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SEC RELEASES LETTER CLARIFYING APPLICATION OF SECTION 402 OF SARBANES-OXLEY ACT

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Last month the SEC issued a no-action letter to a financial services firm that sheds light on the scope of the prohibition under Section 402 of the Sarbanes-Oxley Act of 2002 which makes it unlawful for an issuer to "extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or any executive officer . . . of that issuer."

Historically, the SEC appears to have been reluctant to issue formal guidance respecting the parameters of the loan prohibition under Section 402. Common arrangements left in limbo by this lack of regulatory guidance extend to personal use of company credit cards, personal use of company cars, travel-related advances, and broker-assisted option exercises.

The SEC's no-action letter was issued to RingsEnd Partners, a financial services firm. The letter addresses a program established to facilitate the payment of taxes associated with the grant of restricted stock awards. Under this program, recipients of restricted stock awards make a qualifying election to be taxed on those shares at the time of grant (a so-called 83(b) election) and then transfer those shares to a trust administered by an independent trustee who is directed to borrow funds from an independent bank through non-recourse loans sufficient in amount to pay the tax liability incurred as a result of the stock awards. Through this mechanism, recipients of these awards can retain ownership of all shares granted to them rather than sacrificing a number of those shares necessary to pay applicable tax obligations. To facilitate utilization of the program, however, an employer is involved in a variety of administrative actions necessary to maintain the program, including delivering the share awards to the trust, providing information to the lending institution and delivering prospectuses and registration statements covering the shares to the trustee. All administrative costs associated with administering the trust are borne by those recipients electing to participate in the trust.

The SEC concluded that employers whose employees where involved in this program would not by their administrative activities be deemed to be in violation of the prohibitions of Section 402. The conclusions reached by the SEC in this case would appear to be very instructive in reaching

conclusions about the permissibility of other more common practices that would appear to involve arrangements that are no more administratively intensive, such as broker-assisted option exercises.

MEET THE TEAM

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