U.S. Regulation of the International Securities and Derivatives Markets, § 6.01, INTRODUCTION

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 6.01 (11th and 12th Editions 2014-2017)
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This chapter discusses considerations relevant to directors, officers and major shareholders of public companies in the United States, with a focus principally on foreign private issuers. [1]

Section 6.02 discusses corporate governance requirements applicable to the directors and officers of a foreign private issuer that has registered its equity securities under the Exchange Act.

Section 6.03 discusses disclosure required in an issuer's filings regarding directors, officers and significant shareholders.

Section 6.04 discusses certain U.S. reporting requirements under the Exchange Act, including for:

- shareholders beneficially owning more than 5% of a class of voting equity securities registered pursuant to § 12 of the Exchange Act, §§ 13(d) and 13(g), which are intended to keep investors aware of significant accumulations of shares that may lead to a change in control of an issuer; [2] and
- directors and officers of a U.S. issuer (but not a foreign private issuer) with equity securities registered pursuant to § 12 of the Exchange Act, and for shareholders beneficially owning more than 10% of a class of voting equity issued by such an issuer, § 16(a), which generally requires these "insiders" to report equity trading activity to facilitate enforcement of § 16(b)'s "short-swing" profit recovery provision.

Section 6.05 discusses potential liabilities under the federal securities laws for material misstatements or omissions in disclosure, as well as for insider trading.

Section 6.06 discusses resales by directors, officers and significant shareholders, including "affiliates," of an issuer.

Footnotes

1 *See* § 3.01, Note 1 for a discussion of the definition of "foreign private issuer."

2 The 13(d) shareholder reporting requirements for significant accumulations of shares were added to the Exchange Act by the Williams Act of 1968. Williams Act of 1968, Pub. L. No. 90-439, 82 Stat. 454 (1968).

U.S. Regulation of the International Securities and Derivatives Markets, § 6.02, REQUIREMENTS AFFECTING DIRECTORS AND OFFICERS RELATING TO CORPORATE GOVERNANCE

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The U.S. securities laws impose corporate governance requirements on the directors and officers of a foreign private issuer that has registered its equity

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securities under the Exchange Act. These requirements, which are discussed in detail elsewhere in this book, [3] include:

- Rule 13b2-2 under the Exchange Act, as amended by the SEC to implement § 303 of the Sarbanes-Oxley Act, which prohibits the directors and officers of an issuer, and any person acting at their direction, from taking any direct or indirect action to coerce, manipulate, mislead or fraudulently influence any independent public or certified public accountant in an audit or review of the issuer's financial statements required to be filed with the SEC, if such person knew or should have known (a negligence standard) that such action could, if successful, result in rendering the financial statements materially misleading (*see* § 5.03[5]);
- Rules 13a-15(f) and 15d-15(f) under the Exchange Act, relating to internal control over financial reporting, which is a process designed by, or under the supervision of, an issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles (*see* § 5.04[2]);
- §§ 302 and 906 of the Sarbanes-Oxley Act, which require an issuer's principal executive officer(s) and principal financial officer(s), or persons performing similar functions, to make certain certifications in the issuer's annual report (*see* § 5.04[4]);
- § 402(a) of the Sarbanes-Oxley Act, which prohibits an issuer and its subsidiaries from directly or indirectly extending, maintaining, renewing or arranging for an extension of credit in the form of a personal loan to or for any executive officer or director of the issuer (*see* § 5.05[1]);
- § 304 of the Sarbanes-Oxley Act, which requires the chief executive officer and chief financial officer of an issuer to reimburse it for all bonuses and other incentive-based or equity-based compensation received, as well as all profits realized from sales of issuer securities, in the 12-month period following the first public issuance or filing of reported financial statements that are later restated due to material noncompliance with any financial reporting requirement as a result of misconduct (*see* § 5.05[2]); and
- § 21C of the Exchange Act and § 8A of the Securities Act, as amended by § 1105 of the Sarbanes-Oxley Act, which authorize the SEC, in connection

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with a cease-and-desist proceeding, to issue an order barring any person who has violated § 10(b) of the Exchange Act or § 17(a)(1) of the Securities Act, as applicable, from acting as a director or officer of any issuer "if the conduct of that person demonstrates unfitness to serve as an officer or director" (*see* § 5.05[3]).

Footnotes

3 *See* Chapter 5.

U.S. Regulation of the International Securities and Derivatives Markets, § 6.03, DISCLOSURE IN ISSUER'S FILINGS OF INFORMATION REGARDING DIRECTORS, OFFICERS AND SIGNIFICANT SHAREHOLDERS

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[1] Disclosure in Issuer's Filings of Information Regarding Directors and Officers

A foreign private issuer that is subject to the reporting requirements of the Exchange Act is required to make disclosures relating to the share ownership of its directors and officers and certain compensation matters, including:

- information as to share ownership in the issuer (including ownership of options over shares in the issuer) by the directors and members of its administrative, supervisory or management bodies (*see* § 4.07[9]);
- information concerning the compensation of directors and officers (*see* § 4.07[9]); and
- information regarding related party transactions (*see* § 4.07[10]).

[2] Disclosure in Issuer's Filings of Shareholders That Beneficially Own 5% or More of the Issuer's Shares or Control the Issuer

An issuer registering a public offering under the Securities Act [4] or registering or filing an annual report under the Exchange Act [5] (for example, in connection with a U.S. exchange listing) is required to name each owner known to it of 5% or more of its voting securities [6] and persons controlling the issuer, together with certain other information related to control. [7]

Rule 12b-2 under the Exchange Act defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise." [8]

As this definition suggests, the determination of whether "control" of one person or company by another exists is essentially factual in nature, rather than legal. The analysis looks to the dynamics and functional realities of each situation, rather than to formal legal structures or arrangements. It is clear that majority share ownership is not required for control. There are cases where, for one purpose or another, control has been found to exist at relatively low share ownership levels, although generally not below 10%. [9]

Share ownership is not the only consideration in determining whether control exists. Other relevant factors, which might militate for or against a finding of control, include:

- whether the shareholder is, or has the right to be, represented on the issuer's board of directors as well as any key committees of the issuer's board;
- whether any officers of the issuer are designees of the shareholder or have been selected by, or with the concurrence of, the shareholder, and, if so, which officers;
- whether any major policy decisions by the issuer are, as a practical matter, ever precleared by or discussed in advance with the shareholder;

- the nature and volume of any ongoing business and contractual relationships between the shareholder and the issuer;
- whether there are regulatory restrictions on the shareholder's ability to exercise control;
- whether the shareholder could be found to control, or have an ability to influence, the day-to-day activities of the issuer;
- the background of, reasons for and method by which the shareholder obtained its share ownership in the issuer;

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- whether there are other shareholders with a comparable ownership position and, if so, the nature of the relationship among such shareholders; and
- corporate structure, for example, whether there are one or more boards that manage the company, as in Germany.

Footnotes

4 *See* Chapter 3, particularly § 3.02.

5 *See* §§ 3.03[1] and 4.02.

6 *By contrast*, § 13(d) of the Exchange Act applies to beneficial owners of more than 5% of the class.

7 Form 20-F, Item 7. In 1999, the SEC replaced almost all the existing Form 20-F requirements with international disclosure standards adopted by IOSCO in 1998. *See* SEC Release No. 33-7745 (Sept. 28, 1999). The SEC reduced the threshold for disclosure of beneficial ownership from 10% to 5% of each class of the registrant's voting stock and now requires disclosure of significant changes in beneficial ownership by such shareholders over the last three years.

8 Rule 12b-2 under the Exchange Act.

9 *Cf*. Rule 10A-3(e)(1) under the Exchange Act (providing that those persons who are not executive officers or shareholders beneficially owning more than 10% of a class of voting equity securities of an issuer are deemed not to control such entity for purposes of rules implementing § 301 of the Sarbanes-Oxley Act; this safe harbor does not create a presumption that persons outside the safe harbor control an entity, or are affiliates, for which a facts-and-circumstances analysis is appropriate). *See* § 5.02[1][b].

U.S. Regulation of the International Securities and Derivatives Markets, § 6.04, REPORTING AND OTHER REQUIREMENTS APPLICABLE TO SIGNIFICANT BENEFICIAL OWNERS OF SHARES

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[1] Section 13 Reporting Requirements

[a] Scope

Sections 13(d) and 13(g) of the Exchange Act are intended to provide the investing public (and issuers) with information about beneficial ownership of significant blocks of voting securities. [10] Under these provisions, persons who are directly or indirectly beneficial owners of more than 5% of any class of voting equity securities registered under § 12 of the Exchange Act are required to file reports with the SEC. [11] A person is the beneficial owner of a security if he or she has or shares the power to vote or the power to sell the security, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise. [12] Furthermore, a person is deemed the beneficial owner of any shares that he or she has the right to acquire (such as pursuant to the exercise of an option

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or a conversion right) if the right is exercisable within 60 days or was acquired with the purpose or effect of changing or influencing control of the issuer. [13] Accordingly, more than one person can be deemed to beneficially own the same shares.

The beneficial ownership reporting requirements of § 13 of the Exchange Act apply to both U.S. and foreign entities that hold Exchange Act-registered voting equity securities regardless of (i) the issuer's home country, (ii) whether the securities were purchased outside the United States, (iii) whether U.S. jurisdictional means were used in connection with the purchase and (iv) any position reporting obligations that may be incurred in other jurisdictions. For example, a German person or entity that acquires in France more than 5% of the outstanding stock of a French company whose shares are registered under § 12 of the Exchange Act must file, whether or not reporting is also required under French law. In this regard, the U.S. beneficial ownership reporting system is similar to the position reporting systems adopted by many other jurisdictions. [14]

[b] Qualification for Schedule 13G

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Regulation 13D-G under the Exchange Act generally requires each person (or group of persons acting together) [15] acquiring any voting "equity securities" registered under the Exchange Act as a result of which such person or group beneficially owns [16] more than 5% of such securities to file with the SEC, within ten days after the 5% threshold is crossed, a report on Schedule 13D. [17] However, under certain circumstances, investors that have acquired the securities without the purpose or effect of changing or influencing control of the issuer [18] may qualify to file a short-form report on Schedule 13G instead of a Schedule 13D. Utilization of Schedule 13G is available for such passive investments only if such investor (i) has acquired the securities in the ordinary course of its business and is (A) one of the types of entities enumerated in Rule 13d-1(b) under the Exchange Act, which include U.S. banks as defined in § 3(a)(6) of the Exchange Act, registered investment companies and other specified types of U.S. institutional investors, or (B) is a foreign institution that is functionally equivalent to

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one of the specified types of U.S. institutional investors and is subject to a substantially comparable regulatory scheme [19] ((A) and (B) together, a "qualified institutional investor"), or (ii) beneficially owns less than 20% of the outstanding voting equity securities (a "nonqualified passive investor"). [20]

Qualified institutional investors generally need not file their Schedule 13G until 45 days after the end of the calendar year in which the acquisition occurred, and only if they remain above the 5% threshold at the end of the calendar year. [21] Nonqualified passive investors must file their Schedule 13G within the same period as a Schedule 13D would be due, *i.e.*, within ten calendar days of crossing the 5% threshold. [22]

Section 13(d) requires a person to make a filing only if it *acquires* more than 5% of a class of voting equity securities that is already *registered* under the

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Exchange Act. Thus, a person already owning more than 5% of a company at the time the shares are initially registered under the Exchange Act is "grandfathered" and is not required to file a Schedule 13D unless and until such person acquires beneficial ownership of an additional 2% of the outstanding stock in any 12-month period. [23] Any such person beneficially owning more than 5% of a registered class of securities as of the end of a calendar year is, however, required to file a Schedule 13G within 45 days of the end of that year. This right to file a Schedule 13G instead of a Schedule 13D does not require the investor to be passive.

[c] Groups

When two or more persons agree to act together "for the purpose of acquiring, holding, voting or disposing of equity securities," a group will be considered to have been formed and will be considered to own beneficially all the equity securities owned by each member. [24] The touchstone of a group within the meaning of § 13(d) "is that the members combined in furtherance of a common objective." [25] The agreement to act together does not need to be in writing, and the SEC or a court may infer an agreement exists by reason of parallel action, an inquiry that is highly fact-specific. [26] Financial institutions and their subsidiaries

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and affiliates are usually thought to be a group for purposes of filing because of common control. Thus, the holdings of all these entities must be monitored. [27]

[d] Schedule 13D Disclosure Requirements and Amendments

Regulation 13D-G under the Exchange Act generally requires each person (or group of persons acting together) acquiring any voting equity securities registered under the Exchange Act as a result of which such person or group beneficially owns more than 5% of such securities to file with the SEC, within ten days after the 5% threshold is crossed, a report on Schedule 13D. [28] (An acquiror may continue to purchase target securities after the 5% threshold is crossed and

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thus hold significantly in excess of 5% of the target securities by the time it files its report on Schedule 13D.)

Schedule 13D requires, among other things, disclosure of:

- the identity of the acquiror (or each member of the group), including its management, directors and controlling entities;
- the source and amount of funds used to acquire the securities; [29]
- the purpose of the acquisition, including any plans or proposals the acquiror may have for future

purchases or sales of target stock or for any changes in the target management or board of directors or any major corporate transaction affecting control of the target, such as a tender offer or business combination;

- the amount and percentage of target securities held by the acquiror and details about transactions in such securities during the 60 days prior to filing of the Schedule 13D (or, if shorter, for the period since the most recent Schedule 13D filing); and
- the nature of any arrangements to which the acquiror is a party relating to the target's securities.

Documents relating to, among other matters, the financing of the acquisition, any contemplated extraordinary transaction involving the issuer and the transfer or voting of the securities must be filed as exhibits to the Schedule 13D. In practice, the filing prepared in response to these requirements is usually quite long and complex and must be put together carefully. If the issuer of the securities is or becomes the target of a hostile bid by the person filing the Schedule 13D or otherwise, litigation may be instituted by the issuer, another shareholder (in some circumstances) or the SEC challenging the accuracy of the filing, especially the accuracy of statements describing the acquiror's purpose and plans. [30] As a consequence, persons or entities obligated to file often try to preserve as

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much flexibility as possible by describing a wide variety of options. [31] A report on Schedule 13D must be amended "promptly" (which can mean almost "immediately" in some circumstances) in the event of a material change in the information disclosed in the schedule, including a change in or, in the view of the SEC, the selection of one particular purpose from, the previously disclosed options. [32] Any acquisition or disposition of 1% or more of the relevant class of securities is deemed material for this purpose, while a lesser change in percentage holding, or a change in holdings that does not occur as a result of an

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acquisition or disposition (*e.g.*, as a result of issuances or repurchases of shares by the issuer), [33] may be material, depending upon the circumstances. [34]

[e] Schedule 13G Disclosure Requirements and Amendments

Schedule 13G requires much more limited information than Schedule 13D. The principal disclosures required by Schedule 13G include:

- the identity of the holder;
- the basis for its eligibility to use Schedule 13G;
- the amount and percentage of target securities that it holds; and
- the identity of the persons on whose behalf it owns the securities or who compose an acquiring group.

A Schedule 13G filer must amend its Schedule 13G filing within 45 days of the end of each calendar year to reflect any changes, as of that year end, in the information filed in its previous report on Schedule 13G. [35]

In addition, an amendment to a qualified institutional investor's report on Schedule 13G must also be filed within ten days after the end of the first month in which the qualified institutional investor's direct or indirect beneficial ownership interest exceeds 10% of the class of outstanding shares, and thereafter within ten days after the end of any month in which such person's interest, computed at the end of the month, increases or decreases by more than 5% of that class. [36]

In contrast, an amendment to a nonqualified passive investor's report on Schedule 13G must be filed "promptly" if at any time the nonqualified passive investor acquires beneficial ownership of more than 10% of the subject class of securities. [37] After a nonqualified passive investor exceeds the 10% threshold and

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so long as its percentage of beneficial ownership remains below 20%, an additional amendment to the nonqualified passive investor's report on Schedule 13G must also be filed "promptly" to reflect any increase or decrease in beneficial ownership of more than 5% of the class of subject securities. [38]

If a nonqualified passive investor increases its ownership above 20%, it must file a Schedule 13D within ten days and is prohibited from purchasing any additional shares or voting the securities subject to the Schedule 13D filing until ten days after the filing. [39] Similarly, both a qualified institutional investor and a nonqualified passive investor must convert to a Schedule 13D within ten days after their intentions are no longer passive and are prohibited from purchasing any additional shares or voting the securities subject to the Schedule 13D filing until ten days after the filing. [40]

Grandfathered investors reporting on Schedule 13G as a result of their ownership of shares before the class was registered under § 12 of the Exchange Act must convert from reporting on a Schedule 13G to reporting on a Schedule 13D within ten days after they have acquired beneficial ownership of additional shares totaling 2% or more of the outstanding class of securities in any 12-month period, [41] but they do not need to amend their Schedule 13G or file a Schedule 13D merely by reason of a change in their intent or plans.

[f] Electronic Filing Required

The SEC rules mandate electronic filing for foreign private issuers through the SEC's Electronic Data Gathering, Analysis and Retrieval System (known as EDGAR). [42] Accordingly, persons (including non-U.S. persons) required to make filings on Schedule 13D or 13G by virtue of acquisitions or ownership of shares of foreign private issuers may not make such filings on paper, absent a hardship exemption. It should be noted that a person filing a Schedule 13D or 13G must have its own EDGAR codes, which can be obtained by electronically filing a Form ID with the SEC. [43] The SEC will generally provide the codes within two business days of receiving the form.

[2] Section 16 Reporting and Other Requirements Not Applicable to Shareholders of Foreign Private Issuers

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Section 16 of the Exchange Act requires "insiders" of certain issuers that are not foreign private issuers [44] to report their transactions in the issuer's equity securities and to pay or disgorge to the issuer profits (or deemed profits) resulting from "short-swing" trading in the issuer's equity securities. [45] Section 16 is intended to provide "bright-line" rules that do not depend on an insider's possession of material nonpublic information or on the insider's intent. In practice, these bright-line rules present many potential pitfalls.

In general, insiders of issuers that have a class of equity security (whether or not entitled to vote) registered under § 12 of the Exchange Act and that are not foreign private issuers are subject to the requirements of § 16. Non-U.S. persons who are insiders are subject to the same rules as domestic persons who are insiders. Insiders are defined for purposes of § 16 to include officers [46] and directors [47] of an issuer and persons who are "beneficial owners" of more than 10% of a registered class of voting equity securities of an issuer. [48]

Insiders generally must file reports regarding their ownership of, and transactions in, equity securities of the issuer. [49] They are also subject to "short-swing profit recapture" provisions designed to recapture for the benefit of the issuer profits realized on purchases and sales of equity securities within any six-month

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period. [50] Additionally, Section 16(c) prohibits insiders from selling equity securities of a § 12 issuer that the seller does not own (*i.e.*, certain types of short sales). [51]

[a] Section 16(a)

Section 16(a) requires insiders to file reports on Forms 3, 4 or 5, depending upon the nature of the transaction involved. These filings must be made with the SEC and with the issuer. [52]

Within ten days of becoming an insider (or on the effective date of the Exchange Act registration statement for an issuer registering securities under § 12 for the first time— *e.g.*, pursuant to a Form 8-A in an initial public offering), the insider is required to file a report on Form 3 stating the insider's aggregate position in (i) the class of equity securities of the issuer giving rise to its status as an insider and (ii) all other equity securities (whether voting or nonvoting and whether or not registered under the Exchange Act, including derivative securities and rights, contracts or arrangements treated as derivative securities) [53] of that issuer, in each case, as to which such insider has a direct or indirect pecuniary interest. [54]

Subsequent to the initial filing on Form 3, an insider is required to report changes in beneficial ownership of equity securities as to which it has a direct or indirect pecuniary interest on Form 4 or Form 5, depending on the circumstances. [55] Insiders are required to report virtually all of their transactions in an

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issuer's equity securities on a Form 4 before the end of the second business day following the day on which the transaction is executed, [56] although a very limited number may be reported on Form 5 within 45 days following the end of the issuer's fiscal year.

In addition, all Form 3, Form 4 and Form 5 reports must be filed electronically, and issuers that maintain corporate websites must provide the reports electronically to the public not later than the end of the business day following filing. [57] The SEC's rules additionally require, among other things, that issuers with corporate websites make the forms available free of charge, that the forms not be burdensome to access and that they be available for at least 12 months. [58]

An issuer subject to § 16 is required to publicly disclose, generally in its annual proxy statement to shareholders, any failures of an insider to file on a timely basis any reports required under § 16(a) of the Exchange Act. [59] Such disclosure must include the insider's name, the number of transactions either reported late or not reported at all and certain other information.

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In addition, the SEC is empowered, in connection with any reporting failure, to seek civil penalties against an insider, [60] to issue a permanent cease-and-desist order against an insider and to require an accounting of affected transactions and disgorgement of profits to the issuer. [61]

[b] Section 16(b): Short-Swing Profit Recovery Rules

Section 16(b) of the Exchange Act requires insiders to disgorge to an issuer profits realized from purchases and sales of equity securities of the issuer within any six-month period. (As noted above, this section is not applicable to foreign private issuers.) The transactions can occur in any order, *i.e.*, a purchase followed by a sale at a higher price or a sale followed by a purchase at a lower price. In addition, transactions in the actual equity security can be "matched" for these purposes with transactions in derivative securities relating to that equity security. Section 16(b) imposes strict liability on an insider, and an insider's good faith is irrelevant to any determination of liability. Nonetheless, purchases and sales resulting in a duty to disgorge profits are not illegal and do not result in criminal liability or SEC penalties or sanctions. Most § 16(b) claims are initiated by plaintiffs' attorneys who specialize in pursuing such claims.

In calculating "profit" under § 16(b), courts will match the lowest purchase price paid by the insider against the highest sales price received by the insider in any six-month period. As a result, even though an insider may have suffered a net economic loss with respect to a series of transactions effected in issuer securities during a six-month period, the insider may be treated for purposes of § 16(b) as having realized a "profit" recoverable by the issuer. For example, an insider who during any six-month period buys 100 shares of stock at $10, buys another 100 shares at $20 and sells 200 shares at $12 will have a recoverable "profit" as a result of those transactions of

$200 (100 shares sold at $12 less 100 shares bought at $10) notwithstanding that the actual overall economic effect of the insider's transactions during the six-month period was a $600 loss.

[c] Exempt Transactions

There are a small number of transactions that are exempt from § 16(a) reporting and a somewhat larger number of transactions that are exempt from the short-swing profit recovery rules of § 16(b). Many transactions, such as exercises of employee stock options, that are exempt from § 16(b) are nonetheless reportable under § 16(a). Transactions exempt from § 16(b) are not taken into

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account when determining whether a matchable purchase and sale have occurred during any six-month period. As a result, an insider may effect an exempt purchase and a nonexempt sale (or *vice versa*) in a six-month period without incurring liability under § 16(b).

For example, Rule 16b-3 under the Exchange Act generally provides an exemption from § 16(b) for grants, awards or acquisitions of equity securities from the issuer, or dispositions of equity securities to the issuer, provided that the transaction is approved by the board of directors of the issuer or by holders of a majority of the voting securities of the issuer. Rule 16b-6 under the Exchange Act provides an exemption generally for exercises of derivative securities such as options, warrants or convertible securities with exercise or conversion privileges at a fixed price related to an equity security.

For persons who are not officers or directors (including by deputization), but become subject to § 16 because they acquire more than 10% of a class of registered voting equity securities, the transaction that initially takes them over 10% cannot be matched with any sales. Thus, if such an investor does not purchase any additional shares after the transaction that takes it over 10% ownership (which can be a block purchase that takes it significantly over 10%), subsequent sales within six months will not be subject to § 16(b). [62]

Footnotes

10 Sections 13(d) and 13(g) of the Exchange Act apply only to classes of voting equity securities registered under the Exchange Act. They do not apply to equity securities of issuers that must file periodic reports only by reason of § 15(d) of the Exchange Act as a result of having made a U.S. public offering or to foreign companies that furnish information to the SEC pursuant to Rule 12g3-2(b) under the Exchange Act. Moreover, if an issuer has two classes of equity securities, one registered and one not (or one voting and one not), the sections only apply with respect to the registered, voting class. However, if the unregistered (or nonvoting) class is immediately (or within 60 days) convertible into a registered voting class, filing will be required with respect to the securities owned of the unregistered (or nonvoting) class if such securities would, if converted, represent more than 5% of the registered, voting class. *See* Rule 13d-3(d) under the Exchange Act.

11 ADRs are not a separate class of voting equity securities for purposes of § 13(d) or § 13(g) of the Exchange Act. SEC Release No. 33-6894 (May 23, 1991). Thus, a person owning ADRs will be required to file reports under § 13(d) and § 13(g) of the Exchange Act only if the voting equity securities represented by his or her ADRs plus any underlying securities that he or she beneficially owns outside the ADR facility constitute more than 5% of the underlying securities (including those represented by ADRs).

An ADR holder's standing directions to a depositary to vote shares underlying the ADRs in the manner set forth in a deposit agreement do not confer voting power on the depositary. Consequently, the depositary would not be considered the beneficial owner of such shares and no reporting obligations would arise in connection therewith. *See Second National Bank of Warren* (avail. Aug. 15, 1988).

12 The definition of beneficial ownership generally was not interpreted historically to cover most swaps relating to voting equity securities. With the passage of the Dodd-Frank Act, however, §§ 13(d), 13(f) and 13(g) of the Exchange Act expressly include the purchase or sale of security-based swaps, to the extent defined by

rule by the SEC, as one type of beneficial ownership, thereby giving the SEC the authority to adopt rules that would include security-based swaps within the definition of beneficial ownership. *See* § 766 of the Dodd-Frank Act. The SEC has not utilized this authority other than to readopt existing Rules 13d-3 and 16a-1 under the Exchange Act to ensure that persons who purchase or sell security-based swaps after July 16, 2011 remain within the scope of the beneficial ownership rules to the same extent they were covered prior to July 16, 2011. SEC Release No. 34-64628 (June 8, 2011).

The language in Title VII of the Dodd-Frank Act was preceded by case law finding that a holder of derivative instruments could be regarded as a beneficial owner of shares held for hedging purposes by their counterparties where there is a course of conduct regarding the voting or disposition of such shares. *See CSX Corp. v. TCI Fund Management (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), *aff'd in part*, *vacated in part*, 654 F.3d 276 (2d Cir. 2011), which discusses in *dicta* whether the 5% beneficial ownership threshold was met and concomitant § 13(d) reporting requirements were triggered due to the holding of equity swaps, in addition to actual shares, by two hedge funds, which each owned less than 5% of CSX outright, but held equity swap positions with an economic interest equivalent to 8% to 12% of CSX. The court found that the hedge funds were required to file a Schedule 13D because they were a "group," but further noted that the holding of swaps could be considered beneficial ownership because the swap holder could influence the counterparty's voting decisions due to the nature of the equity swap market. The SEC's Division of Corporation Finance wrote an *amicus* letter arguing that beneficial ownership would not arise from holding equity swaps, and that economic incentives and influence were insufficient to provide "voting power" to the holders of the swaps. On appeal, the Second Circuit did not address the question whether a long holder of equity swaps may be deemed to beneficially own the shares purchased by the short party as a hedge; however, one member of the panel addressed in a concurrence the reasons that the long party should not be deemed to beneficially own the shares, because it does not, through the swap, obtain investment or voting power over the shares.

13 Rule 13d-3 under the Exchange Act.

14 For example, both U.K. and non-U.K. persons are required to report large holdings in certain companies pursuant to the U.K. Vote Holder and Issuer Notification Rules set out in Chapter 5 of the Disclosure and Transparency Rules of the U.K. Financial Conduct Authority Handbook of Rules and Guidance. The U.K. system requires reporting of such holdings in U.K. companies whose shares are admitted to trading on an EEA-regulated market or on a U.K.-prescribed market (*e.g.*, AIM) and in other companies incorporated in an European Economic Area state (an "EEA state"), with shares admitted to trading on a regulated market, where the United Kingdom is their home state. A non-EEA company with shares admitted to trading on an EEA-regulated market for which the United Kingdom is its home member state is also subject to these requirements unless its domestic regime is deemed equivalent (presently, the United States, Japan, Israel and Switzerland). Similar requirements arise in other EEA states as a result of implementation of the European Union's Directive of the European Parliament and of the Council on Transparency Obligations of December 15, 2004 (Directive 2004/109/EC), as amended by Directive 2010/73/EU and Directive 2013/50/EU.

15 For a further discussion of groups, *see* § 6.04[1][c].

16 *See* § 6.04[1][a].

17 The *Hart-Scott-Rodino Antitrust Improvements Act* ("HSR Act"), as well as other statutes, may, however, delay purchases above certain levels that, depending on the stock price, may be below or above 5%. *See* § 9.06. Similarly, specific ownership thresholds may be relevant in other contexts, such as in regulated industries (e.g., telecommunications, gaming and energy); pursuant to business combination statutes (*e.g.*, DGCL § 203, which generally prohibits, unless a company has in its charter expressly opted out of the provision, an "interested stockholder"—generally a person beneficially owning 15% or more of a corporation's voting stock or an affiliate or associate of that person—from engaging in a "business combination" for three years following the date on which the person became an interested stockholder); and in connection with review by the Committee on Foreign Investment in the United States ("CFIUS"), which has the authority to review transactions in which a foreign person acquires direct or indirect "control" over a

U.S. company to determine whether national security issues may exist, but generally does not review passive acquisitions of voting securities representing less than 10% of outstanding voting securities (*see* § 9.07).

18 A determination of whether securities were acquired without the purpose or effect of changing or influencing control of the issuer is highly dependent on the attendant facts and circumstances. *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Question 103.11 (July 14, 2016).

19 *See* Rule 13d-1(b)(1)(ii)(J) under the Exchange Act. A foreign institution relying on this rule must certify on Schedule 13G that it is subject to a regulatory scheme that is substantially comparable to the regulatory scheme applicable to its U.S. counterparts and undertake to provide to the SEC information that would otherwise be required if the institution filed on Schedule 13D. This rule is a codification of the pre-2008 practice of the SEC of issuing no-action letters permitting Schedule 13G to be used by certain foreign institutional investors that, except for their nationality, qualified for the form in their capacity as qualified institutional investors. The requirements applicable to qualified institutional investors are less onerous than those applicable to nonqualified passive investors, and qualified institutional investors may file a Schedule 13G (and not convert to filing on Schedule 13D) even if their ownership interest exceeds 20%. *See*, *e.g.*, *National Consumer Cooperative Bank* (avail. Jan. 3, 2011); *Morgan Stanley Smith Barney LLC* (avail. May 29, 2009); *Goldman, Sachs & Co.* (avail. Dec. 30, 2008); *Auction Rate Securities* (avail. Sept. 22, 2008); *Orbis Group* (avail. July 16, 2008); *DnB NOR ASA* (avail. Jan. 9, 2008); *Natixis S.A*. (avail. Oct. 9, 2007); *Mellon Financial Corp*. (avail. Nov. 16, 2006); *Mitsubishi UFJ Financial Group, Inc.* (avail. Jan. 23, 2006); *Citigroup Inc*. (avail. May 27, 2004); *Stichting Pensioenfonds ABP* (avail. May 7, 2004); *CGNU PLC* (avail. Mar. 19, 2002); *Cater Allen International Limited* (avail. Mar. 7, 2001); *Swiss Bank Corp*. (avail. Jan. 17, 1997); *Deutsche Bank AG* (avail. Apr. 9, 1996); *Union Bank of Switzerland* (avail. Nov. 23, 1992); *Ontario Teachers' Pension Plan Board* (avail. May 6, 1992); *Royal Bank of Canada* (avail. Dec. 10, 1990); *B.A.T. Industries plc* (avail. Nov. 26, 1990). Certain foreign governments have also used Schedule 13G as qualified institutional investors. *See*, *e.g.*, *Her Majesty's Government* (avail. Dec. 10, 2008).

20 Rule 13d-1(c) under the Exchange Act.

21 Rules 13d-1(b)(2) and 13d-1(d) under the Exchange Act. Section 13(d) requires a person to make a filing only if it *acquires* more than 5% of a class of equity securities that is already *registered* under the Exchange Act. Similarly, where any holding is increased to more than 5% solely due to the issuer's repurchase of its shares, the holder has not made an acquisition within the meaning of § 13(d) and there is no Schedule 13D filing obligation, although a Schedule 13G is required to be filed within 45 days after the year end. *See Drico Industrial Corp.* (avail. June 25, 1976). This exception from the obligation to file a Schedule 13D is not available to persons who influence or control the change in the aggregate number of outstanding securities, including, but not limited to, officers and directors of the issuer. *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Question 103.08 (Sept. 14, 2009).

22 Rule 13d-1(c) under the Exchange Act.

23 § 13(d)(6)(B) of the Exchange Act. The SEC staff has indicated that the 2% calculation should be based on the number of shares outstanding at the beginning of the 12-month period. *See Refreshment Machinery, Inc.* (avail. June 16, 1975). The SEC staff has provided relief from filing a Schedule 13D where a person purchases shares above the 2% threshold to maintain an existing percentage interest in an issuer, where the purchases were contemporaneous with new issuances and sales to other parties. *See Exxon Corporation* (avail. Dec. 13, 1989); *Coca-Cola Co.* (avail. Dec. 12, 1991).

24 § 13(d)(3) of the Exchange Act; Rule 13d-5(b) under the Exchange Act.

25 *Wellman v. Dickinson*, 682 F.2d 355, 363 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983); *see also Roth v. Jennings*, 489 F.3d 499 (2d Cir. 2007).

26 *See*, *e.g.*, *SEC v. Savoy Industries, Inc.*, 587 F.2d 1149 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979); *CSX Corp. v. TCI Fund Management (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), *aff'd in part*, *vacated*

in part, 654 F.3d 276 (2d Cir. July 18, 2011) (the district court found that a group was formed based on concerted investment action in a highly fact-specific analysis; the Second Circuit remanded the question of group formation for further review); *GAF Corp. v. Milstein*, 453 F.2d 709 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972) (finding a group may be formed without any accompanying agreement to acquire additional securities); *Dreiling v. America Online, Inc.*, 578 F.3d 995 (9th Cir. 2009) (finding no group existed where there was no probative evidence suggesting that there ever was an agreement by the parties to act together to acquire, hold, vote or dispose of the subject stock). Evidence of a pre-existing relationship is inadequate by itself to prove the formation of a group. *See*, *e.g.*, *Bayly Corp. v. Marantette*, Fed. Sec. L. Rep. (CCH) ¶98,834 (D.D.C. Oct. 19, 1982). Moreover, action with respect to particular securities must proceed beyond preliminary discussions to actual agreement to act in concert. *See*, *e.g.*, *Lane Bryant, Inc. v. Hatleigh Corp.*, Fed. Sec. L. Rep. (CCH) ¶97,529 (S.D.N.Y. June 9, 1980). *See also Morales v. Quintel Entertainment, Inc*., 249 F.3d 115 (2d Cir. 2001), in which the Second Circuit held that it was a triable issue of fact whether an individual owner, Richard Morales, of less than 2.5% of the common stock of a publicly traded corporation, Quintel, was the "beneficial owner" of more than 10% of such stock by reason of the existence of a "group" of three shareholders for purposes of § 13(d), and therefore had liability under § 16(b). In vacating the district court's decision in part and remanding the case to it, the Second Circuit found, as evidence of the existence of such a group, that the three shareholders had entered into a sales agreement to sell their interest in a closely held corporation in exchange for the issuance of Quintel common stock (though not necessarily for the purpose of acquiring control of Quintel); that such agreement contained lock-up provisions governing the holding and disposal of Quintel common stock; that all three shareholders had deposited their holdings in identical trusts naming the same person as trustee; and that Quintel had redeemed the holdings of all three shareholders together on the same day. In addition, the Second Circuit noted that, although they had disclaimed beneficial ownership of the others' shares in such filing (but not in filings made by Morales on Forms 4 and 5), the three had jointly filed a single Schedule 13D. *But see Lowinger v. Morgan Stanley & Co. LLC*, 841 F.3d 122 (2d. Cir. 2016) (finding an ordinary course lock-up agreement between shareholders and underwriters in connection with Facebook, Inc.'s initial public offering did not result in the formation of a group); *see also Chechele v. Scheetz*, 819 F. Supp. 2d 342 (S.D.N.Y. 2011), *aff'd*, 466 F. App'x 39 (2d Cir. 2012).

27 The SEC has clarified that in cases where appropriate information barriers are in place between business units, divisions or subsidiaries within a group, thereby allowing for the independent exercise of voting and investment powers by the party holding the securities, the attribution of beneficial ownership from the holding party to parties on the other side of the barrier may not be required. The determination as to the independent exercise of voting and investment powers is based on facts and circumstances, but the SEC has indicated that written policies and procedures reasonably designed to prevent the flow of information relating to voting and investment between the relevant parties should be maintained and enforced. These policies and procedures should also be subject to an annual, independent assessment as to their effectiveness. In addition, the separation of the parties must not be "artificial"— *e.g.*, the parties should not participate in a common compensation pool that may result in the alignment of voting and investment decisions between them. Finally, the parties on the other side of the barrier should not have any officers, directors or employees involved in the exercise of the holding party's voting and investment powers. In this regard, the SEC has stated that the existence of an independent investment committee would be evidence of an effective separation between the parties. *See* SEC Release No. 34-39538 (Jan. 12, 1998); *Goldman Sachs Group, Inc.* (avail. Mar. 30, 2001).

28 Title IX of the Dodd-Frank Act gives the SEC rulemaking discretion to shorten the current ten-day reporting time period under Schedule 13D, which it has not elected to exercise to date. In addition, the Dodd-Frank Act amended § 13(d) of the Exchange Act such that the filer is no longer required to mail copies of the filings to the issuer or relevant national securities exchange.

29 In the case of funds loaned in the ordinary course of business by a bank operating under the laws and supervision of bank regulators of the United States or any state, the name of the bank will not be made available to the public if the acquiror at the time of filing of the Schedule 13D so requests in writing and files

such request, naming such bank, with the SEC. Schedule 13D, Item 3; § 3(a)(6) of the Exchange Act; *see also* Item 1007(d) of Regulation M-A under the Securities Act, which allows for the same relief in the business combination context. An acquiror must, however, disclose the identity of any foreign bank providing funds used to acquire the securities.

30 *See* Schedule 13D, Item 4; *see also* Item 1006(c) of Regulation M-A under the Securities Act, which contains substantially similar provisions in the business combination context. The failure to accurately amend a report to describe new intent on Schedule 13D could also lead to violations of state law. *See NACCO Industries*, *Inc. v. Applica Inc.*, 997 A.2d 1 (Del. Ch. 2009) (allowing a fraud claim under state law where an investor filed a Schedule 13D including an allegedly misleading statement on a change in the intent of the investment, stating that its intent was for investment, while accumulating a large stake in anticipation of a takeover bid). The U.S. Court of Appeals for the Seventh Circuit has found a private right of action relating to a Schedule 13D exists in favor of shareholders only in the context of a tender offer or aggregation of shares for the purpose of controlling the issuer. *See Edelson v. Ch'ien*, 405 F.3d 620 (7th Cir. 2005); *see also Motient Corp. v. Dondero*, 529 F.3d 532 (5th Cir. 2008); *E.On AG v. Acciona, SA*, 468 F. Supp. 2d 537 (S.D.N.Y. 2006).

31 For example, investors might disclose their intention as follows: to review their investment in the issuer on a continuing basis, and increase or decrease their investment in the issuer depending upon the price and availability of the securities, subsequent developments affecting the issuer, the issuer's business and prospects, other investment and business opportunities available to the investors, general stock market and economic conditions, tax considerations and other factors. The SEC staff has indicated that generic disclosure must be amended when the security holder has formulated a specific intention with respect to one of the matters enumerated in Item 4(a)-(j). *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting, Question 110.06 (Sept. 14, 2009).

32 The SEC has taken enforcement action that illustrates its construction of the requirement to amend "promptly" reports on Schedule 13D. *See SEC v. Edelman*, SEC Litigation Release No. 12835 (Apr. 11, 1991). For example, on Sunday, September 10, 1989, Asher Edelman established a plan to buy additional stock of Datapoint Corporation. He purchased shares on the following Monday and Tuesday and amended his Schedule 13D the next day. Subsequent comments by the SEC staff suggested that Mr. Edelman may have been obligated to amend his outstanding Schedule 13D (which stated that he would review his holdings in Datapoint from time to time) as early as the morning following his formulation of a plan to purchase more Datapoint shares. Kevin G. Salwen, *Edelman Named In SEC Action On 1989 Plan*, WALL ST. J., Apr. 12, 1991; *see also In the Matter of Cooper Laboratories Inc.*, SEC Release No. 34-22171 (June 26, 1985).

A change in intent triggers an obligation to amend Schedule 13D. A "plan or proposal," as those terms are used in Item 4 of Schedule 13D, arises upon formulation of a specific intention, not only once a formal agreement has been signed or a tender offer launched. *See In the Matter of Tracinda Corp.*, SEC Release No. 34-58451 (Sept. 3, 2008). Tracinda Corporation proposed selling 28 million shares of General Motors Corporation to a broker-dealer on November 20, 2006, but only sold 14 million shares because the bid offered by the broker-dealer for the full 28 million shares represented a deeper discount than Tracinda was willing to accept. On November 22, 2006, Tracinda amended its 13D reporting the sale of 14 million shares, but omitted to disclose its plan and proposal to sell the 28 million shares. On November 28, 2006, Tracinda sold an additional 14 million shares of GM stock. This sale reduced its holdings in GM to 4.95%. On November 30, 2006, Tracinda sold its remaining shares of GM stock. The SEC found violations of § 13(d)(2) of the Exchange Act and Rules 12b-20 and 13d-2(a) thereunder and Tracinda was ordered to cease and desist from committing or causing any violations, and any future violations, of such provisions and rules.

33 *See Darco Asso. Calny Food Services, Inc.* (avail. May 6, 1979).

34 Rule 13d-2(a) under the Exchange Act. The requirement to amend "promptly" reports on Schedule 13D creates problems for filers disposing of a material block of the class of subject securities. In such cases, difficulty may arise because of the tension between the requirement of the seller to file an amendment

promptly and the desire of the block positioner to delay the filing until the sale is completed. *See supra* Note 33.

35 Rule 13d-2(b) under the Exchange Act. An amended Schedule 13G must only be filed if there are changes as of the end of the calendar year, and no amendment is required if there is a change in the percent of the class outstanding previously reported if the change results solely from a change in the aggregate number of securities outstanding.

36 Rule 13d-2(c) under the Exchange Act.

37 Rule 13d-2(d) under the Exchange Act. The requirement to file "promptly" is the same standard that applies to amendments to reports on Schedule 13D.

38 Rule 13d-2(d) under the Exchange Act.

39 Rule 13d-1(f) under the Exchange Act.

40 Rule 13d-1(e) under the Exchange Act.

41 § 13(d)(6)(B) of the Exchange Act. The SEC staff has indicated that the 2% calculation should be based on the number of shares outstanding at the beginning of the 12-month period. *See Refreshment Machinery, Inc.* (avail. June 16, 1975); *Exxon Corporation* (avail. Dec. 13, 1989); *Coca-Cola Co.* (avail. Dec. 12, 1991); *Stolt Tankers and Terminals (Holdings) S.A.* (avail. Mar. 12, 1992).

42 *See* SEC Release No. 33-8099 (May 14, 2002) and § 4.02[3][b][i], for a further discussion of EDGAR.

43 *See generally* Regulation S-T under the Securities Act. The Form ID must be filed by completing an online form *available at* https://www.filermanagement.edgarfiling.sec.gov. The SEC does not accept submissions of Form ID by mail.

44 *See* Rule 3a12-3 under the Exchange Act.

45 *See* Peter J. Romeo & Alan L. Dye, SECTION 16 TREATISE AND REPORTING GUIDE (4th ed. 2012) for a comprehensive treatment of § 16 of the Exchange Act.

46 For purposes of § 16, an "officer" is defined to include the president of an issuer, its principal financial and accounting officers or controllers, any other individual who is a vice president in charge of a principal business unit, division or function of the issuer and any other individual who performs a policy-making function for the issuer. *See* Rule 16a-1(f) under the Exchange Act. A person may be an officer for these purposes without regard to that person's title or formal position.

47 A "director" is, in general, any director of a corporation. § 3(a)(7) of the Exchange Act. However, an "honorary director" or "director emeritus" may be deemed to be a director for purposes of § 16 of the Exchange Act, depending on the person's authority, responsibility and access to inside information. *See* SEC Release No. 34-28869 (Feb. 8, 1991); SEC Release No. 34-26333 (Dec. 2, 1988); SEC Release No. 34-18114 (Sept. 24, 1981). A shareholder of an issuer may be deemed to be a director of the issuer if the corporation "deputizes" a representative to occupy the shareholder's position on the board of directors of the issuer, *i.e.*, designates one of its representatives to be a director of the issuer. The shareholder is subject to disgorgement under § 16(b) if it trades, even if the director it designated has not engaged in any trading. *See Blau v. Lehman*, 368 U.S. 403 (1962); *Feder v. Martin Marietta Corp.*, 406 F. 2d 260 (2d Cir. 1969), *cert. denied*, 396 U.S. 1036 (1970).

48 The determination of whether a person is a 10% beneficial owner of an issuer is based on the beneficial ownership provisions of § 13(d) of the Exchange Act discussed above. *See* Rule 16a-1(a)(1) under the Exchange Act; § 6.04[1][a].

49 § 16(a) of the Exchange Act.

50 § 16(b) of the Exchange Act.

51 *But see* Rule 16c-4 under the Exchange Act, which exempts certain short positions that are fully covered through ownership of the underlying equity positions. §§ 16(d), 16(e), 16(f) and 16(g) describe the application of §§ 16(a), 16(b) and 16(c) to certain types of transactions.

52 Rule 16a-3 under the Exchange Act.

53 In general, the term "equity security" is defined very broadly for most purposes of § 16, and includes instruments that may not be considered securities for other purposes of the Exchange Act. In addition to common stock, the term "equity securities" includes derivative securities, such as options to acquire stock and debt convertible into stock, as well as other contracts, rights or arrangements the value of which is based on the value of equity securities, including equity swap contracts and certain rights that are typically awarded in connection with executive compensation arrangements.

54 The term "pecuniary interest" means, generally, an economic interest. A pecuniary interest may arise from a direct holding of an equity security, from an indirect interest in a security through a corporation, partnership or trust (of which the insider is a trustee, a settlor or a beneficiary), from equity securities held by certain family members or from equity securities held by an investment partnership from which the insider is entitled to a performance-related management fee. Rule 16a-1(a)(2)(i) under the Exchange Act.

55 The Sarbanes-Oxley Act shortened the period for the reporting of most insider transactions from ten days following the end of the month in which they transpire to within two business days following their occurrence. *See* § 6.04[2]. The Sarbanes-Oxley Act did not amend the ten-day reporting rule applicable to insiders initially becoming subject to § 16 reporting obligations. *See* § 16(a)(2) of the Exchange Act; Form 3. However, Title IX of the Dodd-Frank Act gives the SEC rulemaking discretion to shorten the current ten-day reporting time period for initial reporting.

56 The SEC has established two limited exceptions to the two-day rule to cover circumstances where the insider does not select the date of the execution of the transaction. The first exception covers transactions pursuant to a contract, instruction or written plan for the purchase or sale of issuer securities that satisfies the conditions of Rule 10b5-1(c) under the Exchange Act. These conditions set out an affirmative defense to insider trading liability under Rule 10b-5 where an insider enters into a written plan to engage in nondiscretionary securities transactions before becoming aware of relevant material nonpublic information. *See* § 11.05[2][a][i]. The second exception covers "discretionary transactions" (as defined by Rule 16b-3(b)(1) under the Exchange Act) involving an employee benefit plan, whether or not exempted by Rule 16b-3 under the Exchange Act (which exempts certain transactions from § 16(b) liability). In these cases, the date of execution (triggering the two-day filing deadline) is deemed to be the date the executing broker, dealer or plan administrator notifies the insider of the execution, except that if the notification occurs later than the third business day following the actual trade date of the transaction, then the deemed date of execution is that third business day. The SEC has noted that it expects insiders to make arrangements with executing entities to provide such notification as quickly as feasible and has urged executing entities to provide such information either electronically or by telephone and not to rely on mailed confirmations. *See* SEC Release No. 34-46421 (Aug. 27, 2002).

57 § 16(a)(4) of the Exchange Act.

58 *See* Rule 16a-3(k) under the Exchange Act; SEC Release No. 33-8230 (May 7, 2003). In order to facilitate the easy filing of Forms 3, 4 and 5 by individuals, the SEC established a separate website, https://www.onlineforms.edgarfiling.sec.gov, dedicated exclusively to the on-line creation and submission of the forms. It also adopted a rule providing that direct transmission of the forms through the website on or before 10:00 P.M. Eastern time on a business day will result in the forms being deemed filed on that day. The forms may not be filed via the traditional means of EDGARLink. *See* SEC Release No. 33-8224 (Apr. 30, 2003); SEC Release No. 33-8230 (May 7, 2003).

59 Item 405 of Regulation S-K under the Securities Act.

60 § 32 of the Exchange Act.

61 § 21C of the Exchange Act.

62 *See* Rule 16a-2 under the Exchange Act; *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232 (1976).

U.S. Regulation of the International Securities and Derivatives Markets, § 6.05, POTENTIAL LIABILITY FOR MATERIAL MISSTATEMENTS OR OMISSIONS AND INSIDER TRADING

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 6.05 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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Directors, certain executive officers and controlling shareholders, as well as any selling shareholders, may be liable for materially deficient disclosure, including disclosure contained in registration statements filed under the Securities Act and the Exchange Act and offering documents used in private placements. [63]

In addition to potential liability for material misstatements or omissions in disclosure, U.S. securities laws—specifically § 10(b) of the Exchange Act and Rule 10b-5 and the extensive case law thereunder—prohibit trading by certain persons while knowingly in possession of material nonpublic (*i.e.*, "inside") information in connection with the purchase or sale of securities. [64]

Footnotes

63 *See* § 11.03.

64 *See* § 11.05[2][a]. Issuers commonly adopt insider trading policies that impose "black-out periods," during which trading in issuer securities by directors, officers and other employees is prohibited, to prevent such persons from trading while they may be in possession of material nonpublic information.

U.S. Regulation of the International Securities and Derivatives Markets, § 6.06, RESTRICTIONS ON RESALES BY DIRECTORS, OFFICERS AND SIGNIFICANT SHAREHOLDERS OF THE ISSUER

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 6.06 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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[1] Resales of Securities by Affiliates

U.S. law, and contractual arrangements entered into in connection with U.S. public offerings, can restrict the resale of an issuer's securities by its directors, executive officers and significant shareholders.

Resales of securities by "affiliates" of the issuer are restricted under the U.S. securities laws, even when the issuer is public in the United States and has listed securities there. A person is an "affiliate" of an issuer if it directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with the issuer. Rule 405 under the Securities Act defines control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise." [65] An issuer's directors, executive officers and significant shareholders (*e.g.*, those holding at least 10% of the outstanding equity securities) are generally considered to be its affiliates.

Offers and sales of an issuer's securities by an affiliate of the issuer may not be made in the United States unless: (i) prior to their offer and sale, the securities have been registered with the SEC under the Securities Act or (ii) the affiliate's offers and sales of the securities are made pursuant to an exemption from these registration requirements. As a practical matter, the most frequently used exemptions involve sales of limited numbers of shares through transactions under Rule 144 under the Securities Act, [66] resales under Rule 144A under the Securities Act [67] and private placements. [68]

As indicated in Chapter 3, the issuer itself must register any of its securities that are to be sold in the United States pursuant to a registration statement filed with the SEC, even resales by shareholders. Because shareholders may not always be able to cause an issuer to register their securities under the Securities Act for resale purposes, even where they are deemed to "control" the issuer for purposes of determining whether they are affiliates for U.S. securities law purposes, substantial shareholders sometimes negotiate with issuers in order to obtain specific contractual rights with respect to registration of the shareholders' securities in order to permit their public sale. Such registration rights generally

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take the form of the issuer's commitment to (i) prepare a "shelf registration statement" registering the sale of the shares, (ii) register the sale of the shares within a specified period, upon demand (generally referred to as "demand rights"), or (iii) include the shareholder's shares as one portion of any contemplated sale involving the filing of a registration statement within a specified period. The third category is usually referred to as "piggyback rights" because the shareholder's offering is, in a sense, carried along as part of the primary offering contemplated by the issuer or a secondary offering by another shareholder. [69]

Affiliates also may sell securities of the issuer in a transaction that takes place outside the United States and complies with Regulation S under the Securities Act. [70]

[2] Lock-Ups in Connection with Offerings of Shares by the Issuer

In connection with securities offerings, directors, officers and shareholders are often required to enter into lock-up agreements with the underwriters of the offering in order to facilitate an orderly trading market following the completion of the offering. [71] In an initial public offering, all or nearly all of the existing shareholders typically will be required to enter into lock-up agreements with the representative(s) for the underwriters. In a follow-on offering, typically only the selling shareholders or those with a separate contractual obligation to do so (*e.g.*, pursuant to a shareholders' agreement) enter into lock-up agreements. Shareholders' agreements and registration rights agreements often include a commitment by the shareholders to enter into lock-up agreements in connection with securities offerings.

[3] Prohibition of Insider Trades During Certain Plan Blackout Periods

Section 306(a) of the Sarbanes-Oxley Act, and Regulation Blackout Trading Restriction ("Regulation BTR") adopted by the SEC to clarify the operation of § 306(a), prohibit directors and executive officers of an issuer from, directly or indirectly, purchasing, selling or otherwise acquiring or transferring any equity security of an issuer that was acquired in connection with the director's or

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executive officer's service or employment in such capacity [72] during a pension plan blackout period that prevents plan participants or beneficiaries from engaging in issuer equity securities transactions. [73] Although not the exclusive remedy, any profit realized by a director or executive officer from any transaction in equity securities of an issuer in violation of § 306(a) is recoverable by the issuer, regardless of the intention of the director or executive officer. [74] In addition, § 306(a) and Regulation BTR require issuers to provide notice of blackout periods to affected officers and directors, as well as to the SEC, and specify the content and timing of that notice. [75]

[a] Applicability to Foreign Private Issuers

Regulation BTR provides that § 306(a) of the Sarbanes-Oxley Act applies to equity securities transactions by directors and executive officers of a foreign private issuer only if (i) 50% or more of the participants or beneficiaries in individual account plans [76] maintained by the issuer [77] who are located in the United States are subject to a blackout period and (ii) either (a) the affected employees

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located in the United States represent more than 15% of the total number of employees of the foreign private issuer and its consolidated subsidiaries worldwide or (b) more than 50,000 participants or beneficiaries located in the United States are affected.

[b] Definition of Blackout Period and Exceptions

A blackout period is any period of more than three consecutive business days during which the ability of not fewer than 50% of the participants or beneficiaries located in the United States under all individual account plans maintained by an issuer (and certain 80% or more commonly controlled entities) to purchase, sell or otherwise acquire or transfer an interest in any equity security of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan. [78] Section 306(a)(4)(B) of the Sarbanes-Oxley Act and Rule 102 of Regulation BTR expressly exclude from the definition of "blackout period" (i) certain regularly scheduled blackout periods and (ii) any suspension imposed solely in connection with the commencement or termination of participation in an individual account plan by reason of a corporate merger, acquisition, divestiture or similar transaction involving the plan or the plan sponsor.

[c] Persons Subject to the Trading Prohibition

With respect to foreign private issuers, the term "director" is defined as any director who is a "management employee" of the foreign private issuer, thus excluding outside directors and non-management employee directors. [79] The term "executive officer" is defined, with respect to foreign private issuers, as the principal executive officer or officers, the principal financial officer or officers and the principal accounting officer or officers. [80]

[d] Securities Subject to the Trading Prohibition

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Section 306(a) applies to any equity securities of an issuer other than an exempt security (as defined in § 3(a)(12) of the Exchange Act). Regulation BTR defines "equity security of the issuer" to include any equity security or derivative security relating to an issuer, whether or not issued by that issuer. [81] As a result, § 306(a) applies to options, warrants and exchangeable securities issued by third parties. Regulation BTR defines "derivative security" by reference to Rule 16a-1(c) under the Exchange Act. [82]

[e] Exempt Transactions

Rule 101(c) of Regulation BTR exempts from the trading prohibition certain categories of transactions that occur automatically, are made pursuant to an advance election or are otherwise outside the control of the director or executive officer, including, among others, (i) acquisitions of equity securities under certain dividend or interest reinvestment plans, (ii) purchases or sales of equity securities under so-called "10b5-1 plans" [83] in certain circumstances, (iii) purchases or sales of equity securities made under certain tax-qualified employee benefit plans (other than discretionary transactions), (iv) compensatory grants and awards of equity securities pursuant to programs under which grants occur automatically, (v) exercises, conversions or terminations of certain derivative securities which, by their terms, occur only on a fixed date or are exercised, converted or terminated by a counterparty not subject to influence by the director or executive officer and (vi) increases or decreases in equity securities holdings resulting from a stock split, stock dividend or *pro rata* rights distribution.

Footnotes

65 Rule 405 of Regulation C under the Securities Act.

66 *See* § 7.04[2].

67 *See* § 7.04[1]. A resale under Rule 144A would not be available, however, for shares of the same class as shares listed on a U.S. securities exchange unless the resale shares were issued prior to the listing. § 7.02[3][b].

68 *See* § 7.04[3].

69 *See generally* § 7.05 for a discussion of private offerings with registration rights.

70 *See* Chapter 8. This option may be much more limited in the case of a U.S. issuer, as the requirements of Regulation S applicable to offshore sales of securities of U.S. issuers generally are much more restrictive than the requirements applicable to offshore sales of securities of foreign private issuers.

71 *See* § 3.02[5][d]. Such lock-up agreements are generally not deemed to create a "group" for purposes of § 13(d) of the Exchange Act. *See Lowinger v. Morgan Stanley & Co. LLC*, 841 F.3d 1224 (2d. Cir. 2016).

72 Equity securities sold or otherwise transferred during a blackout period by a director or executive officer of an issuer will be considered to have been acquired in connection with service or employment as a director or executive officer to the extent that the director or executive officer owned such securities at the time of the transaction, unless he or she establishes that the equity securities were not so acquired. To establish this defense, a director or executive officer must specifically identify the origin of the equity securities in

question and demonstrate that this identification of the equity securities is consistent for all purposes related to the transaction (such as tax reporting and any applicable disclosure and reporting requirements). Rule 101(b) of Regulation BTR under the Exchange Act; SEC Release No. 34-47225 (Jan. 22, 2003).

73 § 306(a)(1) of the Sarbanes-Oxley Act; Rule 101 of Regulation BTR under the Exchange Act. *See* § 5.05[7] for a discussion of issuer-adopted policies restricting directors, officers and certain other employees from trading during specified periods.

74 Rule 103 of Regulation BTR under the Exchange Act.

75 § 306(a)(6) of the Sarbanes-Oxley Act; Rule 104 of Regulation BTR under the Exchange Act. In the case of a foreign private issuer, notice to the SEC will be considered timely if provided as an exhibit to the first annual report on Form 20-F filed after such notice is given to the affected officers and directors or, as encouraged by the SEC, furnished earlier on Form 6-K.

76 The definition of "individual account plan" in Rule 100(j) of Regulation BTR under the Exchange Act is based on § 3(34) of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, as amended ("ERISA"), and includes retirement plans providing for individual accounts for each participant that provide benefits based solely upon amounts contributed to the account and any earnings and losses (and would include 401(k) plans, profit sharing plans and stock bonus plans). It does not include one-participant plans or plans in which only directors may participate.

77 The SEC has clarified that, for purposes of calculating the 50% threshold, individual account plans "maintained by the issuer" include individual account plans in which participants or beneficiaries held or could hold equity securities of the issuer, and would include account plans that (i) permit participants to invest their plan contributions in equity securities of the issuer, (ii) provide for an "open brokerage window" that permits participants to invest in the equity securities of any publicly traded company, including the issuer, (iii) match employee contributions with equity securities of the issuer or (iv) reallocate forfeitures that included equity securities of the issuer to remaining plan participants, whether or not the plan actually contains equity securities of the issuer at the time of the calculation. SEC Release No. 34-47225 (Jan. 22, 2003).

78 Rule 100(b)(3)(ii) of Regulation BTR under the Exchange Act excludes individual account plans maintained outside the United States primarily for the benefit of nonresident aliens.

79 Rule 100(c)(2) of Regulation BTR under the Exchange Act.

80 Rule 100(h)(2) of Regulation BTR under the Exchange Act. This definition and the definition of "director" in Rule 100(c)(2) are intended to assist foreign private issuers in identifying the individuals who are subject to § 306(a) and ensure that § 306(a) does not apply to lower-level employee representatives or nonemployee directors who may be on the boards of directors of foreign private issuers. SEC Release No. 34-46778 (Nov. 6, 2002).

81 Rule 100(f) of Regulation BTR under the Exchange Act. Rule 100(e) of Regulation BTR refers to the definition of "equity security" set out in § 3(a)(11) of the Exchange Act and Rule 3a11-1 thereunder. In the case of foreign private issuers, this includes American Depositary Shares ("ADSs") evidenced by ADRs.

82 Rule 100(d) of Regulation BTR under the Exchange Act.

83 *See* § 11.05[2][a] for a discussion of 10b5-1 plans.