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RULE 10B5-1 TRADING PLANS: CONSIDERATIONS IN LIGHT OF INCREASED SCRUTINY

Wilson Sonsini Goodrich & Rosati attorneys Steve Bochner and Nicki Locker recently provided an update to clients concerning heightened scrutiny of executive trading and trading plans. This memorandum provides a summary of that presentation, including issues to consider when developing trading plan policies in the current environment.¹

The aggressive use (or misuse) of Rule 10b5-1 trading plans is likely to become a significant area of focus for regulatory enforcement and securities class action plaintiffs. The floodlights now aimed at such plans are the result of recent *Wall Street Journal* articles showing that corporate insiders, even those executing trades pursuant to Rule 10b5-1 plans, have generated significant profits—or avoided significant losses—by trading company stock in the days just before their companies issued market-moving news.² Federal prosecutors and the Securities and Exchange Commission (SEC) have commenced investigations into certain of the trades identified in those articles. Shareholder lawsuits undoubtedly will follow.

The Insider Trading and Securities Fraud Enforcement Act of 1988 makes employers liable for acting recklessly in failing to prevent an insider-trading violation, such as the failure to maintain appropriate policies. Accordingly, companies may have liability in

certain situations for illegal trades, in addition to the publicity, distraction, expense, increased risk of securities litigation and regulatory enforcement interest, and other ramifications of trades that, with the benefit of hindsight, look suspiciously timed.

In light of these events, we expect corporate boards to come under pressure to increase oversight of Rule 10b5-1 plans and insider-trading policies and procedures. The following summary outlines the requirements of Rule 10b5-1 and provides considerations for developing additional policies for the adoption and use of trading plans in light of the heightened scrutiny.

Rule 10b5-1 Trading Plan Requirements

Under Rule 10b5-1, officers, directors, and other insiders may establish an affirmative defense to an illegal insider-trading charge when their trades are made pursuant to a pre-existing written trading plan meeting the following requirements:

1. The plan must be established when the participant was not aware of material non-public information.
2. The plan must specify the number of securities to be traded, at what price the securities are to be traded, and the date of the trade, or it must include a

formula for making such a determination.

3. The participant may not exercise any subsequent influence over how, when, or whether to effect transactions.
4. The plan must be entered into in good faith and not as part of a scheme to evade insider trading liability.

Considerations in Developing Trading Plan Policies

The following provisions provide a strong defensive posture and should be considered in developing trading plan policies and procedures. However, these provisions may not be appropriate for all issuers or in every circumstance, and the Rule 10b5-1 affirmative defense may be available with less restrictive provisions.

- Timing of Adoption/Modification. Trading plans should be adopted and modified only when the insider can buy or sell securities under the company's insider-trading policy, such as during an open trading window and ideally soon after an earnings announcement.
- Waiting Period. A reasonable waiting period should be required for the first trade following the date of a plan's

¹ Please note that the views expressed in this memorandum are those of the authors and do not necessarily reflect the views of the firm.

² Please see the following articles published in *The Wall Street Journal*: "Executives' Good Luck in Trading Own Stock," November 27, 2012; "Insider-Trading Probe Widens, U.S. Launches Criminal Investigation Into Stock Sales by Company Executives," December 10, 2012; and "Trading Plans Under Fire Despite 2007 Warning, Experts Say Loopholes Remain for Corporate Insiders," December 14, 2012 (subscription required).

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adoption or modification—for example, no trades permitted for the greater of three months from such adoption/modification or the beginning of the next open trading window.

- **Insider-Trading Policy Implications; Pre-Clearance.** An exception to the company's insider-trading policy for Rule 10b5-1 plans should be conditioned on use of a company-approved plan template containing the required restrictions. All plans, including plan modifications, should be pre-cleared through the company's legal counsel/compliance officer in advance.
- **Disclosure.** Trades pursuant to Rule 10b5-1 plans should be publicly disclosed on Form 4 and Form 144 filings. Such disclosure could take the following form:

*Sales pursuant to trading plan meeting the requirements of SEC Rule 10b5-1.

- **Mandatory Usage.** Consideration should be given as to whether use of a Rule 10b5-1 trading plan should be mandatory for all insiders.
- **Multiple Plans; Frequent Modifications.** Multiple trading plans for the same insider for the same pool of stock should be discouraged, as should frequent modifications.
- **Simplicity.** Simple plans with a prescribed, regular pattern of stock sales (e.g., 1,000 shares a month on the 15th day of the month) provide greater protection than more complicated plans. We recommend a plan duration of 12 months or more. Frequent, shorter-term plans, such as those with terms of less than six months, can appear to be timed to take advantage of inside information, and more frequent adoption dates increase plan vulnerability. A plan with too long a term increases the likelihood that the plan will require modification or termination due to a change in circumstances.

Notwithstanding the increased scrutiny, we believe that well constructed Rule 10b5-1 trading plans continue to afford substantial protection against accusations of impropriety. However, the current climate of heightened scrutiny has increased the need for careful oversight of trading plans and conservatism in their construction and operation.



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