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ALERTS

Financial, Corporate Governance And M&A Litigation Alert - Rule 10b5-1 Trading Plans Under Scrutiny

February 5, 2013 | Atlanta | Chicago | Columbus | Delaware | Elkhart | Fort Wayne | Grand Rapids | Indianapolis | Los Angeles | Minneapolis | South Bend

For more than a decade, corporate officers and directors of publicly traded companies have relied on trading plans, known as Rule 10b5-1 trading plans, in order to trade stock in their companies without running afoul of laws prohibiting corporate “insiders” from trading on material information not known to the general public. Historically, effective 10b5-1 plans have provided corporate insiders with an affirmative defense to allegations of unlawful insider trading.

Such plans typically involve a prior agreement between a corporate executive or board member and his or her broker. Under such agreements, the insider would provide standing trading instructions to the broker, requiring the broker to trade at a set stock price or a set time, for example. The broker would then effect the trade at the required price or time, regardless of the information held by the insider.

Recently, notwithstanding the Securities and Exchange Commission’s (SEC) longtime knowledge of potential abuses, such 10b5-1 plans have been under fire. In a Nov. 27, 2012, article in the Wall Street Journal titled “Executives’ Good Luck in Trading Own Stock,” the authors aired several complaints about such plans, including that “[c]ompanies and executives don't have to file these trading plans with any federal agency. That means the plans aren't readily available for regulators, investors or anyone else to examine. Moreover, once executives file such trading plans, they remain free to cancel or change them—and don't have to disclose that they have done so. Finally, even when executives have such a preset plan, they are free to trade their companies' stock at other times, outside of it.” The article went on to chronicle several purported abuses by officers and directors of such plans.

The current regulatory environment has simultaneously raised suspicions about plans and trades that are innocent, and potentially provided shelter for others that may be less so. In fact, in a Feb. 5, 2013, article in the Wall Street Journal entitled “SEC Expands Probe on Executive Trades,” the author noted that “[t]he Securities and Exchange Commission, expanding a high-profile investigation, is gathering data on a broad number of trades by corporate executives in shares of their own companies, according to people familiar with the probe.”

It would appear, from news like this, that the SEC is concerned that corporate insiders are adopting or amending 10b5-1 plans when in possession of non-public information that might affect market participants’ decision to trade in the company’s stock. Such changes could nullify the use of a 10b5-1 plan as a defense.

Seemingly in reaction to the perceived manipulation of 10b5-1 plans, the

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Council of Institutional Investors (CII) submitted a letter to the SEC on Dec. 28, 2012, requesting that the SEC implement rulemaking to impose new requirements with respect to Rule 10b5-1 trading plans. The CII letter calls for company boards of directors to become explicitly responsible for monitoring 10b5-1 plans, which undoubtedly will subject boards to increased scrutiny by the SEC. In addition, the CII letter proposes stricter regulatory rules including:

- Adoption of 10b5-1 plans may occur only during a company open trading window
- Prohibition of an insider having multiple, overlapping 10b5-1 plans
- Mandatory delay of at least three months between 10b5-1 plan adoption and the first trade under the plan
- Prohibition on frequent modifications/cancellations of 10b5-1 plan

The CII also advocates pre-announced disclosure of 10b5-1 plans and immediate disclosure of plan amendments and plan transactions. Under the CII's suggested new rules, a corporate board also would be required to adopt policies covering 10b5-1 plan practices, monitor plan transactions, and ensure that such corporate policies discuss plan use in a variety of contexts. A similar set of suggestions can be found in Wayne State University professor Peter J. Henning's Dec. 10, 2012, article, "The Fine Line Between Legal, and Illegal, Insider Trading," found online at: http://dealbook.nytimes.com/2012/12/10/the-fine-line-between-legal-and-illegal-insider-trading/.

Given the uncertainty in the market concerning the current use of Rule 10b5-1 plans and the future of such plans, companies or individuals who may be subject to Rule 10b5-1 plans and/or future regulations in this area should consult with counsel before adopting or amending such plans.

Barnes & Thornburg LLP is working in conjunction with Natoma Partners LLC, an independent provider of financial consulting and forensic accounting services, to perform such assessments. For more information, contact Vincent Paul (Trace) Schmeltz III at 312-214-4830 or by e-mail at trace.schmeltz@btlaw.com.

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