as a non-employee director if the most recent filing with the Commission that required disclosure of Item 404 information included no Item 404(a) or (b) disclosure about the director and the issuer reasonably believes that no such transactions or relationships are likely during the current fiscal year based on information available to it at the time the action is taken. As to the second concern, even if the most recent filing with the Commission disclosed Item 404(a) or (b) relationships or transactions as to a particular director, if those relationships and transactions have been terminated prior to the time that the action for which exemption is sought is taken, the director would qualify as a non-employee director. Please confirm that these interpretations are consistent with the language of the Rule.

2. Scope of Discretionary Transaction Definition - Cash Distributions

Paragraphs (c), (d) and (e) of Rule 16b-3 exclude from their exemptive coverage "Discretionary Transactions". A Discretionary Transaction is defined in Rule 16b-3(b)(1) and includes, among other things, a "cash distribution funded by a volitional disposition of an issuer equity security" We assume that this requirement must involve a fund established by the issuer or an employee benefit plan of the issuer that holds issuer equity securities. Please confirm that the following are not Discretionary Transactions:

- Cash settlement of an option, SAR or phantom stock right.

Discretionary Transactions occur pursuant to employee benefit plans and involve either intra-plan transfers involving an issuer securities fund or a cash distribution from a plan that is funded by the disposition of an equity security. Thus, the definition should not by its terms apply to options, SARs or phantom stock rights that are stand-alone equity instruments because

they are issued under plans that do not have investment funds and their disposition does not "fund" the payment.

The same analysis should hold true for phantom stock units in a deferred compensation plan where issuer equity securities are the only investment medium. By their nature, these units must be held in a plan. However, the cash settlement of these units is no more a Discretionary Transaction than is the cash settlement of a stand-alone SAR or phantom stock right.

- An election to take a stock bonus award in cash rather than stock.

This transaction should be analyzed as an award of the stock followed by a disposition to the issuer similar to the exercise of an SAR or phantom stock right, both of which would be exempt if the requisite approvals were received under Rule 16b-3.

- Withdrawal of cash from an employee stock purchase plan prior to the end of the purchase period.

In an employee stock purchase plan, participants generally accumulate funds through payroll deductions during a purchase period, which funds are used to acquire securities at an exercise price that is generally not fixed until the end of the period. Because no derivative security is created until the end of the period, there is no disposition of an equity security that can be characterized as a Discretionary Transaction. Even if the exercise price were fixed at the beginning of the period, a cash withdrawal should not be considered a Discretionary Transaction: it is simply an election not to participate in the plan. The cash accumulated bears no relationship to the value of an equity security and a distribution of that cash in no way should be considered to be funded by a disposition of the option.

3. **Scope of Discretionary Transaction Definition: Qualified Plans - The "Required to be Made Available" Requirement**

The definition of discretionary transaction excludes transactions "required to be made available" by the Code. For many such elections, the Code sets minimum standards for plans that are qualified under the Code. Many plans elect to comply with these minimum standards by allowing more generous elections. This question relates to the scope of the phrase "required to be made available" for transactions pursuant to Section 401(a)(9) of the Code.

Section 401(a)(9) requires qualified plan distributions to "commence" no later than April 1 after the year in which the participant reaches age 70-1/2, even if the participant is still employed. (This provision would be eased under the new Pension Simplification legislation, by not requiring distributions until termination of employment, regardless of age, unless the

