

Insider Trading: Education, Prevention, and Rule 10b5-1 Plans

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Roadmap for Presentation

- **Overview of various cases and interesting themes**
- **Fundamentals of insider trading law**
- **Compliance programs**
- **Rule 10b5-1 trading plans**
- **SEC investigations**
- **Martha Stewart case: lessons and training**



U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 20034 / March 8, 2007

SEC v. Shashikant C. Shah, Civil Action No. 2:07cv1075 (D.N.J.)

SEC Charges Shashikant Shah, Former Vice President of Now-Defunct Drug Manufacturer Able Laboratories, Inc., with Unlawful Insider Trading in Connection with Scheme to Conceal Quality Control Deficiencies

On March 8, 2007, the Securities and Exchange Commission (Commission) filed in the United States District Court for the District of New Jersey a settled civil injunctive action against Shashikant C. Shah (Shah) alleging that Shah, the Vice President of Quality Control, Quality Assurance and Regulatory Affairs of former drug maker Able Laboratories, Inc. (Able), engaged in unlawful insider trading by selling shares of Able's common stock during a 16-month period in which he possessed material, non-public information about Able's faulty quality control testing practices. Before halting operations in May 2005 due to such testing improprieties, Able developed, manufactured and sold at least 40 generic drugs including numerous antibiotic, analgesic and antipsychotic medications.

The Commission's complaint alleges that on eight separate occasions from August 2003 through December 2004, Shah acquired an aggregate of 58,000 shares of Able's common stock by exercising employee stock options, and in each case sold the securities either immediately thereafter or within a few days. According to the complaint, at the time he engaged in these transactions, Shah was aware that Able was concealing from the U.S. Food

Shares sold in cases of insider trading often come from option exercises or restricted stock vesting.

Posted on Sat, Mar. 17, 2007

Nacchio's case relies on secrets

Trial to hinge on Qwest chief's intent when he unloaded stock

BY SANDY SHORE
Associated Press

DENVER — The insider-trading case opening Monday against the former head of one of the nation's largest telephone service providers deals and what a CEO should be expected to know about his company.

Joseph Nacchio, former CEO of Denver-based Qwest Communications, is charged with improperly selling stock. The provider became mired in a multibillion-dollar accounting scandal. Prosecutors claim Nacchio, a former executive at Enron, knew the company was at financial risk. Shares of Qwest Communications International Inc. plummeted from nearly \$40 a share in 2002 and its near-collapse left thousands of pensioners in financial straits.

Nacchio has an unusual defense: The sale wasn't improper, he maintains, because he believed Qwest stood at the time to get millions in secret contracts from clandestine government agencies. Within Qwest, he alone was privy to the contracts, he says.

The contracts are a key point of evidence. Both sides have agreed financial data from the contracts will be used at trial, through the agencies involved will remain secret.

Qwest is the primary telephone service provider in 14 states, including Minnesota.

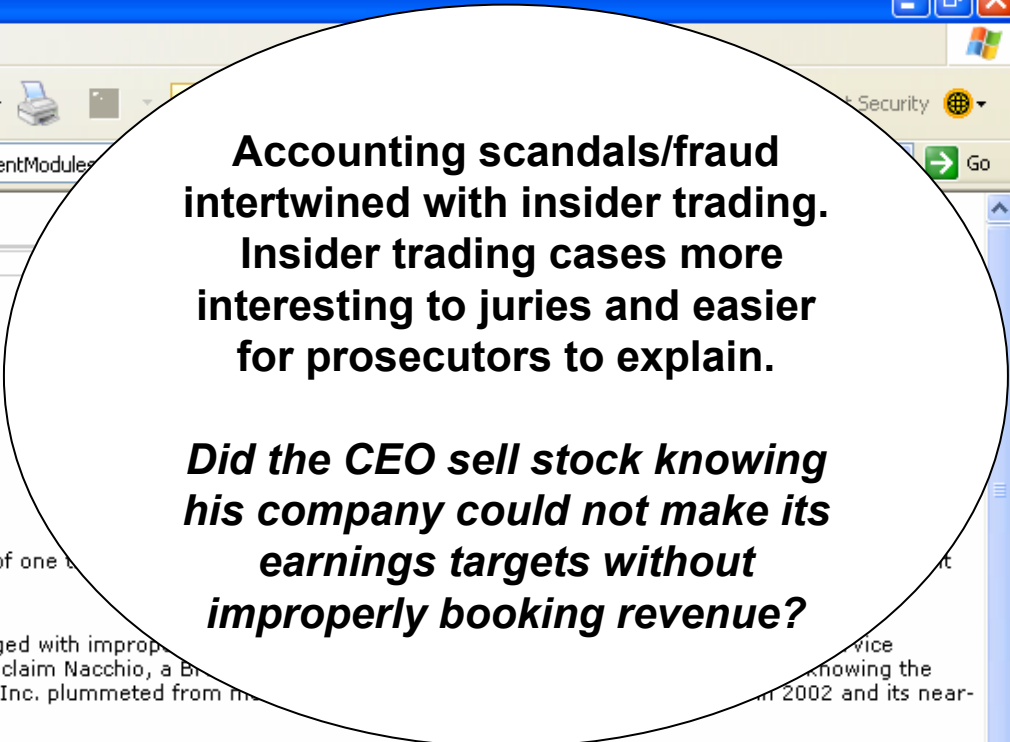
Jury selection starts Monday in Denver federal court.

It could be a complex trial: Evidence includes some 13 million pages of material from classified documents; internal e-mails and memos; complicated financial tables; and statements from top Qwest executives during Nacchio's reign.

In the end, the case will come down to what Nacchio knew and his intentions when he sold the stock, legal analysts say.

Nacchio "doesn't deny selling the Qwest stock nor can he deny that he avoided rather significant losses when the stock fell off the cliff," said Peter Henning, a Wayne State University law professor who has followed the Qwest case. "This is all intent."

Nacchio was charged in December 2005, nearly three years after then-Attorney General John Ashcroft announced the first indictments in the Qwest Communications International Inc. investigation, calling it an example of the government's intolerance of white-collar crime.



Accounting scandals/fraud intertwined with insider trading. Insider trading cases more interesting to juries and easier for prosecutors to explain.

Did the CEO sell stock knowing his company could not make its earnings targets without improperly booking revenue?

Browser interface showing address bar (http://www.sec.gov/litigation/litreleases/2007/lr20040.htm), menu bar (File, Edit, View, Favorites, Tools, Help), toolbar (Search Web, Upgrade Now!, Mail, My Yahoo!, NCAA Hoops, Fantasy Sports, Games, Music), and tabs (Melvyn C. Goldstein: Lit. ... x, Is it possible to violate inside..., Bank Of America Snagged B...).



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U.S. Securities and Exchange Commission

U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 20040 / March 14, 2007

SEC v. Melvyn C. Goldstein, 07 Civ. 2199 (TPG) (S.D.N.Y.)

SEC Files Settled Insider Trading Charges Against Former Del Laboratories, Inc. Chief Financial Officer

The Securities and Exchange Commission today announced that it filed a settled civil action in federal district court against Melvyn Charles Goldstein (Goldstein), alleging insider trading in the common stock of Del Laboratories, Inc. (Del), a manufacturer of cosmetics and over-the-counter pharmaceuticals. The settlement is subject to Court approval.

The Commission's complaint, filed in the U.S. District Court for the Southern District of New York, charges Goldstein with violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The complaint alleges that Goldstein unlawfully traded in the securities of Del, while in possession of material non-public information, one week prior to the announcement on July 2, 2004, that two companies had reached a definitive agreement to acquire Del. According to the complaint, Goldstein learned, while working at Del as a consultant in Del's Finance Department, that Del was in sales negotiations and would soon announce its plans to be acquired. Goldstein had previously been Del's Chief Financial Officer for sixteen years. By trading in advance of the public announcement of the acquisition agreement, Goldstein stood to profit by \$38,308.

Without admitting or denying the allegations in the complaint, Goldstein

The SEC detects and prosecutes even small-profit cases. \$38,000 in profits by former CFO.

Criminal charges are now more likely. Justice Department and local US Attorneys interested in these cases.

Ex-Countrywide execs get probation terms for insider trading By ALEX VEIGA, AP Business Writer

LOS ANGELES—November 26, 2007 Three former Countrywide Financial Corp. executives who pleaded guilty to criminal charges of insider trading were sentenced Monday to serve three years probation, the U.S. attorney's office said. They must also serve several hundred hours of community service and pay fines. In their plea agreements earlier this year, the executives admitted they used confidential data showing Countrywide would not meet Wall Street earnings projections for the third quarter of 2004. They then used the information to sell off their shares, to buy put options and, eventually, to short-sell the stock, in efforts to profit from a fall in the stock's price, prosecutors said. Put options allow an investor to sell shares at a set price within a certain time period. The scheme generated more than \$100,000 in profits combined



SEC Enforcement Action Against Banc of America Securities for Failing to Safeguard Nonpublic Research Information and Publishing Fraudulent Research; Firm to Pay \$26 Million

FOR IMMEDIATE RELEASE
2007-42

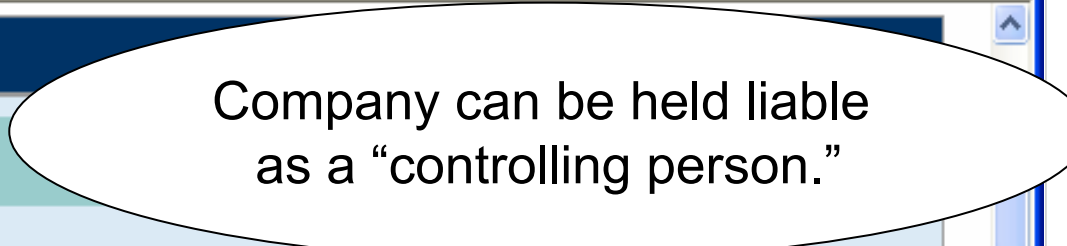
Washington, D.C., March 14, 2007 - The Securities and Exchange Commission announced today a settled enforcement action against Banc of America Securities LLC (BAS) for failing to safeguard its forthcoming research reports, including analyst upgrades and downgrades, and for issuing fraudulent research. As part of the settlement, BAS agreed to a censure, a cease-and-desist order, and payment of \$26 million in disgorgement and penalties.

"We are determined to plug the improper leak of information on Wall Street," said Linda Thomsen, Director of the Commission's Division of Enforcement. "Today's action makes it clear that firms must have appropriate safeguards on all their nonpublic information, including upcoming research reports."

"BAS failed to discharge vital compliance responsibilities," said Antonia Chion, Associate Director of Enforcement. "Firm policies that are required by law cannot exist only on paper - they must be implemented and enforced."

The Commission's Order finds that, from January 1999 through December 2001, BAS experienced a breakdown in its internal controls designed to detect and prevent the misuse of forthcoming research reports by the firm or its employees. BAS sales and trading employees learned of forthcoming

Penalties against companies for not having "appropriate safeguards on all their nonpublic information."



Headlines

[Company Information Center](#)
[Quote/Chart](#)

September 29, 2003 04:19 PM US Eastern Timezone

AmeriCredit Statement Regarding Employee Insider Trading

FORT WORTH, Texas--(BUSINESS WIRE)--Sept. 29, 2003--AmeriCredit Corp. (NYSE:ACF) announces that it believes the Securities and Exchange Commission ("SEC") has concluded its investigation of five Company employees for insider trading. None of the five is or ever has been a member of executive management.

In its investigation, the SEC asserts that five present or former AmeriCredit employees traded in shares of the Company's common stock in January 2002 while purportedly in possession of material, non-public information about the Company -- prior to the release of its financial results for the quarter ended December 31, 2001. The Company has cooperated fully with investigators and has taken appropriate disciplinary action.

The SEC also asserts that AmeriCredit is liable for a civil penalty under Section 21A of the Securities Exchange Act of 1934 as a "controlling person" of those employees who are alleged to have committed a violation of the Act. The Company neither admits nor denies liability under the Exchange Act by virtue of the trading activity of these employees, but has offered to resolve its part of this matter with the SEC by paying a civil penalty of \$100,000 as full settlement. The Company believes that the SEC has accepted this offer and that they will be making an announcement soon to conclude this issue.

AmeriCredit has recently adopted tighter restrictions for employees that trade in Company securities, including the implementation of stricter trading blackout periods and defined trading windows for a broader group of employees.

Zomax, Inc. et al.: Lit. Rel. No. 19262 / June 9, 2005 - Microsoft Internet Explorer provided by Comcast ...

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U.S. Securities and Exchange Commission



U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 19262 / June 9, 2005

SEC V. ZOMAX, INC. ET AL, (United States District Court for the District of Minnesota No. 05-1128)

SEC FILES INSIDER TRADING CHARGES AGAINST TWO OF ZOMAX INC.'S FORMER OFFICERS AND FILES SETTLED FINANCIAL REPORTING CHARGES AGAINST ZOMAX, INC. AND TWO OF ITS OFFICERS

The Securities and Exchange Commission announced that it filed a civil injunctive action in the United States District Court for Minnesota alleging that James T. Anderson (Anderson), Zomax's former Chairman of the Board of Directors and Chief Executive Officer, and his wife, Michelle Bedard-Anderson (Bedard-Anderson), Zomax's former Executive Vice-President of

Internet

Company pays \$2 million civil penalty.

Regulators charge 14 in insider case connected to hedge funds - MarketWatch - Windows Internet Explorer

http://www.marketwatch.com/news/story/regulators-charge-14-insider-trading/story.aspx?guid=%7b08B9C58-F9A6-4211-1-1

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Regulators charge 14 in insider case connected to he...

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Regulators charge 14 with insider trading 'Brazen' scheme involved hedge funds, SEC says

By [Robert Schroeder](#) & [David Weidner](#), MarketWatch
Last Update: 4:08 PM ET Mar 1, 2007

NEW YORK (MarketWatch) -- U.S. securities regulators charged 14 people, including a compliance officer, in a "brazen" insider-trading scheme that allegedly netted participants more than \$15 million in illegal profits by selling tips on pending stock-rating changes and mergers and acquisitions.

The Securities and Exchange Commission said Thursday that a lawyer for Morgan Stanley (MS) as well as a UBS (UBS) research executive, among others, participated in the scheme.

Three hedge funds were the biggest beneficiaries of the alleged fraud that took place during a five-year period, regulators said. The SEC's seeking repayment of ill-gotten gains as well as other penalties.

In addition, the U.S. Attorney for the Southern District of New York said 13 people have been charged criminally and four have pleaded guilty to securities fraud, conspiracy and commercial bribery.

"Our action today is one of several that will make very clear the SEC is targeting hedge-fund insider trading as a top priority," SEC Chairman Chris Cox said in a statement.

Among those charged in the schemes was Mitchel Guttenberg, 41, an executive director and institutional client manager at UBS, who served on

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Increase in "brazen" intentional insider trading schemes.

Newsday.com: Inside a trading scandal - Windows Internet Explorer

http://www.newsday.com/business/ny-bzinsi145129806mar14,0,5139508,print.story?coll=ny-business-print

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Newsday.com: Inside a trading scandal

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Inside a trading scandal

Long Island couple, ex-schoolmate among those accused of sharing information for market profit

BY ROBERT E. KESSLER
robert.kessler@newsday.com

March 14, 2007

On a fall afternoon in 1990, Christopher Collotta caught a pass for a touchdown in a high school football game.

The score was significant for more than the six points on the scoreboard: Collotta was able to play for Half Hollow Hills West that day because his cancer, diagnosed two years earlier, was in remission.

And it came on the day the football field in Dix Hills was dedicated in honor of his dad, Robert, who had been the school's widely respected football and baseball coach. Even as Christopher had fought his illness and survived, his father had died the previous spring, at the age of 42, of a heart attack.

"It's hard to explain how I've dealt with this," Christopher Collotta said in an interview that fall. "It's a

Cases contain fun facts and involve families and friends. They are not dry, like Section 16, Rule 144, or Section 404.

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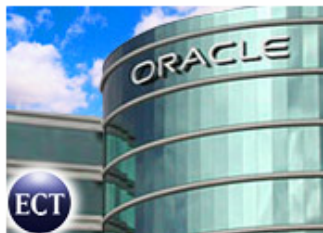
Increase in "pillow-talk" cases: e.g. husband learns information from wife. Oracle case involved information a VP learned about potential Oracle acquisition targets from his wife, an assistant to the CEO. Another recent case involved an Amgen VP who told her husband about positive results with a cancer drug jointly developed with Abgenix, and that they might buy the company. She told her husband not to buy the stock, but he did.

[E-Commerce Times](#) > [Business](#) > [Legal](#)

May 19, 2007 07:58:16 PM

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Ex-Oracle VP Puts Insider Trading Charges Behind Him for \$198K




By Keith Regan
E-Commerce Times
05/15/07 10:26 AM PT

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An ex-Oracle vice president, Christopher Balkenhol, agreed to pay nearly \$200,000 to settle insider trading charges. Balkenhol used information obtained from his wife -- an assistant to top Oracle executives including CEO Larry Ellison -- to purchase shares of companies Oracle planned to buy.

A former [Oracle](#) (Nasdaq: ORCL)  vice president has settled insider trading charges that he used information gained through his wife -- an assistant to Oracle's swashbuckling, acquisition-hungry CEO Larry Ellison and other company leaders -- to buy and sell stock in companies that Oracle was planning to purchase.

The [Securities](#) and Exchange Commission (SEC) filed its civil suit against Christopher Balkenhol on Monday. The commission alleged that Balkenhol used information from his wife to buy shares of two companies -- Retek and Siebel Systems -- before Oracle made public its plans to buy those companies.

Balkenhol agreed to pay approximately US\$198,000 to settle the case. The sum includes more than \$97,000 in profits realized due to the stock purchases and sales . Balkenhol agreed to pay an additional \$100,000 in fines and interest, though he did not admit to any wrongdoing as part of the settlement agreement, according to the SEC.

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Fundamentals of insider trading law

- **What is insider trading?**
- You are aware of material confidential information about a public company (whether your company or another company).
- You trade on that information, or tip others who trade on it, before the information is released publicly and is absorbed by the market.
- 50% of cases involve tipping, and in 50% of those cases the tippers do not even trade.

Fundamentals of insider trading law

- **What are the penalties?**

- Civil penalties: any profit made or loss avoided and a penalty of up to three times this amount.
- May be prohibited from serving as a D&O at a public company. 10x increase in SEC charges.
- Individuals face up to 20 years in prison and fines of up to \$5 million.
- Additional charges: Racketeering, mail and wire fraud, tax evasion, and obstruction of justice.

Fundamentals of insider trading law

- **More penalties:**

- New crime of “securities fraud”: fines and jail time of up to 25 years.
- New disgorgement penalty under Sarbanes-Oxley for restating financials because of misconduct.
- Controlling person liability for company and managers.
- Corporations: fines increased 10-fold, from \$2.5 million to \$25 million.

Fundamentals of insider trading law

- **What is material information?**

- News expected to affect a company's stock price, for better or worse.
- Stock plan professionals know material information about client companies in direct and in indirect ways.
- Lower-level employees and managers may know more market-moving information than executives.
- This includes knowledge of:
 - Takeovers/M&A (50% of reported cases on www.sec.gov)
 - accounting problems and other bad news (30%)
 - dividends/splits/repurchases
 - product developments (good news about 10% of cases)
 - earnings different than expected

Increase in M&A activity brings more insider trading

- Buyers pay significant premium over the market price, and deals involve many different individuals with access.
- Trading spikes in stock and call options in days leading up to deal announcements, such as with New Corp's bid for Dow Jones.
- *Financial Week* reports that there is more suspicious pre-deal trading with private equity buyouts than with corporate M&A. Complex deals with more players have more "leakage potential."

You can find examples of current insider trading cases by searching on SEC.gov and on Google/Yahoo/MSN under the News tab. Distribute these stories to executives and employees as ongoing reminders.



SEC Seal

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U.S. Securities and Exchange Commission

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This search page will not retrieve company filings from our EDGAR database. To search EDGAR, click [here](#).

Search words and phrases Search by section Sort by rank or date

(e.g., "example") See [Search Help](#)

Found **1154** documents (limited to **800**). **40** are presented, ranked by relevance within section.

Litigation

[Zomax, Inc. et al.: Lit. Rel. No. 19262 / June 9, 2005](#)

Fundamentals of insider trading law

- **When does information become public?**
 - You must allow time for dissemination.
 - Generally, a rule of thumb used to be two business days after release of information. Cable news, internet, internet forums, and blogs now can make this two minutes.
- For more fundamentals, see articles, FAQs, and quizzes in the section SEC Law on www.myStockOptions.com

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SEC Law

- Basics
- Insider Trading**
- Rule 10b5-1 Trading Plans
- Rule 144
- Section 16

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SEC Law: Insider Trading

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Articles [\(Jump to FAQs\)](#)

Prevent A "Martha Stewart Moment": Insider Trading In Your Company's Stock
Bruce Brumberg

Whether you think that Martha Stewart is guilty or innocent, or that the government should not have brought criminal charges against her, she made a number of rash mistakes that we all can learn from to avoid civil or even criminal charges of insider trading.

How Executives And Directors Can Avoid SEC Troubles Before Trading Their Company Stock (Part 1)
Merrill Freed and Steven Schraibman

Your advisors say now is the time to buy or sell your company stock or to exercise options. But before you proceed, you'd better understand the securities laws that apply. Otherwise, you risk losing your profits, paying big fines, attracting unwanted media attention, and perhaps even going to jail. The storm of controversy over the backdating of stock option grants shows how closely executive stock sales are scrutinized.



Knowing the rules helps avoid an SEC investigation

FEATURED FAQs

NEW! My company backdated more stock options than just those of the senior executives. How does this affect employees like me and the taxation of my stock grants?

At a minimum, do not expect any new stock option grants with an exercise price lower than the market price on the grant date unless...

What will happen to my Rule 10b5-1 plan if I die? [mso+](#)

Ordinarily, a 10b5-1 plan ends if you die. However...

Can my company force me to use a Rule 10b5-1 trading plan to sell stock? [mso+](#)

Some companies' policies on insider trading actually require all...

[More Related FAQs](#)

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myStockOptions.com has content section devoted to insider trading, with quiz to test your knowledge.

Insider trading law and stock plans

- **How does insider trading apply to stock plans?**
 - Exercise of stock options is not a trade (if shares are held).
 - Cashless exercise/same-day sale is a trade.
 - Knowledge of unreported backdating and CEO stock trades is material.
 - The rules also apply to trades into and out of company stock funds in 401(k) plans.
 - The rules apply to post-termination trades if the insider is still aware of material nonpublic information.
 - Tax treatment date is not delayed for blackout periods or other company-imposed restrictions related to insider trading. Does not create “substantial risk of forfeiture” that avoids recognition of income. [Revenue Ruling 2005-48](#) and cases such as *Merlo v. Comr* (2007 5th Circuit decision).

Insider trading law and stock plans: grant date timing

- Concerns about making stock grants when the company has material nonpublic information (springloading, bullet dodging) and whether the exercise price reflects all material information, have led to development of company policies on how and when grants should be approved.
- Various methods: regularly scheduled dates, or only during open windows.
- Merck: Every grant is “contingent upon an assurance of the general counsel that the company is not in possession of material undisclosed information.” If it is, the grants are suspended until the second business day after the public dissemination of the information.”
- Target: Stock options and RSUs granted on date of regularly scheduled compensation committee meeting in January. Performance share units are granted on date of regularly scheduled compensation committee meeting in March.

Fundamentals of insider trading law

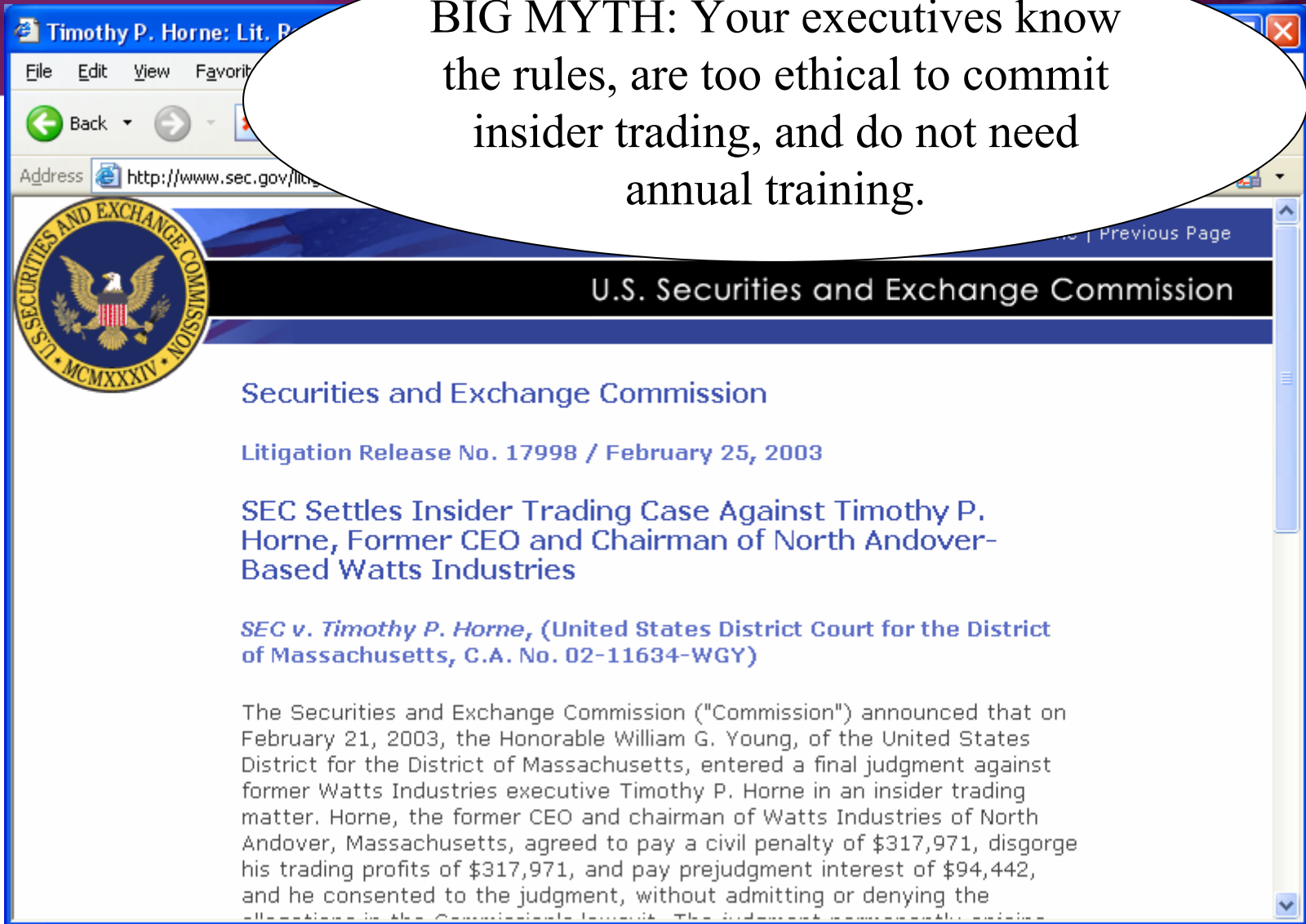
• MYTHS

- Only a company's officers or directors can commit insider trading. You need to trade and be caught in the act.
- You can always trade during a window period.

• TRUTHS

- The law applies to anyone who knows material nonpublic information at the time of the trade or tip regardless of whether it is window period.
- It applies to stock of customers, suppliers, merger partners. You do not need to work at the company whose stock you trade.
- Tipping, even if the tipper doesn't trade, is illegal. Does not need to be tipped with intent for someone to buy/sell securities.
- Most cases are based on circumstantial evidence. Emails create a stronger case.
- Applies to any type of security, such as call options.
- These rules are separate from, and additional to, the Section 16 rules for senior executives and directors.

BIG MYTH: Your executives know the rules, are too ethical to commit insider trading, and do not need annual training.



The screenshot shows a web browser window with the address bar displaying "http://www.sec.gov/litigation". The page header includes the U.S. Securities and Exchange Commission logo and the text "U.S. Securities and Exchange Commission". The main content area features the following text:

Securities and Exchange Commission

Litigation Release No. 17998 / February 25, 2003

SEC Settles Insider Trading Case Against Timothy P. Horne, Former CEO and Chairman of North Andover-Based Watts Industries

SEC v. Timothy P. Horne, (United States District Court for the District of Massachusetts, C.A. No. 02-11634-WGY)

The Securities and Exchange Commission ("Commission") announced that on February 21, 2003, the Honorable William G. Young, of the United States District for the District of Massachusetts, entered a final judgment against former Watts Industries executive Timothy P. Horne in an insider trading matter. Horne, the former CEO and chairman of Watts Industries of North Andover, Massachusetts, agreed to pay a civil penalty of \$317,971, disgorge his trading profits of \$317,971, and pay prejudgment interest of \$94,442, and he consented to the judgment, without admitting or denying the allegations in the Commission's lawsuit. The judgment permanently enjoins

What was the CEO thinking?

The Commission alleged in its complaint, filed on August 15, 2002, that Horne received a call in May 1999 from an investment banker inquiring whether Watts Industries would be interested in acquiring Central Sprinkler Corporation, indicating that an auction process was under way and that Watts would need to move quickly if interested. Further, the Commission alleged that Horne told the investment bank that Watts might be interested in acquiring Central Sprinkler. The complaint alleged, however, that **Horne did not inform the Watts board of this acquisition opportunity and instead began buying stock of Central Sprinkler in his personal brokerage account**, spending over \$500,000 to accumulate 30,000 shares over the next three business days. **According to the complaint, Horne never informed anyone at Watts of his trading, which violated a Watts written policy prohibiting trading in any company's securities on the basis of nonpublic information.** Shortly thereafter, when Tyco International Ltd. publicly announced its acquisition of Central Sprinkler, Horne sold his stock for a profit of \$317,971.

Approaches companies take

- Written policy
- Blackout periods before earnings announcements until information is absorbed by the market.
- Special blackout periods for other confidential information, such as acquisitions or FDA decisions. These can vary by level in company and by who knows the information.
- Pre-clearance of trades by executives and directors. Compliance, legal, corporate secretary staff reviews all trades for any problems.
- Rule 10b5-1 trading plans: permit, encourage, or require (and at what level in company)?

Even compliance staff and lawyers go wrong

SEC Litigation Release No. 17871 / December 3, 2002

SEC Charges High-Ranking Attorney at Cambridge Biotech Company
with Insider Trading

Securities and Exchange Commission v. Andrew S. Marks (United States District Court for the District of Massachusetts, No. 02 CV 12325 (JLT) (D.Mass.)

The Commission announced today that it has filed insider trading charges against Andrew S. Marks, of Wayland, Massachusetts, in connection with his September 2001 sale of stock in Vertex Pharmaceuticals, Inc., a Cambridge-based biotechnology company. The SEC alleges that Marks, who at the time was Vertex's highest-ranking attorney, learned on September 20, 2001 that Vertex planned to announce the suspension of clinical trials of one of its promising drugs on September 24.

According to the Commission's complaint, at the time he traded, Marks was the designated attorney for employees to consult regarding compliance with Vertex's employee securities trading policy. In that capacity, the complaint alleges, Marks wrote Vertex's CEO an email on September 20, advising him to make sure that an employee who had requested permission to trade had no knowledge of the impending press release. According to the Commission's complaint, Marks' email went on to say:

“I guess that I am troubled about any employee trading prior to that release because it is likely to have an effect on the stock (looks like I can't sell any shares) and, depending on the degree of that effect, could create the perception of insider trading.”

Rule 10b5-1 trading plans

- **What are Rule 10b5-1 trading plans?**
- When unaware of *any material inside information*, the insider adopts a written plan for periodically trading a specific amount of securities at set prices and/or times (or formula or algorithm triggers the trade and the number of shares involved)
- **Example:** A written one-year contract between executive and broker (not the company) that instructs the broker to sell 10,000 shares on the first trading day of each month and twice as many shares (20,000) if the price has increased by 5% since the prior sale date.
- These plans can provide an affirmative defense (not a shield) against insider trading claims.
- Plans must be entered into in good faith.

Rule 10b5-1 trading plans

- Sales can take place even when insiders are aware of material nonpublic information and during closed periods.
- Companies can manage public perception of insiders' sales.
- Can head off negative reactions and analysts' questions about reported sales. Can also lead to more calls for explanations of sales.
- Form 4 filing: Consider adding footnote with Transaction Code S in Column Three of Table I: "Sales reported on this Form were made according to a Rule 10b5-1 trading plan adopted by NAME on X Date."
- Voluntary corporate disclosure: Not required to report plans in 8-K, though some companies do this or, more commonly, issue a press release.

Rule 10b5-1 trading plans

- **How else do 10b5-1 plans help?**
 - Can be used for prearranged sales of shares for taxes with restricted stock/RSU vesting.
 - Used by companies for share-buyback programs. Giving up flexibility compared to discretionary repurchase program. Also need to comply with safe harbor in Rule 10b-18.
 - For more details and evolving practices, see webcast archived on www.theCorporateCounsel.net and section on myStockOptions.com under SEC Law/[Rule 10b5-1](#) plans.

Data on use of plans

- [Equilar](#) looked at 10b5-1 activity reported on Form 4 between January 1, 2005, and the first half of 2007 for companies in the S&P 500. It found that during this period at the surveyed companies:
- 28.7% of the companies in 2006 had at least one executive who sold shares under a 10b5-1 trading plan.
- In 2006, the number of executives who made 10b5-1 transactions rose 31.2% over 2005. For 2007, if the rate of disclosures through the middle of the year continues at the same pace, the increase will be 51% over 2006. During 2006, 509 executives elected to use a 10b5-1 plan, up from 388 executives during 2005. In the first half of 2007 alone, 384 executives made 10b5-1 transactions.
- In 2006 at companies with these plans the average number of executives who used them averaged 3.7, up from 3.1 in 2005.

Use of plans for withholding

- Withholding sometimes used to pay the taxes due at vesting. Companies permit this or require it as a condition of accepting a grant. For senior executives who may know material nonpublic information at the time of a grant, this plan may be in a separate document from the grant itself.
- A benchmarking survey in 2006 by the [American Society of Corporate Secretaries and Governance Professionals](#) received responses from 305 companies about whether they require a Rule 10b5-1 trading plan for shares that are sold to cover the withholding taxes when restricted stock and RSUs vest. The survey found that:
 - 223 of the responding companies do not require a Rule 10b5-1 plan.
 - 20 companies do mandate the use of 10b5-1 plans.
 - 62 companies did not answer the survey question.
 - 19 of the companies implement these plans through a designated broker, 33 don't, and the majority (253) did not give an answer.

SEC looking into trading plans

- Adopted in 2000 with little case law. Concerns about misuse and unresolved details in the rule.
- Study by Stanford University Business School professor Alan Jagolinzer shows that executives who trade within a 10b5-1 plan outperform their peers who trade without a plan by nearly 4.1% over six months.
- Examples of sales under plans before stock drops.
- Rules not clear on ending plans before fully executed, setting up multiple short-term plans, and selling immediately after adoption.

Remarks by SEC Enforcement Director at the Corporate Counsel Institute, March 7 2007

- “[E]xecutives with plans sell more frequently and more strategically ahead of announcements of bad news. This raises the possibility that plans are being abused in various ways to facilitate trading based on inside information.
- “We're looking at this—hard. We want to make sure that people are not doing here what they were doing with stock options. If executives are in fact trading on inside information and using a plan for cover, they should expect the ‘safe harbor’ to provide no defense.”
- <http://www.sec.gov/news/speech/2007/spch030807lct2.htm>

Remarks by SEC Enforcement Director at the NASPP conference, October 10, 2007

- Her comments implied acceptance of the need to let insiders trade stock under Rule 10b5-1 plans. She clarified that her harsh prior statements were directed at blatant abuses or the use of Rule 10b5-1 to shelter insider trading.
- She recognized that allowing executives and founders with substantial company stock holdings to diversify and to get liquidity is a “legitimate concern.” She expressed an understanding that window periods are narrow. This somewhat new rule was developed in 2000 to help individuals plan trades when they do not know or possess material nonpublic information.
- Both her comments and those of the other experts on the panel, such as Alan Dye, made it clear that terminating a plan early raises questions of whether the plan was set up in good faith: in other words, this may be “inviting trouble.” It can cause trades to lose the protection of Rule 10b5-1, whether under the prior plan or under any new plan set up after the termination. The recommendation is: “Live with it [i.e. the plan] right now.”

Ex-chief at Qwest found guilty of insider trading: role of Rule 10b5-1 plan

- Federal District Court jury deliberated six days before finding Joseph Nacchio guilty on 19 of 42 counts of insider trading (April 19, 2007).
- Many of the “not guilty” stock trades were made earlier under a predetermined trading plan.
- Some of the “guilty” stock trades happened after he canceled his plan, learned that revenue targets would not be reached, and then began selling stock at a faster rate than he did under his prior plan.
- Other “guilty” trades occurred under a new plan set up when he knew confidential bad news.

Best practices evolving for Rule 10b5-1 plans

- **When to adopt.** Plans are adopted only during a window period. Consider pre-clearance procedure for adoption of plans similar to review of trades.
- **Waiting period after first trade.** When the plan is adopted, a waiting period applies before trading starts, e.g. 30 days. The longer the wait the less likely it appears set up when know material information to time the trade.
- **Terminations and modifications.** Ending a plan before it is fully implemented, or modifying it, can raise concerns. This raises questions about whether you entered into the plan in good faith. Additional suspicions are raised when another plan is started soon after the termination of a prior plan.
- *Wall Street Journal* and Reuters have reported that the CEO of Countrywide Financial is under SEC investigation for sales he made in company stock under a pre-arranged trading plan. Among the activities raising suspicion were the suspension of trades for two months during a liquidity crisis that caused the company's shares to fall.

Best practices evolving for Rule 10b5-1 plans

- **Avoid very short plans.** The plans that involve large block sales over shorter periods, particularly before stock price drops, will raise questions and possibly SEC investigations.
- **Reporting of plan.** While not required by SEC regulations, some companies do this by press release or in 8-K. This can sensitize the market to the upcoming trades. A trade under the plan is then disclosed on Form 4.
- **Trade outside of plan.** While a plan is being executed, trades are made only under it. Trades outside the plan do not have the affirmative defense against insider trading charges and can prompt suspicions that confidential information encouraged them.

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- ▶ Rule 10b5-1 Trading Plans
- ▶ Rule 144
- ▶ Section 16

Insider Trading
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Pop quiz: How do you report sales of company stock on your tax return?

SEC Law: Rule 10b5-1 Trading Plans

Test your knowledge with our [Insider Trading](#) quiz.

Articles [\(Jump to FAQs\)](#)

▶ **How To Use Rule 10b5-1 Trading Plans To Sell Company Stock (Part 1)** [mso+](#)

Darryl Rains and Sunil Kulkarni

Insider trading restrictions can cause constant headaches for executives and their companies. Rule 10b5-1 trading plans are an ideal solution when they are properly drafted and implemented.

▶ **How To Use Rule 10b5-1 Trading Plans To Sell Company Stock (Part 2)** [mso+](#)

Darryl Rains and Sunil Kulkarni

Insider trading restrictions can cause headaches for executives and companies. Rule 10b5-1 trading plans are an ideal solution. Part 2 explores their restrictions and flexibility, and how to disclose them.

▶ **How Executives And Directors Can Avoid SEC Troubles Before Trading Their Company Stock (Part 1)** [mso+](#)

Merrill Freed and Steven Schraibman

Your advisors say now is the time to buy or sell your company stock or to exercise options. But before you proceed, you'd better understand the securities laws that apply. Otherwise, you risk losing your profits, paying big fines, attracting unwanted media attention, and perhaps even going to jail. The storm of controversy over the backdating of stock option grants shows how closely executive stock sales are



Knowing the rules helps avoid an SEC investigation

Enter

FEATURED FAQs

[What are best practices for Rule 10b5-1 trading plans?](#) [mso+](#)

SEC Rule 10b5-1 does not have many details on setting up and operating these prearranged stock-trading plans. Best practices have evolved...

UPDATED! [My company backdated more stock options than just those of the senior executives. How does this affect employees like me and the taxation of my stock grants?](#)

At a minimum, do not expect any new stock option grants with an exercise price lower than the market price on the grant date. The tax treatment varies by type of grant. Some companies are freezing exercises and ESPP purchases and are making modifications in grants by...

myStockOptions.com has content about Rule 10b5-1 trading plans.

Insider trading investigations

- Movement to “real time” enforcement. Freezing accounts before traders are identified.
- Traditionally, the SEC starts with an informal, confidential investigation and then moves to a formal investigation.
- There may be a referral from a stock exchange to the SEC. They conduct their own initial investigation.
- Companies hope to head off a full-blown investigation and its disclosure. Individuals and corporations volunteer information and materials, such as an insider trading policy and employee lists.
- Be careful about protecting attorney work product and attorney-client privilege.



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TXU insider trading alleged

By **Aaron Siegel**
March 5, 2007

The Securities and Exchange Commission charged unnamed investors with engaging in illegal billion buyout of TXU Corp.

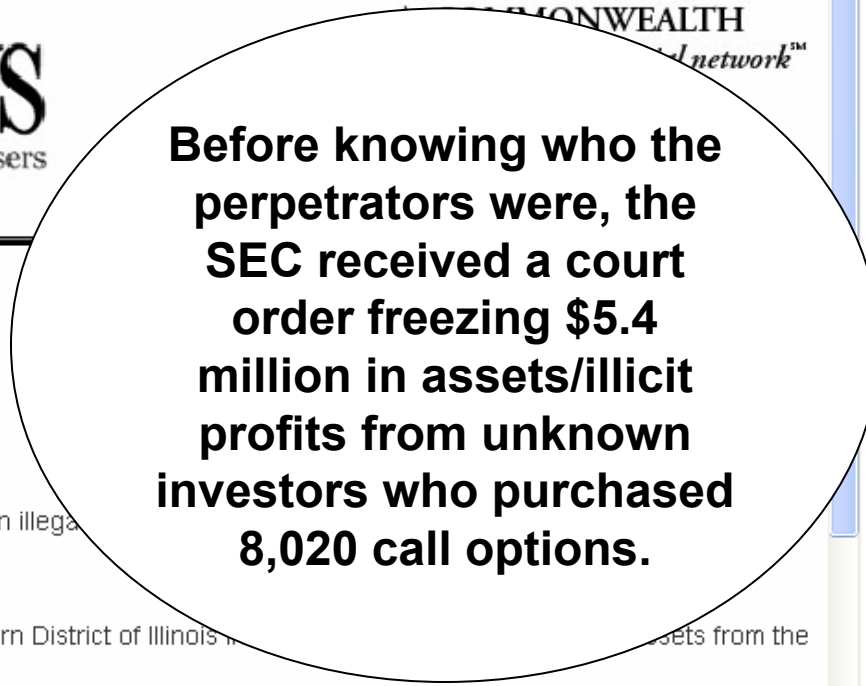
The SEC said that it won a court order in the United States District Court for the Northern District of Illinois to freeze assets from the investors that had purchased 8,020 call options in the Dallas-based energy provider.

The investors used accounts at three U.S. broker-dealers between Feb. 21 and Feb. 23 to acquire the options, which led to the stock rising 13% on the 23rd.

The complaint further alleged that the increased in stock brought in unrealized illicit profits on these option contracts worth approximately \$5.4 million.

The SEC said in the complaint that 1,060 call options were purchased through an account at Credit Suisse in Zurich, Switzerland and cleared through Swiss American Securities Inc. on Feb 21.

A batch of 260 TXU call options were purchased through an account at Fimat Banque Frankfurt Zweigniederlassung between Feb. 21 and Feb. 22 and were



Before knowing who the perpetrators were, the SEC received a court order freezing \$5.4 million in assets/illicit profits from unknown investors who purchased 8,020 call options.

Insider trading investigation: you get a call from the SEC

- Do not answer any questions or hand over documents if your company did not tell you to expect the call and to cooperate. Explain to the government investigator that you must contact your company's legal department before you can respond.
- If concerned that your personal activity may be the reason for the call: contact your own attorney for separate legal counsel.
- When you do talk to the government, be aware that lying and document-destruction fire up an investigation and can be independent cause for criminal prosecution. Even without an oath, you may not give false statements to government officials (18 USCA 1001).
- Resist pressure or bribes from senior executives and bosses who want to hide what they did. The indictment of Sam Waksal mentions that he told individuals to destroy certain documents and delete computer files at ImClone.

Formal SEC investigation

- Formal order by full Commission that gives the SEC Enforcement Division staff the authority to force testimony and document production.
- 8-K definitely filed and resulting media coverage
- The SEC has subpoena power to force your cooperation.
- The SEC can then require the involved company, brokerage firm, and individuals to hand over, and it can obtain on its own, telephone records, bank and brokerage firm statements, emails, databases, computers, Rolodexes, and other personal files.
- There may be a parallel criminal prosecution by the U.S. Attorney/Justice Department.

Internal corporate investigations

- Standard practice in response to inquiries and allegations about corporate and employee wrongdoing, or suspicious leaks.
- Corporations discover weaknesses in their own compliance programs along with other wrongdoers and illegal activity, assess potential exposures and defenses, and document past and future “good faith” efforts to prevent misconduct.
- Self-policing can prevent SEC enforcement action against companies and reduce penalties under the Federal Sentencing Guidelines.
- The SEC has articulated criteria it will consider in determining the impact of corporate self-policing, self-reporting, remediation, and cooperation in enforcement actions. (See www.sec.gov/news/press/2001-117.txt, October 23, 2001.)

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The ImClone case: the players

- Sam Waksal—founder and CEO of ImClone Systems Inc. (currently serving 7-year prison term, along with at least \$3.8 million in penalties and disgorgement of gains; still faces civil suits)
- Aliza, Jack, and Patti Waksal—his daughter, father, and sister
- Peter Bacanovic—their Merrill Lynch broker
- Douglas Faneuil—Bacanovic's assistant
- Martha Stewart—friend of Waksal and fellow client of Bacanovic (served five-month sentence)

The ImClone case: the key facts

- December 21, 2001: ImClone GC sends email announcing a trading blackout until the FDA release on ImClone's application for Erbitux cancer drug.
- December 26, 2001: Sam Waksal learns that the FDA will reject ImClone's application for review.
- That night, Sam advises daughter Aliza and others in his family (father Sam) either that the company would be receiving bad news or to sell their ImClone shares.
- December 27, 2001: Aliza and family accountant begin calling Faneuil at Merrill Lynch. Aliza sells \$2.5M of her ImClone shares as price falls; Jack sells \$7M.
- Merrill Lynch blocks an attempted sale by Sam.

The ImClone case: the key facts

- December 27, 2001:
- Stewart returns Faneuil's call from her private jet, which is en route to Mexico. At the end of a two-minute call, she instructs him to sell all \$228K of her ImClone shares, at approximately \$58 per share (it opened at \$63.50).

What did Merrill and ImClone know?

- **On December 27, 2001, Doug Faneuil has between 75 and 100 phone calls other than the notorious call from Martha:**
 - Aliza Waksal (two or three calls)
 - Elana Waksal (two or more calls)
 - Sam Waksal's accountant (30 calls, plus faxes)
 - Merrill employees in Hopewell, NJ (a handful of calls)
 - Merrill administration and compliance people (two in-person conversations, one call)
 - Peter Bacanovic (five or six calls)
 - Merrill's credit administration risk desk (one call)
 - The office of general counsel at ImClone (one call)
 - Other Bacanovic clients (unspecified number of calls)
- Lesson: Compliance programs sometimes fail the stress test.

Did ImClone have any discussions on December 27 with Sam about his attempted blackout violations?

- December 28, 2001: FDA notifies ImClone about Erbitux decision at 4 p.m. The company announces it at 6 p.m.
 - Sam Waksal (whose ImClone stock is heavily margined) buys January put options through Swiss brokerage account.
 - Jack Waskal also continues to sell his ImClone stock and sells stock in Patti's account.
 - ImClone stock drops 16% to close at approximately \$46 by December 31, the next trading day.
 - Martha Stewart's earlier sale saves her about \$45K on day one (although the stock continues to fall for several days to below \$20).

Discussion points for executives and employees

- **What is material nonpublic information, and when does it become public?**
- Difference between Sam Waksal's classic insider trading and Martha's "outsider" trading.
- Martha: What did she know? Does not need to be directly about the stock. What did she think (she did not "think twice") at the moment she learned the information, and how would you prevent the same mistake? Who gave her the information? (Does not need to be an insider.)
- How not to respond to government investigators.
- Rule 10b5-1 programs.
- May brokers tell other clients that senior executives are buying or selling? May stock plan administrators? Check with your stock plan provider and brokerage firms your executives must use for their company stock trades. Are the firms told about special blackouts and how to handle attempted trades?

Resources on Martha Stewart/ImClone saga

- *Slate* Magazine's day-by-day dispatches at <http://slate.msn.com/id/2093610/>
- *SEC v. Martha Stewart and Peter Bacanovic*, SEC Litigation Release and complaint at <http://www.sec.gov/litigation/litreleases/lr18169.htm>
- Waksal criminal indictment at <http://www.usdoj.gov/dag/cftf/chargingdocs/waksalind.pdf>
- SEC Settlement with Martha Stewart at <http://sec.gov/news/press/2006/2006-134.htm>. \$195,000 fine and 5 year D&O ban.
- Game prizes for employees at <http://www.savemartha.com>
- Insider trading resources and training videos at <http://www.insidertradingvideos.com>

Five actions for you and your company

- 1. Go to www.sec.gov. Search for insider trading enforcement releases and cases. Distribute interesting stories and situations in hard copy or by email. Link to them from your intranet. Similarly, search for stories through Google/Yahoo news tab.
- 2. Rethink who at your company has information that interests analysts and hedge funds. What policies and education do you need to implement for these lower-level employees/managers who know market-moving information?

Five actions for you and your company

- 3. Confirm that your insider trading policy makes it clear that the standard window period is not a “green light” on trading company stock. You still cannot have material nonpublic information at the time of the trade.
- 4. Discuss the SEC’s new focus on Rule 10b5-1 trading plans, if you have them, with appropriate people at your company. Explain the recommendation by experts that plans not be modified or terminated.
- 5. Put your insider trading blackouts through a stress test with your firm that handles trading.

Questions?

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