

of, or following the completion of, the transaction, the securities will be considered "acquired in connection with service or employment as a director or executive officer" to the extent that they are received in respect of equity securities of the target entity that were "acquired in connection with service or employment as a director or executive officer" of the target entity.<sup>65</sup> For example, where an executive officer of a target entity becomes an executive officer of the acquiring entity in connection with a business combination and, in the transaction, receives equity securities of the acquiring entity in respect of equity securities of the target entity that he or she owned, the equity securities received will be considered "acquired in connection with service or employment as a director or executive officer" only to the extent that they are received in respect of securities that were previously "acquired in connection with service or employment as a director or executive officer" of the target entity.

(b) *Service or Employment Presumption.*

To simplify identification of equity securities involved in a disposition subject to the trading prohibition of Section 306(a)(1) of the Act and to prevent evasion of the trading prohibition, we proposed an irrebuttable presumption that any equity securities sold or otherwise transferred during a blackout period were "acquired in connection with service or employment as a director or executive officer" to the extent that a director or executive officer owned such securities at the time of the transaction, without regard to the actual source of the securities. One commenter supported the proposed presumption, citing the difficulty in tracing the actual source of the securities disposed.<sup>66</sup> However, most commenters opposed the presumption, asserting that because it would treat all equity securities held as fungible, it would act as an absolute bar on sales or other dispositions during a blackout period, regardless of how the securities actually were acquired.<sup>67</sup> Some commenters indicated that, because a violation of Section 306(a)(1)

is not limited to a private action for profit recovery, an irrebuttable presumption would potentially expose directors and executive officers to civil and criminal penalties.<sup>68</sup> They argued that the proposed presumption would effectively erase the "acquired in connection with service or employment as a director or executive officer" requirement from Section 306(a) of the Act.

These commenters encouraged us to permit directors and executive officers to specifically identify, or "trace," the source of equity securities sold or otherwise transferred during a blackout period to establish that the transaction did not involve securities "acquired in connection with service or employment as a director or executive officer." They pointed out that because "tracing" is permitted under both the Internal Revenue Code<sup>69</sup> and some federal securities laws,<sup>70</sup> it would not impose an undue burden on directors and executive officers.

We are persuaded by these comments that an irrebuttable presumption is unnecessary. Accordingly, new Rule 101(b) of Regulation BTR<sup>71</sup> provides that any 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 "acquired in connection with service or employment as a director or executive officer." To establish this defense, a director or executive officer must specifically identify the origin of the equity securities in question (which must not be "acquired in connection with service or employment as a director or executive officer" as defined in new Rule 100(a)), 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).<sup>72</sup>

For example, if an executive officer owned 1,000 shares of an issuer's

common stock, 250 shares of which were acquired as the result of the exercise of an employee stock option, a sale of 250 shares of common stock during a blackout period will be treated as a sale of the option shares and, therefore, subject to the Section 306(a) trading prohibition, unless the executive officer establishes a different source of the shares sold and this identification is consistent for all purposes related to the transaction (such as tax reporting and any applicable disclosure and reporting requirements).

(c) *Transitional Situations.*

Except as provided in new Rule 100(a), equity securities acquired by an individual before he or she becomes a director or executive officer are not "acquired in connection with service or employment as a director or executive officer" for purposes of Section 306(a) of the Act. Thus, equity securities acquired under a compensatory plan, contract, authorization or arrangement while an individual is an employee, but not a director or executive officer, will not be subject to the Section 306(a) trading prohibition. However, equity securities acquired by an employee before becoming a director or executive officer will be considered "acquired in connection with service or employment as a director or executive officer" if the equity securities are part of an inducement award.<sup>73</sup>

In contrast, equity securities acquired by an individual in connection with service or employment as a director or executive officer before an entity becomes an "issuer" (as defined in Section 2(a)(7) of the Act and new Rule 100(k)) are considered "acquired in connection with service or employment as a director or executive officer" for purposes of Section 306(a) and Regulation BTR and are subject to the statutory trading prohibition. Similarly, equity securities acquired by a director or executive officer in connection with his or her service or employment as a director or executive officer of an "issuer" (as defined in Section 2(a)(7) of the Act and new Rule 100(k)) before the effective date of Section 306(a) are subject to that section and Regulation BTR.

(d) *Exempt Transactions.*

Because some transactions by a director or executive officer involving issuer equity securities do not present the concerns that Section 306(a) of the Act is intended to remedy, we are adopting new Rule 101(c) of Regulation BTR,<sup>74</sup> which exempts from the statutory trading prohibition:

<sup>73</sup> See the discussion in Section II.B.4.a above.

<sup>74</sup> 17 CFR 245.101(c).

<sup>65</sup> In addition, equity securities acquired in connection with a merger, consolidation or other business combination by an individual (whether or not a director or executive officer of the target entity) as an inducement to becoming a director or executive officer of the acquiring entity will be considered "acquired in connection with service or employment as a director or executive officer." See new Rule 100(a)(4) of Regulation BTR [17 CFR 245.100(a)(4)].

<sup>66</sup> See the PWC Letter.

<sup>67</sup> See, for example, the ABA Letter, the Letter dated December 16, 2002 of Intel Corporation (the "Intel Letter") and the PSCA Letter.

<sup>68</sup> See the ABA Letter and the S&C Letter.

<sup>69</sup> See Treas. Reg. 1.1012-1(c).

<sup>70</sup> See, for example, Securities Act Rule 144(d) [17 CFR 230.144(d)].

<sup>71</sup> 17 CFR 245.101(b).

<sup>72</sup> While not required, a director or executive officer may want to add a note describing the date and nature of the transaction in which the securities were acquired in the "Explanation of Responses" section of the Form 4 [17 CFR 249.104] reporting the transaction.