

# COMPLIANCE WEEK

## Executives' Interest In Stock Trading Plans Is Surging

By Stephen Taub — May 16, 2006

Interest in automatic stock-trading plans is surging among executives lately, fueled by fears of more litigious shareholder groups and a burgeoning scandal over back-dating of stock option grants.

According to a new study by compensation research firm Equilar, the number of executives participating in so-called "10b5-1 plans" jumped 22 percent last year and the number of companies offering such plans rose 21 percent. Moreover, early numbers show an even sharper increase in the compensation plans is likely for 2006.

"There is increasing risk aversion among executives due to the pretty active plaintiffs bar," says Tim Ranzetta, president of Equilar. "I also wonder how much is tied to folks who want to systematically take money off the table" due to the recent surge in the stock market.

Named after Rule 10b5 from the 1934 Securities Exchange Act, 10b5-1 trading plans are designed to provide a legal defense against allegations of insider trading. Under such plans, corporate insiders essentially spread stock trades over a period of time automatically, regardless of any material, non-public information they may receive after adopting the plans. The plans were instituted in October 2000 along with Regulation Fair Disclosure.

Equilar's data show that 434 executives at 138 companies elected to use a 10b5-1 plan last year, compared to 355 executives at 114 companies during 2004. And in the first quarter of 2006 alone, 297 executives at 105 companies made 10b5-1 transactions. At three-quarters of the companies that have a 10b5-1 plan, the total number of executive officers with plans is between one and five persons. More than 19 percent of them have 6 to 9 executives participating, while another 6.8 percent of the companies have 10 or more executives participating.



Whatever the reasons for this growing trend, governance experts applaud the move. "Typically, I think it's a good governance thing to do," says Paul Hodgson, compensation expert for watchdog group The Corporate Library. "It announces in advance significant off-loading of stock. Everyone knows about it in advance and not the day after the company announces earnings."


Hodgson Companies say they encourage use of these plans because it enables their top executives to buy and sell shares of their company's stock and exercise their sometimes substantial option holdings without fear of being accused of trading on material, nonpublic information. The plans also give executives more flexibility with the timing of these transactions.

The three industries that had the highest percentage of companies with at least one 10b5-1 transaction were: healthcare (45.5 percent), information technology (41.5 percent) and industrials (38.6 percent). "This would

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 [Equilar Report On 10b5-1 Plans \(April 2006\)](#)

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appear to be partially explained by the volatility of share prices in the healthcare and information technology industries that can make insider sales particularly precarious,” Equilar points out in a recent analysis.



Coburn

“We generally believe if you enter into a written plan in advance and you are not in the possession of material, non-public information, it is safer for the executive,” says John Coburn, corporate secretary for Nike, which has 17 executives participating in its 10b5-1 plan. “It also provides greater flexibility for directors and officers subject to limited trading periods for buying and selling stock any time of the year.” For executives not in Nike’s 10b5-1 plan, Coburn says, the footwear giant typically bars insiders from trading its stock in the month leading up to the release of quarterly results.

Regulation FD is not the only pressure executives feel these days to distance themselves from insider trading of securities. UnitedHealth Group, Converse Technology, Altera, Vitesse Semiconductor and other corporations have all lurched into the regulatory spotlight this spring amid allegations that the companies back-dated awards of stock options to boost the value of executives’ compensation plans; just last week, UnitedHealth admitted it had a “significant deficiency” in its administration of stock options and disclosed an informal probe by the Securities and Exchange Commission. 10b5-1 plans won’t necessarily prevent such accounting machinations, experts say, but they do add an additional layer of protection from accusations of wrongdoing.

Hodgson also theorizes that accusations that Enron executives unloaded stock holdings shortly before company’s stock cratered in late 2001 sent a sobering warning to other executives of the risks of trading their own stock without the cover of 10b5-1 selling programs.

### Different Plans, Different Reasons

For those reasons, Ohio-based utility FirstEnergy Corp. has coaxed 30 of its executives participate in the company’s 10b5-1 plan, first instituted in 2004. “This helps them assure compliance,” spokeswoman Ellen Raines says. “It is something that we recommend.”

Under FirstEnergy’s plan, Raines explains, executives must wait six months after

#### THE RULE

The "Rule 10b5-1" excerpt below is from Securities Exchange Act of 1934, published by in "Securities Lawyer's Deskbook," The University of Cincinnati College of Law:

#### Rule 10b5-1: Trading "On The Basis Of" Material Nonpublic Information In Insider Trading Cases

a. *General.* The "manipulative and deceptive devices" prohibited by Section 10(b) of the Act and Rule 10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.

b. *Definition of "on the basis of."* Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is "on the basis of" material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.

c. *Affirmative defenses.*

1.

i. Subject to paragraph (c)(1)(ii) of this section, a person's purchase or sale is not "on the basis of" material nonpublic information if the person making the purchase or sale demonstrates that:

A. Before becoming aware of the information, the person had:

1. Entered into a binding contract to purchase or sell the security,
2. Instructed another person to purchase or sell the security for the instructing person's account, or

establishing their plan before they can conduct any transactions—which encompasses all stock-related transactions, including restricted stock, options and stock invested in 401(k) plans.

A six-month waiting period is much more conservative than most other companies, which either don't require a waiting period or require plan participants to wait for 90 days, Ranzetta says.

At Nike, the plan is not just restricted to top executives, Coburn says; lower level financial employees and senior managers also participate. They have entered into these periodic stock trading plans for a variety of reasons, including asset diversification and the need to raise money in a single year to pay for a child's college education, he explains. Coburn says Nike's plans typically involve just a portion of the individual's stock or option holdings. "Most people don't want to sell all of their Nike shares," he says.

Indeed, Equilar's Ranzetta points out that nearly one-third of those who have set up these pre-planned stock selling programs did so to execute just one transaction.

Back in 2004, Monsanto Chief Executive Officer Hugh Grant created a stock trading plan to satisfy company requirements to own Monsanto stock in an amount equal to five times his annual base salary. At the time, the company said roughly 40 executives had stock ownership requirements of varying levels. Those guidelines were amended in April 2005 to keep the dollar value requirements of stock ownership commensurate with base pay multiples while reducing the number of required shares, to reflect the increased fair market value of the company's stock at that time.



Earlier this month, Kulicke & Soffa Industries, a supplier of semiconductor equipment, announced that its chairman and chief executive officer, Scott

3. Adopted a written plan for trading securities;
- B. The contract, instruction, or plan described in paragraph (c)(1)(i)(A) of this Section:
1. Specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;
  2. Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or
  3. Did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not have been aware of the material nonpublic information when doing so; and
- C. The purchase or sale that occurred was pursuant to the contract, instruction, or plan. A purchase or sale is not "pursuant to a contract, instruction, or plan" if, among other things, the person who entered into the contract, instruction, or plan altered or deviated from the contract, instruction, or plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale), or entered into or altered a corresponding or hedging transaction or position with respect to those securities.
- ii. Paragraph (c)(1)(i) of this section is applicable only when the contract, instruction, or plan to purchase or sell securities was given or entered into in good faith and not as part of a plan or scheme to evade the prohibitions of this section.
  - iii. This paragraph (c)(1)(iii) defines certain terms as used in paragraph (c) of this Section.

Kulicke Kulicke, had re-established a 10b5-1 plan to diversify his assets. Under the plan, Kulicke will sell up to 20,000 shares per month over a one-year period beginning June 1. The maximum number of shares that may be sold during this period represents approximately 15 percent of Kulicke's current holdings of K&S common stock and options to purchase common stock, and 0.4 percent of the currently outstanding common stock of K&S.

And in April, Oracle Corp. announced that one of its directors, Michael Boskin, adopted a pre-arranged stock trading plan to sell a portion of his company stock over time as part of his individual long-term strategy for asset diversification and liquidity. Under his plan, Boskin may sell as much as 162,000 shares over a period of roughly 13 months. These shares will be acquired through the exercise of employee stock options that are scheduled to expire on their 10-year anniversary in May 2007. Oracle elaborated that Boskin's plan has a series of laddered price triggers for the sale of shares.

- A. *Amount*. "Amount" means either a specified number of shares or other securities or a specified dollar value of securities.
- B. *Price*. "Price" means the market price on a particular date or a limit price, or a particular dollar price.
- C. *Date*. "Date" means, in the case of a market order, the specific day of the year on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution). "Date" means, in the case of a limit order, a day of the year on which the limit order is in force.

- 2. A person other than a natural person also may demonstrate that a purchase or sale of securities is not "on the basis of" material nonpublic information if the person demonstrates that:
  - i. The individual making the investment decision on behalf of the person to purchase or sell the securities was not aware of the information; and
  - ii. The person had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of material nonpublic information. These policies and procedures may include those that restrict any purchase, sale, and causing any purchase or sale of any security as to which the person has material nonpublic information, or those that prevent such individuals from becoming aware of such information.

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#### Source



Securities Lawyer's Deskbook: General Rules And Regulations Promulgated Under The Securities Exchange Act Of 1934 (The University of Cincinnati College of Law)

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