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PROPOSED SECURITIES AND EXCHANGE COMMISSION AND FINAL DEPARTMENT OF LABOR RULES ON EMPLOYEE BENEFIT PLAN BLACKOUT PERIOD PROVISIONS OF THE SARBANES-OXLEY ACT

The Sarbanes-Oxley Act (the "Act"), signed into law by President Bush on 7/30/02, contains important employee benefits-related provisions discussed in our August 2002 Alert.[1] As required by the Act, the Securities and Exchange Commission ("SEC") has issued proposed regulations on the Act's securities trading restrictions on a public company's directors and executive officers during benefit plan blackout periods ("SEC Proposal"), and the Department of Labor ("DOL") has issued interim final rules on the Act's requirements for mandatory notification of blackout periods to employee benefit plan participants ("DOL Rules"). The SEC requests comments on or before 12/16/02 on all aspects of the SEC Proposal. The DOL Rules will become effective without notice or comment on 1/26/03 for blackout periods commencing on or after that date.

[1] Copies of our August 2002 Alert entitled "Employee Benefits Provisions of the Sarbanes-Oxley Act" can be obtained on the firm's website at ***www.kirkland.com***.

PROPOSED SEC RULES ON DIRECTOR AND OFFICER TRADING RESTRICTIONS DURING BLACKOUT PERIODS

In General. The Act prohibits any director or executive officer of an **issuer**[2] from directly or indirectly acquiring or disposing of an equity security received in connection with such person's service or employment as a director or executive officer while the security is subject to a "blackout period." The SEC Proposal contains a new Regulation BTR ("Blackout Trading Restriction")[3] which appears to interpret the Act broadly to preclude acquisitions or dispositions by directors and executive officers of any equity security of an issuer received in connection with service or

[2] For this purpose, an "**issuer**" means a company (1) with equity or debt securities traded on a national securities exchange, or (2) with a class of equity securities held by 500 or more shareholders of record, or (3) required to file 1934 Act §15(d) reports with the SEC (*i.e.*, a company which has previously sold equity or debt securities pursuant to a 1933 Act registration statement, until the registered securities are held by less than 300 persons on the first day of a subsequent fiscal year), or (4) which has filed a 1933 Act registration statement, not yet effective and not withdrawn.

[3] Regulation BTR would be issued under the 1934 Act, and the SEC Proposal also includes proposed amendments to certain 1934 Act rules and SEC forms.

employment while any equity security of the issuer is subject to a blackout period.[4]

Issuers Subject to Trading Prohibition. The SEC Proposal states that, consistent with the Act, an "issuer" includes domestic issuers, foreign private issuers, banks and savings associations, small business issuers and, in rare instances, registered investment companies. However, with respect to foreign private issuers, the trading restrictions would only apply when (1) 50% or more of the participants or beneficiaries in pension plans maintained by the issuer who are located in the United States[5] are subject to a blackout period, and (2) the affected employees represent a significant portion of the issuer's benefit plan participants.[6] The SEC Proposal clarifies that the Act does not apply to blackout periods of foreign employee benefit plans. In addition, the SEC specifically requests comment on whether directors and executive officers of small business and investment company issuers should be excluded from the trading restrictions of the Act.

Persons Subject to Trading Prohibition. The SEC Proposal defines the term "director" as set forth in 1934 Act § 3(a)(7), *i.e.*, as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated." This definition is intended to reflect a "functional and flexible" approach to determining whether a person is a director, so that an individual's title is not dispositive as to his status. Instead, as under 1934 Act § 16, attention is given to the individual's underlying responsibilities or privileges with respect to the issuer and whether the individual has a significant policy-making role. Similarly, the term "executive officer" is defined with reference to the term "officer" in 1934 Act Rule 16a-1(f), *i.e.*, as "an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer."[7] However, because foreign private issuers are not subject to 1934 Act § 16, the SEC Proposal specifically defines "director" to mean only a director who is a management employee and the term "executive officer" to mean the principal executive officer(s), the principal financial officer(s), and the principal accounting officer(s) (or, if there is none, the controller) of the foreign private issuer.

Securities Subject to Trading Prohibition. The Act's trading prohibition applies to any equity security[8] of an issuer, which the SEC Proposal defines to include any equity security or derivative security relating to an issuer even if the security is issued by a third party. In the case of foreign issuers, this definition includes

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[4] The Act provides that "it shall be unlawful for any director or executive officer of an issuer of any equity security . . . directly or indirectly, to purchase, sell, or otherwise acquire or transfer any equity security of the issuer . . . during any blackout period with respect to such equity security if such director or officer acquires such equity security in connection with his or her service or employment as a director or executive officer" (Act § 306(a)(1), emphasis supplied), and can be construed to limit the trading prohibition to the specific equity security subject to the blackout period. However, the SEC Proposal interprets this provision of the Act as "prohibit[ing] an issuer's directors and executive officers from trading in equity securities of the issuer when a substantial number of the issuer's employees are unable to engage in transactions involving equity securities of the issuer through their individual pension plan accounts" and does not appear to restrict the trading prohibition to the particular equity security subject to the blackout period.

[5] For purposes of the SEC Proposal, "United States" includes all States of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States.

[6] See more detailed discussion under "Blackout Period Definition" regarding application of the 50% requirement and what constitutes a "significant portion of the issuer's plan participants" for a foreign private issuer.

[7] 1934 Act Rule 16a-1(f) further provides that: "Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform . . . policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust."

[8] Other than certain "exempt securities" defined with reference to 1934 Act § 3(a)(12).

depositary shares evidenced by American Depositary Receipts ("ADRs"). The term "derivative security" would have the same meaning as set forth in 1934 Act Rule 16a-1(c) and would be interpreted in a manner consistent with 1934 Act § 16, so that, *e.g.*, an interest that may be settled only in cash but the value of which is based on an equity security (such as phantom stock) would be considered a derivative security subject to the Act.

Transactions Subject to Trading Prohibition. The statutory trading prohibition applies to an acquisition of equity securities during a blackout period if the acquisition is in connection with an individual's service or employment as a director or executive officer of an issuer, and a disposition of equity securities during a blackout period if the disposition involves equity securities acquired in connection with such service or employment. The SEC Proposal construes "acquired in connection with service or employment" quite broadly to include equity securities acquired by an individual: (1) at a time when he is a director or executive officer of an issuer (A) under a compensatory plan, contract, authorization or arrangement, including, but not limited to, plans relating to options, warrants or rights, pension, retirement or deferred compensation or bonus, incentive or profit-sharing (whether or not set forth in any formal plan document), including a compensatory plan, contract, authorization or arrangement with a parent, subsidiary or affiliate of the issuer, or (B) as a result of any related-party transaction or business relationship described in Item 404 of Regulation S-K; (2) as "director's qualifying shares" or other securities that he must hold to meet an issuer's minimum ownership requirements for directors or executive officers (including securities acquired on the open market); or (3) prior to becoming, or while, a director or executive officer of the issuer if the equity security was acquired as an inducement to service or employment with the issuer or a parent, subsidiary or affiliate of the issuer or as a result of a merger, consolidation or other acquisition transaction involving the issuer.[9]

The SEC Proposal notes that this definition may reach securities that are acquired in arm's-length commercial transactions but states that the SEC believes inclusion of such securities is necessary to prevent evasion of the statutory trading prohibition. In addition, because the prohibition applies to both "direct and indirect" acquisitions or transfers of equity securities, the SEC Proposal extends to any acquisition or disposition of issuer equity securities in a transaction involving immediate family members sharing the same household, a partnership, corporation, limited liability company or trust if a director or executive officer has an opportunity to profit or share in any profit derived from the transaction.

The SEC Proposal further states that equity securities acquired by an individual in connection with service or employment as a director or executive officer before a company is an issuer will be subject to the trading prohibition if the company later becomes an issuer, and that equity securities acquired in connection with an individual's service or employment as a director or executive officer before the effective date of the Act will be subject to the Act. In addition, in order to "simplify identification and eliminate tracing the source" of equity securities involved in a disposition transaction and "to prevent possible evasion" of the Act, the SEC Proposal establishes 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, without regard to the actual source of the securities. Thus, if a director owns 1,000 shares of an issuer's common stock, 250 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 would be presumed to be a sale of the option shares subject to

[9] However, comment is specifically requested regarding whether equity securities acquired by an individual as a result of a merger, consolidation or other acquisition transaction involving the issuer should be considered "acquired in connection with service or employment as a director or executive officer" only where such securities replace equity securities that otherwise would satisfy the requirements of the definition. *E.g.*, where an employee of a target company becomes an executive officer of an acquiring company and is issued equity securities of the acquiring company to replace equity securities of the target company, should the equity securities received be considered subject to the Act only to the extent such securities were otherwise acquired in connection with service or employment as a director or executive officer of the target company?

the Act without regard to the actual source of the shares sold.

The SEC Proposal exempts from the Act (1) acquisitions of equity securities under broad-based and non-discriminatory dividend or interest reinvestment plans, (2) non-discretionary purchases or sales made pursuant to advance election under a contract, instruction or written plan that satisfies 1934 Act Rule 10b5-1(c) (provided that the advance election is not made or modified during the blackout period or at a time the director or executive officer was aware of the impending blackout), (3) non-discretionary purchases or sales of equity securities made pursuant to advance election under a tax-qualified employee benefit plan, excess benefit plan, or stock purchase plan, and (4) increases or decreases in the number of equity securities held as a result of a stock split or dividend applying equally to all equity securities of a class, and acquisitions of rights, such as shareholder or pre-emptive rights, pursuant to a pro rata grant to all holders of the same class of equity securities.

"Blackout Period" Definition. For purposes of the insider trading restriction, a "blackout period" is a period of more than 3 consecutive business days during which there is a temporary suspension of the ability of at least 50% of the participants or beneficiaries[10] in all individual account plans maintained by an issuer to acquire or dispose of any equity security of the issuer held in the plans.[11] The SEC Proposal clarifies that the individual account plans "maintained by the issuer" considered for purposes of the 50% test include only individual account plans in which participants or beneficiaries hold or could hold equity securities of the issuer regardless of whether the plan actually contains such equity securities, *i.e.*, plans that: (1) permit participants to invest their plan contributions in equity securities of the issuer; (2) include an "open brokerage window" that permits participants to invest in the equity securities of any publicly traded company, including the issuer; (3) match employee contributions with equity securities of the issuer; or (4) reallocate forfeitures that include equity securities of the issuer to remaining plan participants. The SEC Proposal also states that, for purposes of determining the individual account plans "maintained by the issuer," the controlled group rules under Section 414 of the Internal Revenue Code (generally requiring 80% common ownership) will apply.

In the case of a foreign private issuer, however, the SEC Proposal applies a second test not contained in the Act to determine if the statutory trading prohibition is triggered. Specifically, the number of participants or beneficiaries located in the United States under all individual account plans maintained by the issuer subject to the blackout period is compared to the overall number of participants or beneficiaries under all individual account plans maintained by the issuer worldwide. If the resulting percentage is greater than 15% and the concurrent 50% test also is met, the statutory trading prohibition applies to the directors and executive officers of the foreign private issuer.[12]

In addition, under the Act neither a regularly scheduled suspension of trading incorporated in the terms of a benefit plan document and adequately disclosed to participants nor a suspension imposed solely in connection with a participant or beneficiary becoming or ceasing to be a plan participant or beneficiary by reason of a merger, acquisition, divestiture or similar

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[10] The SEC has requested comment regarding the appropriate measurement date for determining the number of participants or beneficiaries in an individual account plan for purposes of the 50% test (*e.g.*, the end of the most recent plan fiscal year, the end of the fiscal quarter, or some other date).

[11] The SEC Proposal notes that the term "individual account plan" will include a variety of qualified plans such as 401(k) plans, profit-sharing and savings plans, stock bonus plans and money purchase pension plans, and states that this definition also could include non-qualified deferred compensation arrangements.

[12] The SEC Proposal provides as an example a foreign private issuer Company X with 100,000 employees worldwide who participate in pension plans maintained by the issuer, with 30,000 participants located in the United States. A fiduciary of the issuer's United States pension plan initiates a blackout that will affect 16,000 of the United States participants. Since plan participants located in the United States who are subject to the blackout comprise 50% or more of the total number of participants located in the United States (16,000/30,000), and plan participants located in the United States who are subject to the blackout represent more than 15% of the total number of plan participants worldwide (16,000/100,000), the prohibition would apply to the foreign private issuer's directors and executive officers.

transaction is a "blackout period." The SEC Proposal states that the requirement that a blackout period be incorporated in the benefit plan is satisfied by including a description of the regularly scheduled blackout period (including the plan transactions to be suspended during, or otherwise affected by, the blackout and its frequency and duration) in the plan documents; and that disclosure is considered adequate if an employee is provided notice of the blackout period provisions at any time prior to or within 30 calendar days after plan enrollment, or within 30 days after adoption of a subsequent plan amendment.[13] In the case of a blackout imposed to consolidate plans following a merger or acquisition, divestiture or similar transaction, the blackout period will not trigger the trading prohibition if its principal purpose is to enable individuals to become participants or beneficiaries in the plan or to terminate participation in the plan, even if the blackout is also used to effect other administrative actions that are incidental to the admission or withdrawal of plan participants or beneficiaries. However, this exemption is only available with respect to the participants or beneficiaries of the acquired or divested entity.

Notice Requirements. If a director or executive officer of an issuer is subject to the blackout period trading restrictions, the issuer must "timely notify" the director or officer and the SEC of the occurrence of the blackout period. Under the SEC Proposal, the notice must include the following information: (1) the reason(s) for the blackout period; (2) a description of the plan transactions to be suspended during, or otherwise affected by, the blackout period; (3) the description of the class of equity securities subject to the blackout period; (4) the actual or expected beginning and ending dates of the blackout period; and (5) the name, address and telephone number of the person designated by the issuer to respond to inquiries about the blackout period, or, in the absence of such a designation, the issuer's human resources director or person performing equivalent functions. The notice must be provided to directors and executive officers at least 15 calendar days in advance of the blackout period.[14] If the blackout period is unforeseeable or results from circumstances beyond the reasonable control of the issuer (*e.g.*, a major computer or other technical failure), the SEC Proposal excuses an issuer from the 15-day notice requirement where the issuer makes a written determination that the circumstances preclude compliance with the requirement and provides the notice as soon as reasonably practicable. If there is a subsequent change to the beginning or ending dates of the blackout period, an issuer must provide an updated notice explaining the reasons for the change and identifying all material changes in the information contained in the prior notice.

For domestic issuers the blackout period notice to the SEC must be made on Form 8-K and include the same content as described above for the required notice to directors and executive officers. The Form 8-K disclosure must be made upon the earlier of receipt of notice of the blackout period from the plan administrator or actual knowledge of the blackout period by the person designated by the issuer to oversee the issuer's pension plans. Foreign private issuers would be required to file as an exhibit to Form 20-F and 40-F reports copies of any blackout period notices provided to directors and executive officers during the previous fiscal year, unless the notices were previously provided to the SEC in a Form 6-K report.[15]

Remedies. The SEC Proposal states that any director or executive officer who violates the trading prohibition is subject to possible civil injunctive actions, cease-and-desist proceedings, civil penalties and any other remedies available to the SEC to redress violations of the Exchange Act; and under appropriate circumstances the director or executive officer may be subject to criminal liability. In addition, any profits realized in violation of the trading restrictions are recoverable by the issuer, or in a derivative action by an owner of any security of the issuer if the issuer has

[13] The notice can be provided in any graphic form that is reasonably accessible to the intended recipient.

[14] The notice must be in any graphic form that is reasonably accessible to the intended recipient and is considered provided as of the date of mailing by first class mail or as of the date of electronic transmission.

[15] In addition, registered investment companies subject to the Act would be subjected to Form 8-K filing requirements for the sole purpose of meeting any filing obligation that arises under the SEC Proposal.

failed to take action within 60 days of a request for such action (subject to a 2-year statute of limitations). Specific comment is requested on whether foreign private issuers should be exempt from the private right of action under the Act. The SEC also notes that the question of whether a transaction has resulted in the realization of recoverable profits is complex and that there are a number of possible ways to calculate realized profits. Thus, the SEC Proposal states that "[i]n view of the complexity associated with this issue, we are not proposing a specific approach for calculating realized profits at this time" and solicits comments on approaches that would be consistent with the purposes of the Act.

Effective Date. The new blackout period trading restrictions for an issuer's directors and executive officers are effective on 1/26/03. Presumably, the SEC will issue final rules and regulations before that date in view of any comments received on the SEC Proposal.

DOL RULES REGARDING ERISA BLACKOUT PERIOD NOTIFICATION REQUIREMENTS

In General. The Act amends ERISA to require the administrator of any individual account plan (*i.e.*, a defined contribution plan such as a 401(k) plan, profit sharing plan, or ESOP) to give 30 days' advance written notice of a post-1/25/03 blackout period to participants and beneficiaries whose rights under the plan will be temporarily suspended, limited, or restricted by the blackout period and to issuers of employer securities subject to the blackout period.[16]

[16] This notice requirement applies to individual account plans maintained by public and private companies, but not to governmental plans, foreign plans or non-electing church plans. The Act also expressly excludes "one-participant retirement plans" from the blackout period notice requirements. For this purpose a "one-participant retirement plan" is a plan that (1) covers only the employer (and his spouse) where the employer owns the entire business <u>or</u> covers only one or more partners (and their spouses) in a business partnership, (2) meets the minimum coverage requirements of § 410(b) of the Internal Revenue Code without being aggregated with any other plan that covers employees of the business, (3) does not provide benefits to anyone except the employer or the partners (and their spouses), (4) does not cover a business that is a member of a controlled group, and (5) does not cover a business that leases employees.

The DOL Rules clarify the provisions of the Act with respect to timing and content of the required notice, provide a model blackout period notice, and establish procedures for imposition and administrative review of ERISA civil penalties for failure or refusal of plan administrators to comply with the Act's notice provisions.

"Blackout Period" Definition. The definition of "blackout period" for purposes of the ERISA notification requirement is different from the definition of "blackout period" for the insider trading restriction requirements discussed above. Under the ERISA notice requirement, a "blackout period" is a period of more than 3 consecutive business days during which the otherwise-available right of a plan participant or beneficiary to direct or diversify plan account balances or to obtain loans or distributions from the plan is temporarily suspended, limited or restricted. However, "blackout period" does not include a suspension, limitation or restriction that (1) results from application of the securities laws (*e.g.*, insider trading restrictions applicable to certain public company executives), (2) is regularly scheduled and results from a plan amendment that is adequately disclosed to participants, or (3) is a consequence of a qualified domestic relations order. The DOL Rules incorporate the Act's definition of "blackout period" without modification.

Content of Participant/Beneficiary Notice. The Act provides that the blackout notice must be written in a manner calculated to be understood by the average plan participant and must contain (1) the reasons for the blackout period, (2) an identification of the investments and other rights affected, (3) the expected beginning date and length of the blackout period, (4) when investment rights will be affected, a statement that participants or beneficiaries should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts during the blackout period,[17] and (5) such additional information as may be required by the DOL pursuant to regulations. The notice must be in writing, although the Act permits electronic or

[17] The DOL Rules provide that this particular notice requirement is deemed satisfied by use of the advisory statement contained in paragraph 4 of the model notice.

"other form" of dissemination to the extent reasonably accessible to the participant.[18]

The DOL Rules add a requirement that the notice must include a description of all rights otherwise available under the plan to affected participants and beneficiaries that will be temporarily suspended during the blackout period (*e.g.*, right to direct or diversify assets in individual accounts, right to obtain loans from the plan, right to obtain distributions from the plan) in addition to the identification of the investments subject to the blackout period; and specify that the notice must contain the expected beginning date and ending date of the blackout period -- not just the "expected beginning date and length" as stated in the Act. The notice must also contain the name, address and telephone number of the plan administrator or other person responsible for answering questions about the blackout period.

In the event that the notice is not provided within the 30-day advance period required by the timing provisions of the Act, the notice must also contain (1) a statement that Federal law generally requires that notice be furnished to affected participants and beneficiaries at least 30 days in advance of the last date on which participants and beneficiaries could exercise the affected rights prior to commencement of a blackout period,[19] and (2) an explanation of the reasons why at least 30 days' advance notice could not be furnished.

Timing of Participant/Beneficiary Notice. The DOL Rules make significant changes to the Act's requirement that notice be given "at least 30 days in advance of the blackout period." Specifically, under the DOL Rules the notice must be provided to affected participants and beneficiaries at least 30 calendar days and not more than calendar 60 days in advance of the last date on which participants and beneficiaries could exercise affected rights before the start of a blackout period. Thus, under certain circumstances the DOL Rules will require that notice be provided more than 30 days in advance of a blackout period. The DOL Rules provide as an example a plan that allows participants to direct their investments during the first 15 days of each month and which will be subject to a suspension of investment direction rights from the 1st to 15th of May in order to accommodate a change in recordkeepers. If the 30-day notice period were counted from the date immediately preceding the start of the blackout period, notice could be provided on April 1st. However, under the DOL Rules the notice must be provided no later than March 16th, *i.e.*, at least 30 days in advance of April 15th, which is the last date on which participants could exercise the affected rights immediately before the start of the blackout period.

The Act provides that the 30-day advance notice requirement may be shortened or eliminated if a plan fiduciary makes a written determination (which must be signed and dated by the fiduciary) that (1) the advance notice requirement would otherwise interfere with the plan administrator's fiduciary duties or (2) the plan administrator's inability to provide advance notice was due to unforeseeable circumstances beyond the plan administrator's reasonable control. An example of the circumstances described in (1) would be the filing of bankruptcy by a company where a plan administrator determines that it would not be prudent to continue to permit participants to direct investments into company stock. An example of the circumstances described in (2) would be a major computer failure which, for some period of time, incapacitates a program for recording and processing loans and distributions from a plan. In all such events, the blackout notice must be provided "as soon as reasonably possible" unless providing the notice prior to the end of the blackout period is "impracticable." However, if the blackout period occurs solely in connection with a participant or beneficiary becoming or ceasing to be a participant or beneficiary by reason of a merger, acquisition, divestiture or similar transaction, the blackout notice must simply be provided "as soon as reasonably practicable" and no written fiduciary determination is required.

If there is a change in a blackout period's beginning or ending date after the notice has been provided, the plan administrator must give written notice of the change to affected plan participants and beneficiaries "as soon as

[18] For purposes of the DOL Rules, a blackout notice will be considered furnished as of the date of first class mailing or as of the date of electronic transmission.

[19] The DOL Rules provide that this specific notice requirement is deemed satisfied by use of the statement contained in paragraph 5 of the model notice.

reasonably practicable." The updated notice must explain the reasons for the change in date(s) and identify all material changes in the information contained in the previous notice.

Public Company Notice Requirement. The Act provides that a plan administrator must give "timely" notice to an "issuer" of any employer securities affected by a defined contribution plan's blackout period (*e.g.*, if a blackout period will restrict participant trading or other rights in connection with an employer stock fund).[20] The DOL Rules state that the timing and content requirements applicable to notices provided to participants and beneficiaries also apply to the issuer notice, except that notice to the issuer need not include (1) the statement advising participants and beneficiaries to review their investments prior to commencement of the blackout period, and (2) the general statement of the 30-day notice requirement and explanation of any failure to comply. The DOL Rules also state that the notice may be provided to the issuer's agent for service of legal process unless the issuer has provided the plan administrator with the name of another person for service of notice. The issuer notice must be in writing except to the extent the person to whom notice must be furnished consents to receive the notice in electronic or other form.

Penalties. The Act creates a new ERISA civil penalty in connection with the blackout period notice requirement.[21] Specifically, if a plan administrator fails or refuses timely to provide a blackout notice to plan participants and beneficiaries, the DOL may assess a civil penalty of up to $100 per participant and beneficiary for each day of the plan administrator's failure or refusal. The DOL Rules clarify the extent to which a plan administrator is liable for partial compliance failures and set forth procedures under which a penalty reduction or waiver may be obtained. In general, the amount of the penalty assessed for each separate violation of the blackout notice requirement will be determined by the DOL, taking into consideration the degree and/or willfulness of the failure or refusal to provide the notice. The amount assessed for each violation cannot exceed $100 per day computed from the date of the administrator's failure or refusal to provide notice up to and including the final day of the blackout period, but such a failure or refusal for any single participant or beneficiary is treated as a separate violation.[22] Before assessing a penalty the DOL will give the plan administrator written notice of the penalty amount, the number of participants and beneficiaries at issue, the period to which the penalty applies, and the reasons for the penalty. In accordance with procedures set forth in the DOL Rules, the DOL may waive all or part of the penalty if the plan administrator can either establish compliance with the rules or present evidence of mitigating circumstances regarding the degree of willfulness of the failure to comply.

The DOL Rules also provide that all administrators of an affected plan are jointly and severally liable for a blackout notice compliance failure, and specify that any resulting penalties cannot be paid from plan assets.

Effective Dates and Plan Amendments. The Act's blackout notice provision is effective 1/26/03. If the provision requires a plan amendment (*e.g.*, because the plan document's language requires an amendment or future regulations require an amendment), the plan

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[20]For purposes of the DOL Rules, "**issuer**" means a company (1) with equity or debt securities traded on a national securities exchange, or (2) with a class of equity securities held by 500 or more shareholders of record, or (3) required to file 1934 Act §15(d) reports with the SEC (*i.e.*, a company which has previously sold equity or debt securities pursuant to a 1933 Act registration statement, until the registered securities are held by less than 300 persons on the first day of a subsequent fiscal year), or (4) which has filed a 1933 Act registration statement, not yet effective and not withdrawn.

[21] In addition to the new civil penalty the Act enhances ERISA's criminal penalties. Under the Act, any individual willfully violating the blackout notice requirement <u>or any other</u> ERISA disclosure or reporting requirement (*e.g.*, the willful failure to provide a summary plan description or a summary annual report, or to file a required Form 5500 annual report) is subject to a criminal fine up to $100,000 (previously $5,000) and/or 10 years' imprisonment (previously 1 year); and any violator that is not an individual (*i.e.*, a corporation or other business entity) is subject to a criminal fine up to $500,000 (previously $100,000). The DOL Rules do not address the ERISA criminal penalty provisions.

[22] Thus, the maximum penalty is $100 times the number of days starting from the date that the administrator failed to provide notice through the last day of the blackout period times the number of participants and beneficiaries who should have been provided notice.

amendment is not required to be made before the first plan year beginning on or after 1/26/03 (*i.e.*, by 12/31/04 for a calendar year plan). However, starting on 1/26/03 the plan must be operated in good faith compliance with the new notice provision and any plan amendment must be retroactively effective to 1/26/03. The DOL Rules are effective for any blackout period commencing on or after 1/26/03 and further provide that, for the period 1/26/03 to 2/25/03, plan administrators must furnish any required blackout notice as soon as reasonably possible.

Form and Content of Model Notice. The following is the model blackout period notice issued under the DOL Rules. Use of the model notice is not mandatory, and with regard to all information except that provided in paragraphs 4 and 5 of the model notice compliance with the notice content requirements of the Act will "depend on the facts and circumstances" of the particular blackout period and plan.

Important Notice Concerning Your Rights Under the [Enter Name of Individual Account Plan]

[Enter Date of Notice]

1. This notice is to inform you that the [enter name of plan] will be [enter reasons for blackout period, as appropriate: changing investment options, changing recordkeepers, etc.].

2. As a result of these changes, you temporarily will be unable to [enter as appropriate: direct or diversify investments in your individual accounts (if only specific investments are subject to the blackout, those investments should be specifically identified), obtain a loan from the plan, or obtain a distribution from the plan]. This period, during which you will be unable to exercise these rights otherwise available under the plan, is called a "blackout period." Whether or not you are planning retirement in the near future, we encourage you to carefully consider how this blackout period may affect your retirement planning, as well as your overall financial plan.

3. The blackout period for the plan will begin on [enter date] and end [enter date].

4. [*In the case of investments affected by the blackout period, enter the following*: During the blackout period you will be unable to direct or diversify the assets held in your plan account. For this reason, it is very important that you review and consider the appropriateness of your current investments in light of your inability to direct or diversify those investments during the blackout period. For your long-term retirement security, you should give careful consideration to the importance of a well-balanced and diversified investment portfolio, taking into account all your assets, income and investments. You should be aware that there is a risk to holding substantial portions of your assets in the securities of any one company, as individual securities tend to have wider price swings, up and down, in short periods of time, than investments in diversified funds. Stocks that have wide price swings might have a large loss during the blackout period, and you would not be able to direct the sale of such stocks from your account during the blackout period.]

5. [*If timely notice cannot be provided, enter*: (A) Federal law generally requires that you be furnished notice of a blackout period at least 30 days in advance of the last date on which you could exercise your affected rights immediately before the commencement of any blackout period in order to provide you with sufficient time to consider the effect of the blackout period on your retirement and financial plans. (B) [Enter explanation of reasons for inability to furnish 30 days advance notice.]]

6. If you have any questions concerning this notice, you should contact [enter name, address and telephone number of the plan administrator or other person responsible for answering questions about the blackout period].

Should you have any questions about this Alert, please contact the Kirkland & Ellis employee benefits attorney with whom you normally work, or any of the following:

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