

AMERICAN BAR ASSOCIATION
Section of Business Law
750 North Lake Shore Drive
Chicago, IL 60611

August 16, 2004

By E-Mail - (rule-comments@sec.gov)

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609
Attn: Jonathan G. Katz, Secretary

**Re: Ownership Reports and Trading by Officers, Directors and Principal
Security Holders
Release Nos. 34-49895; 35-27861; IC-26471
File No. S7-27-04**

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the American Bar Association's Business Law Section (the "Committee")* in response to the Commission's request for comments to Release Nos. 34-49895; 35-27861; IC-26471 dated June 21, 2004 (the "Release"). The Release sets forth proposals intended to clarify the exemptive scope of Rules 16b-3 and 16b-7 under the Securities Exchange Act of 1934, consistent with previous releases and interpretations of the Securities and Exchange Commission (the "Commission"). In addition, the Release describes a proposal to amend Item 405 of Regulations S-K and S-B to harmonize them with the two-day deadline for filing Section 16 reports.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committee.

We commend you for taking clear steps to reiterate the Commission's interpretations of its rules and correct the misinterpretation by the court in *Levy v. Sterling Holding Company*,

* References in this letter to "we" and "our" mean the Committee.

August 16, 2004

Page 2

LLC, 314 F.3d 106 (3d Cir. 2002), *cert. denied*, 124 S.Ct. 389 (U.S., Oct. 14, 2003). It is extremely important to resolve the uncertainty caused by the court's ruling, which has made it impossible for insiders to engage in legitimate transactions in reliance on prior Commission interpretations of these two rules without exposing themselves to the risk of significant liability. It is equally important as an indication to the courts that the Commission stands behind the validity of its interpretations of all of its rules under Section 16. Accordingly, we heartily support the proposed rulemaking. We have a few comments regarding ways in which the proposed amendments might be further clarified as discussed below.

Rule 16b-3

We believe that the proposed amendments accomplish the goal of clarifying the exemptive scope of Rule 16b-3 and would have precluded the result in *Levy v. Sterling Holding Company, LLC*. In response to your question, it should not be necessary to add that participation in an extraordinary transaction (such as a merger, reclassification or exchange offer) is exempt under the rule if the exemptive conditions are met because the note and the rule already state that "any transaction" that satisfies those conditions is exempt.

We believe strongly that Rules 16b-3(d) and (e) should not be limited to compensatory and extraordinary transactions. There may be instances beyond these two categories in which shareholders, the board, or a committee of non-employee directors determines that it is appropriate for the issuer to engage in a transaction in issuer securities with an officer or director. As the Commission stated in its 1996 Release amending Rule 16b-3, transactions between the issuer and its officers and directors "do not appear to present the same opportunities for insider profit on the basis of non-public information as do market transactions by officers and directors." We agree that transactions between the issuer and its officers and directors present little opportunity for the abuses to which Section 16(b) is directed when those transactions are subject to the "gate keeping conditions" set forth in the rule. They do not involve market transactions and, because the other party is the issuer, they do not give rise to the type of concerns regarding misuse of insider information that are appropriately addressed by a strict liability statutory scheme. Whether the transactions are compensatory in nature should be irrelevant to the purposes of Section 16, because the key consideration of the statute is the absence of the ability to take advantage of the other party on the basis of inside information. This is consistent with the Commission's view as reflected in the 1996 Release when it stated: "However, unlike the current rule, a transaction need not be pursuant to an employee benefit plan or any compensatory arrangement to be exempt, nor need it specifically have a compensatory element."

In the 1996 Release, the Commission pointed to the insider's fiduciary duty to the corporation as a constraint on self dealing, and as a further safeguard against the abuses to which Section 16(b) is directed. In fact, the two most commonly relied on "gate keeping conditions" in the rule – approval by the full board or by a committee of non-employee directors – involve an exercise of fiduciary duty not only by the insider engaging in the transaction, but also by the directors approving it. Thus we believe that there is no policy reason for the Commission to allow the Rule 16b-3(d) and (e) exemptions to be narrowed. Moreover, any attempt to limit these exemptions to compensatory transactions would create numerous interpretive issues over

whether particular transactions were “compensatory” in nature. For these reasons, in response to your question, we believe proposed Note 4 should apply to Rule 16b-3(e) as well as (d), and that both rules should apply to all transactions between an officer or director and the issuer that meet one of the conditions for exemption.

We also believe that the Commission should consider taking this opportunity to codify in Rule 16b-3 two interpretations of the rule issued by the Commission staff. One is the interpretation issued in the February 10, 1999 letter to the American Bar Association that, upon satisfaction of its conditions, Rule 16b-3 also exempts an officer’s or director’s indirect pecuniary interest in transactions with the issuer engaged in by the officer’s or director’s immediate family members or certain related entities. The second interpretation is the one reflected in the January 12, 1999 letter to Skadden, Arps, Slate, Meagher & Flom LLP and acknowledged by the Second Circuit Court of Appeals in *Gryl v. Shire Pharmaceuticals PLC* (298 F.3d 136 (2d Cir. 2002)) that for purposes of Rule 16b-3, dispositions “to the issuer” include dispositions to an acquiring company pursuant to a merger or similar transaction. We believe that this clarification should be included in a simple manner, without incorporating all of the procedural requirements of the Skadden letter.

Rule 16b-7

We believe that the proposed changes to Rule 16b-7 are consistent with the statements by the Commission staff in the 1981 Interpretive Release and the Commission’s 1991 amendments to Rule 16b-7 and with the Commission’s amicus brief in *Levy v. Sterling*. Reclassifications are little different in effect from the mergers and consolidations used to implement corporate reorganizations that have been uniformly accepted under Rule 16b-7 as being eligible for exemption from Section 16(b). Reclassifications and similar changes in capital structure do not present opportunities for the type of abuse to which Section 16 is directed. Nevertheless, we believe that the Commission could better accomplish the goal of clarifying the scope of the Rule 16b-7 if the text of Rule 16b-7 were further amended to define the term “reclassification” by redesignating current paragraph (b) as subparagraph (b)(1) and adding a new subparagraph (b)(2) to read as follows:

- (2) A reclassification within the meaning of this section shall include any transaction in which one or more classes or series of a company’s outstanding securities are replaced with securities of a different class or series of securities of a company involved in the reclassification, or the terms of such class or series are changed, through an exchange, conversion, amendment or other action having a similar effect.

No specific conditions for exemption should be required to be satisfied for a transaction to be deemed to be a reclassification. Rather, the term reclassification should be liberally construed in order to effectuate the intent of the exemption. Such a change would preclude a court from misinterpreting the scope of the rule and provide a basis for comfortably relying on the rule in appropriate circumstances.

August 16, 2004

Page 4

Item 405

The proposed amendments to Item 405 are completely appropriate.

* * *

We further urge the Commission to state explicitly in the release adopting the amendments to Rules 16b-3 and 16b-7 that the amendments are simply clarifications of what the rules have always meant, and, accordingly, that the rules as amended are intended to apply to exempt transactions effected before adoption of these clarifying amendments. Such a statement would help to provide certainty for transactions that have been completed in reliance on Commission interpretations.

Again, we wish to thank you for undertaking this rulemaking. We appreciate the opportunity to provide the foregoing comments to the Commission. Members of the Subcommittee on Employee Benefits, Executive Compensation and Section 16 are prepared to meet and discuss the matters addressed in this letter with the Commission and the staff, and to respond to any questions that may arise. Please contact Scott P. Spector at (650) 335-7251 or Anne G. Plimpton at (617) 248-7514, if further information is desired.

Respectfully submitted,

/s/ Dixie L. Johnson

Chair, Committee on Federal
Regulation of Securities

Drafting Committee

Sharon J. Hendricks
Keith F. Higgins
Stanley Keller
Gloria W. Nusbacher
Anne G. Plimpton
Louis Rorimer
Scott P. Spector