GOODWIN | PROCTER

Goodwin Procter LLP
Counsellors at Law
Exchange Place
Boston, MA 02109
T: 617.570.1000

August 9, 2004

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

Mr. Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Proposed Revision to Rule 16b-3 -- Release Nos. 34-49895; 35-27861; IC-26471; File No. S7-27-04 (69 FR 35982, June 25, 2004)

Dear Mr. Katz:

We are pleased to respond to the Commission's request for comments on the above-referenced release (the "Release") soliciting comments on proposed amendments to Rule 16b-3 and Rule 16b-7 issued under the Securities Exchange Act of 1934.

Rule 16b-3

We strongly support the Commission's efforts to clarify the uncertainty regarding the exemptive scope of Rule 16b-3 that has resulted from the decision by the U.S. Court of Appeals for the Third Circuit (the "Third Circuit") in *Levy v. Sterling Holding Company, LLC* ("*Sterling Holding*"). In addition, we strongly support the Commission's proposed amendment (the "Proposed Amendment") to the effect that the exemptions provided by paragraphs (d) and (e) of Rule 16b-3 would apply to any securities of the issuer that satisfy the specified conditions of the applicable paragraph and that such exemptions would not be conditioned on the transaction being intended for a compensatory or other particular purpose. We believe that any more narrowly tailored provision would be inappropriate in view of the policy behind Rule 16b-3.

We understand the Commission's concern with the Third Circuit's holding in *Sterling Holding* in view of the plain and unambiguous meaning of Rule 16b-3, and we support the SEC's willingness to take prompt action in connection with the Proposed Amendment to correct an analysis that in the words of the Commission "runs directly contrary to the Commission's stated reasons for adopting the exemption." The effect of *Sterling Holding* is substantial in both its retroactive application as well as its prospective implications. Directors and officers who have relied on the exemptions afforded by Rule 16b-3(d) or (e) in connection with acquisition and

disposition transactions with the issuer and have already carried out a matching transaction have no ability to pursue an alternative course to avoid the potential strict liability of Section 16(b) if there was no compensatory element to their transaction. As such, many prior transactions that may not have had a compensatory element are at some form of risk. Furthermore, directors and officers have no certainty that similar prospective transactions will not face legal challenge.

The uncertainty caused by the *Sterling Holding* decision is particularly acute in the mergers and acquisitions context. In connection with sale transactions, there is no provision of Section 16(b) other than Rule 16b-3 that is available to exempt the disposition by directors and officers of the seller of the seller's securities in the merger. As such, if the Rule 16b-3 exemption required a "compensatory nexus" for the securities of the seller being disposed of in the merger, directors and officers of the seller would face substantial exposure to potential Section 16(b) liability that ordinarily could not be eliminated. Such exposure creates a serious problem for directors and officers for whom the sale transaction is often a means for achieving long-awaited liquidity. The policy behind Section 16 hardly would be served by permitting all other stockholders to benefit from such liquidity while excluding (or at least subjecting to risk) the very persons that were responsible for negotiating to provide that liquidity, particularly when one considers the fact that the directors and officers are required to act in accordance with their fiduciary duties to the stockholders and therefore may have no ability to extend the sale so that it would occur at least six months after a prior purchase.

Moreover, in view of the gate-keeping role of directors and stockholders as required by Rule 16b-3 and the substantial disclosure inherent in the public sale context, it is hard to understand how the policy behind Rule 16b-3 would be served by limiting the availability of the Rule 16b-3 exemption.

Another effect of the *Sterling Holding* decision is that it discourages stock ownership by directors and officers, who might view the risks created by a circumscribed application of the Rule 16b-3 exemption as unacceptable. In this regard, the obvious benefits to encouraging such ownership by directors and officers counsel strongly in favor of adopting the Proposed Amendment.

In view of the foregoing, it is not difficult to understand why, as a result of the *Sterling Holding* decision, issuers are incurring significantly greater legal costs in connection with analyzing the risks associated with qualifying for an exemption under Rule 16b-3(d) and (e) for transactions that historically have not been the subject of abuse. In an environment where the resources of issuers must be focused on areas where there is a demonstrated need for improvement, such as corporate governance and financial controls, we believe that it would be unfortunate if issuers

were required to continue allocating a portion of their limited resources to contending with the uncertainties created by *Sterling Holding*.

As to the specific language of the proposed amendment, we believe that it should be sufficient to accomplish its purpose. We do not believe that a more narrowly drafted amendment which referred only to "compensatory" or "extraordinary" transactions would be helpful, because the meaning of such terms would likely lead to litigation and uncertainty for directors and officers with respect to transactions that generally do not involve the abuses of any inside information.

In summary, we believe the Proposed Amendment is consistent with the stated policy underlying Section 16 generally and Rule 16b-3 specifically, as articulated by the Commission in its proposing and adopting releases, and we do not believe that there have been any changes in the nature of transactions between issuers and their directors and officers that warrant a corresponding change in that policy. As such, we strongly endorse the Commission's proposal to adopt the Proposed Amendment without any narrowing of its scope.

Rule 16b-7

We also support the proposed amendment to Rule 16b-7 so that it would more clearly cover reclassifications. In response to the questions contained in the Release about Rule 16b-7, we would suggest that a specific reference to the *Sterling Holding* conditions should be added, even though this probably should not be necessary. We also believe that the amendment should be modified to exempt statutory exchanges, conversions and domestications. These types of transactions are similar to mergers, in most cases could instead be accomplished in any event by a merger under the applicable state law, and in many cases will involve even less of an ownership change for the shareholders than is permitted by the 85% ownership provisions in Rule 16b-7.

If you have any questions concerning our comments, please feel free to call Laura Hodges Taylor at 617-570-1536 or Stephen W. Carr at 617-570-1140.

Very truly yours,

Goodwin Procter LLP