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## RULE 10b5-1 TRADING PLANS FACE SCRUTINY

Rule 10b5-1 plan participants, beware. The SEC recently indicated its increased focus on what it perceives as potential abuse of pre-arranged trading plans under Rule 10b5-1. By design, Rule 10b5-1 protects executives' trades executed pursuant to a pre-arranged trading plan established while the executive was not in possession of material nonpublic information. Recently, however, a study conducted by Alan D. Jagolinzer, an assistant professor of accounting at Stanford University's Graduate School of Business, has turned some heads at the SEC. The study demonstrated that trades made by Rule 10b5-1 plan participants outperformed by nearly 6% trades made by non-participants. More specifically, the study found evidence indicating that some 10b5-1 plans were initiated, and sales executed thereunder, shortly before an adverse company disclosure.

The SEC has definitely noticed. In a recent speech, Linda Thomsen, Director of Enforcement at the SEC, commented that "recent academic studies suggest that the Rule is being abused" and further stated, "We're looking at this—hard." Ms. Thomsen's comments, as well as the study itself, are strikingly similar to the events that marked the beginning of stock option backdating investigations in 2006.

Rule 10b5-1 requires that plan participants comply with certain requirements, which, ultimately, are designed to extricate the plan participant's discretion from the covered stock trades. However, the rule does not limit how soon trades can be executed following the implementation of a 10b5-1 plan, nor does it limit the number or value of shares that can be traded under the plan. Additionally, the rule does not restrict the participant's right to prematurely terminate the plan. These factors may help explain Jagolinzer's finding that sales made pursuant to 10b5-1 plans systematically followed disclosures that positively affected the company's stock price, but systematically preceded disclosures that negatively affected the company's stock price.

Using Professor Jagolinzer's study as a roadmap, the SEC is likely to focus on, and public company executives should consider:

- **Timing:** How soon after the initiation of a 10b5-1 plan are sales occurring? Are sales allowed to occur during a company blackout period? Was the plan initiated during a company blackout period? Are there any negative company disclosures in proximity to a sale made pursuant to a recently-initiated 10b5-1 plan?
- **Amount:** Are there large sales, either in number of shares or dollar amounts, occurring during a short period of time?
- **Off-Plan Transactions:** Is the plan participant, or his or her broker, executing trades in the company's securities, or derivatives thereof, in transactions not covered by the 10b5-1 plan?
- **Premature Termination:** Has the plan participant prematurely terminated the 10b5-1 plan?

Companies should also consider disclosure issues in the context of 10b5-1 plans. Although Rule 10b5-1 does not require an individual or a company to disclose the existence of a 10b5-1 plan, companies should consider instituting an internal policy concerning disclosure of the initiation or termination of a 10b5-1 plan by its officers or directors. Such a policy could prescribe the public document in which the initiation or termination of a 10b5-1 plan is to be disclosed; e.g. on Form 8-K if such disclosure is to be made by the company, or in a Section 16 filing if such disclosure is to be made by the individual. The company's policy could also help ensure uniformity and consistency in 10b5-1 plan related disclosures.

**CONTACT INFORMATION:**

**If you have questions about 10b5-1 trading plans or the SEC's interest in these plans, please contact:**

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