

WILLIAM BLAIR & COMPANY, L.L.C.

SEC RULE 10b5-1

A WHITE PAPER THAT DISCUSSES A
METHOD WHICH GIVES CORPORATE
INSIDERS GREATER FLEXIBILITY WHEN
CONDUCTING TRANSACTIONS IN
THEIR COMPANY STOCK



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CORPORATE INSIDERS HAVE MANY RULES AND REGULATIONS THEY MUST ADHERE TO IN THE COURSE OF TRANSACTING IN THE STOCK OF THEIR COMPANIES. ONE OF THESE, SEC RULE 10B5-1, IS A RELATIVELY NEW AND SOMEWHAT OBSCURE REGULATION THAT HAS SIGNIFICANT IMPLICATIONS FOR INSIDERS, AS IT PROVIDES GREATER FLEXIBILITY FOR EXECUTIVES TO MAKE TRANSACTIONS IN THEIR SHARES.

Background

In recent years, the Securities and Exchange Commission (SEC) found itself in an conflicted position. Legal precedents had evolved to a point such that the courts were using inconsistent standards to define insider trading. Some courts associated insider trading with the *use* of material, nonpublic information. Others defined it as trading while in *possession* of material, nonpublic information.

The SEC settled upon the more broad-based "possession" standard as a defining characteristic of what constitutes insider trading. Under this standard, if an individual trades while being aware of material, nonpublic information, he may be found guilty of insider trading. Whether the information was used is not a defining consideration in determining liability.

Market participants were concerned that the more broad-based "possession" requirement would unduly hamper executives, as they are frequently in possession of information that could be deemed material, and nonpublic. In part to give greater flexibility to corporate officers and other senior officials of publicly traded companies, the SEC established Rule 10b5-1. This rule, enacted on October 3, 2000, allows insiders to structure a trading plan at a time when they are not in possession of material, nonpublic information, under which they can then transact in company stock even if they later become aware of material, nonpublic information.

Simply stated, Rule 10b5-1 permits corporate insiders to trade company stock while aware of material, nonpublic information, as long as the trading activity is conducted pursuant to a pre-existing contract, instruction, or plan established when the insider was not aware of any material, nonpublic information.

Benefits

Entering into a Rule 10b5-1 program offers an opportunity for issuers, their officers, and directors to structure trading programs and execute predetermined securities transactions in many situations where they previously might not have out of concern over potential insider-trading liability. By implementing a properly constructed plan, Rule 10b5-1 provides an affirmative defense for corporate insiders to avoid liability for insider trading. Importantly, SEC Rule 10b5-1 allows greater opportunity and flexibility for corporate insiders to sell their shares.

Because many executives find that they have a substantial portion of their net worth in company stock, the ability to access that wealth is important. The rule benefits corporate insiders by providing greater clarity and certainty as to how they can plan and structure securities transactions. This can greatly aid in the process of diversification, wealth transfer, and liquidity management. A properly structured Rule 10b5-1 plan will allow them to sell stock at times they would otherwise be unable to, including during traditional company blackout trading periods. The plans can be customized to

each individual, setting limit prices (both above and below the current market) and selling a varying amount of stock at different times and during a range of dates.

Some companies have elected to use SEC Rule 10b5-1 to structure stock buyback programs. Many companies that repurchase their shares are forced to temporarily suspend purchases (during blackout periods, for example), but a 10b5-1 plan can allow them to set limit prices at which they would be willing to repurchase stock and then act upon this should the stock fall to that price during the blackout period.

Another benefit relates to shareholder perceptions of corporate officers activities. One of the SEC's goals in creating 10b5-1 was to provide more information to market participants regarding insider transactions. A properly executed 10b5-1 plan can reduce the negative implications of insider stock sales as perceived by market participants. This may reduce negative volatility caused by market misinterpretation of insider sales. In addition, general counsel or other trading compliance officers may be relieved of some of the burden of making subjective determinations about materiality.

Plan Requirements

Rule 10b5-1 provides a person with an affirmative defense if:

1. Before becoming aware of the material non-public information, he or she had entered into, in good faith, a binding contract to trade, provided instructions to another person to execute a trade on his or her behalf, or adopted a written plan for trading securities
2. The contract, instructions of plan (1) expressly specified the amount, price and date of the purchase or sale, (2) provided a written formula

or algorithm, or computer program, for determining amounts, prices and dates; or (3) did not permit the person to exercise any subsequent influence over how, when or whether to effect purchases or sales, provided that any other person who did exercise such influence was not aware of the material non-public information when doing so; and the purchase or sale occurred pursuant to the contract, instructions or plan

Plan Examples

Plans can be quite specific or very simple. However, even the simplest plan must include information regarding the date, price, and volume to be transacted. For example, an individual can state, "Sell 10,000 shares of XYZ Corporation on September 3, 2004, at no lower than \$45 per share." A formula or algorithm can be created such as, "On the third trading day of every quarter (March, June, September, December), sell \$50,000 worth of XYZ Corporation."

Plans can be constructed for option exercises, with detailed formulas for calculating the number of shares to be sold to pay for the exercise price, transaction costs, and excess liquidity, for example. In addition, plans can be used to purchase stock, both for individuals as well as companies operating under a share repurchase. This can allow the company to remain in the market during times that it would otherwise need to abstain from purchases.

Modification and Termination of Plans

Modifications to existing plans can occur only when the individual is not in possession of material, nonpublic information and the company has allowed the individual to modify his plan. Cancellations can occur at any

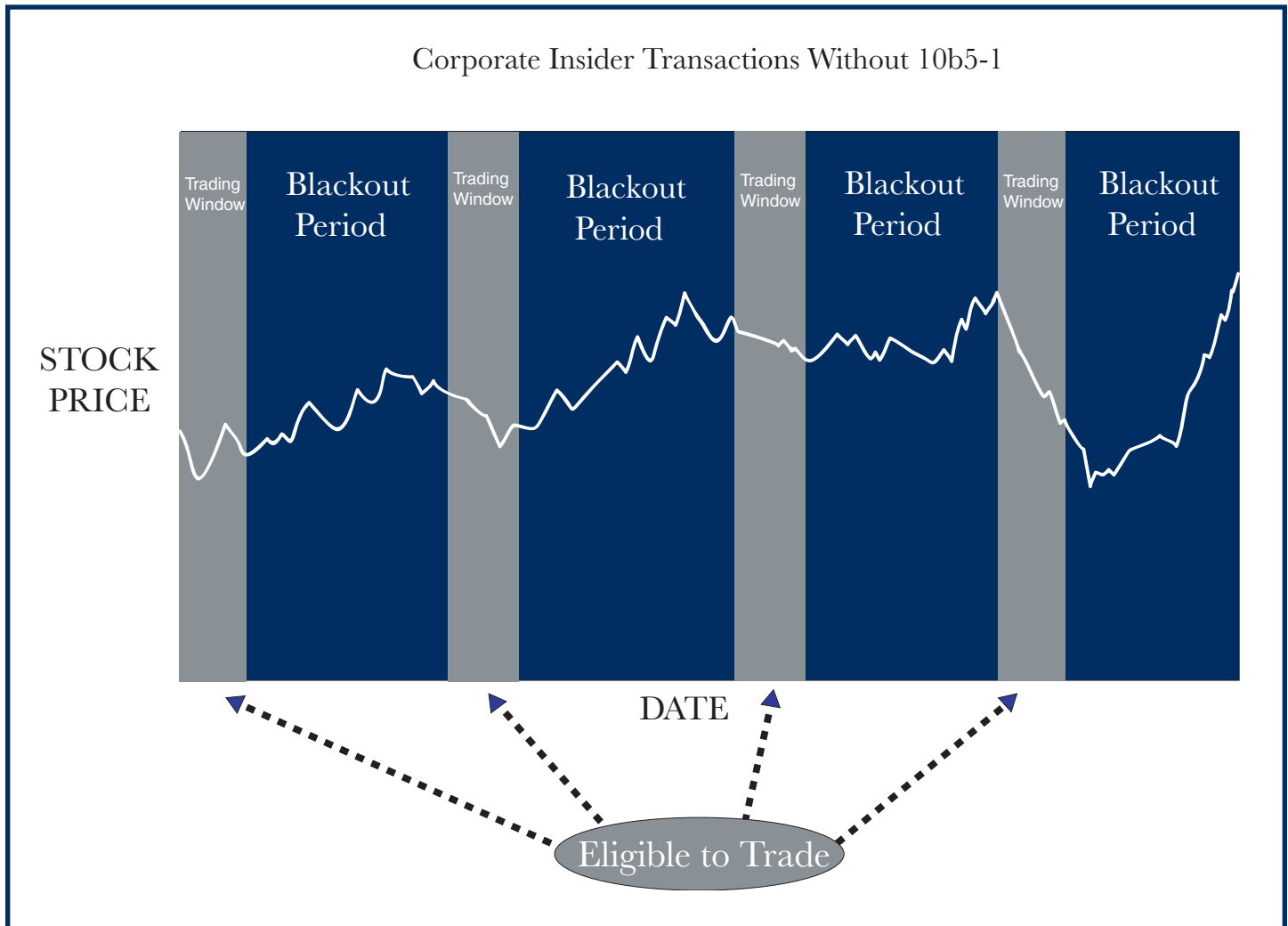
time, even when an executive is aware of material, non-public information. However, the SEC has stated that individuals entering into Rule 10b5-1 programs do so in good faith, and not as part of a plan or scheme to evade the existing insider-trading laws. Insiders may lose the protection afforded by Rule 10b5-1 if there is a pattern of repeated plan cancellations or modifications.

Other Considerations

Many companies have found that their employee-trading policies do not allow for the use of 10b5-1 programs and as such have had to amend their policies. Individuals should consult with their company counsel/employee-trading officer prior to enacting a plan to ensure that they are compliant with company policy.

In addition, although Rule 10b5-1 does not require public disclosure of a plan, companies might find it useful to disclose the existence of a plan (but not the specific details of the plan) in shareholder documents and press releases. A recent survey conducted by William Blair & Company found that approximately 22% of the respondents issued press releases, with the majority of the press releases covering only the 10b5-1 plans of senior officers.

Establishing a trading program does not relieve individuals of their normal regulatory requirements for trade disclosure. For example, insiders still are required to file documents such as Form 4 and 144 for transactions in company stock.



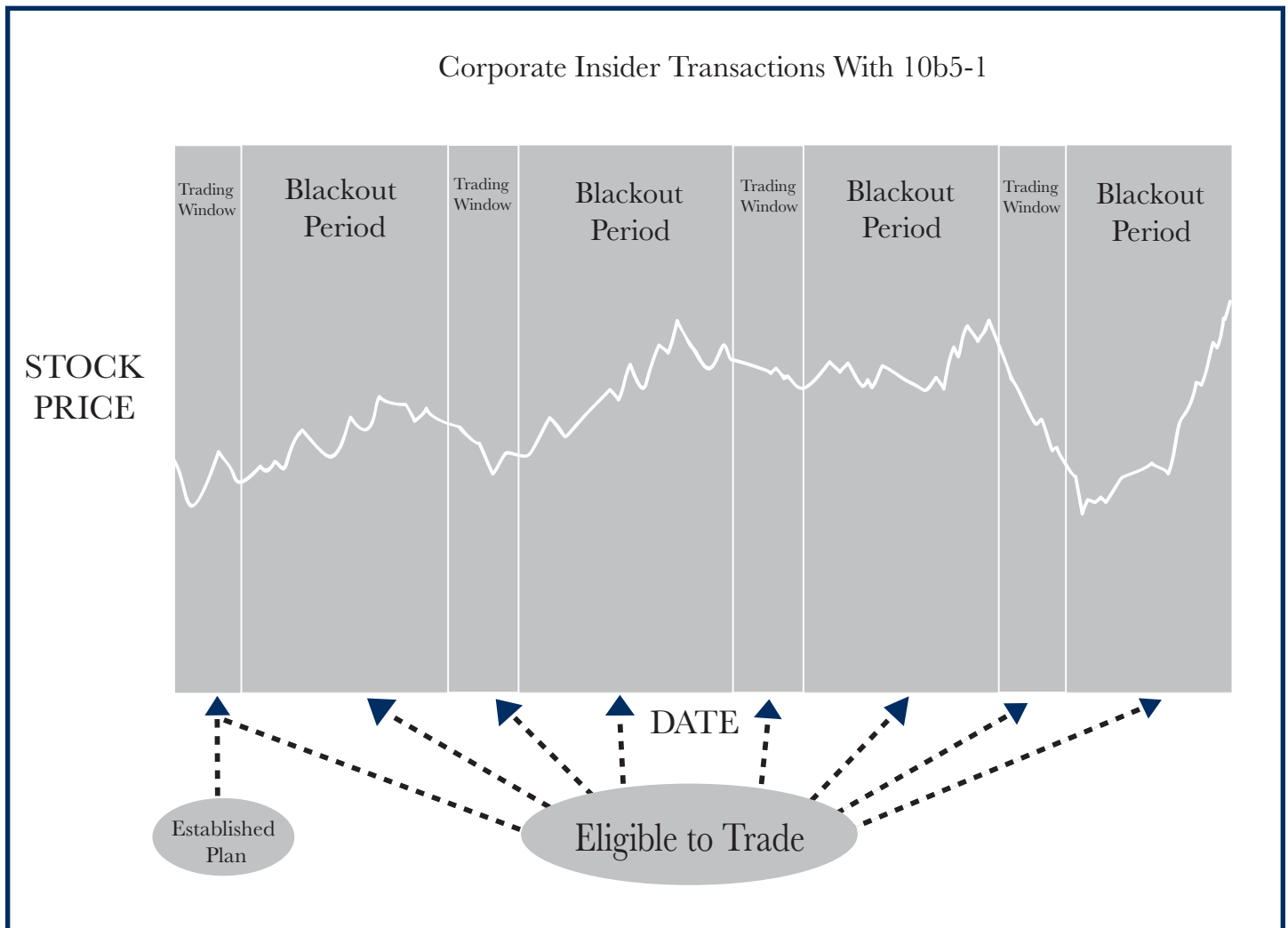
Although the SEC did not specifically discuss the timing for transactions, many commentators have expressed concern that insiders consider allowing a "lag time" between entering into the plan and the first transaction. Please consult with your counsel as to what, if any, lag time is recommended.

Lastly, this is a relatively new rule, and has been without a test in the courts. As such, individuals contemplating using 10b5-1 should consult their counsel prior to entering a plan.

Survey


William Blair & Company has surveyed corporations annually since 2001 on their adoption and subsequent

use of 10b5-1 programs. Surveys indicate an increasing rate of adoption and expected use among responding corporations. Our January 2004 survey found that 72% of the responding companies indicated that their insiders were aware of Rule 10b5-1 trading plans, but the majority had not yet used these plans. Seventy-four percent of those who have used 10b5-1 plans reported a positive experience. Lastly, insiders have used 10b5-1 plans for a varying amount of their total shareholdings. For those who have used 10b5-1, 27% stated that the plans covered between 1% and 10% of their holdings, 40% used plans covering between 10% and 25% of their holdings, 15% were between 25% and 50% of their holdings, and 9% of the respondents had plans covering more than 50% of their stockholdings.



Summary

Corporate officers often have a high percentage of their net worth in their company stock, so access to this wealth is critical. A properly designed SEC Rule 10b5-1 plan allows executives greater opportunity to transact in their shares than previously, including during blackout periods. The plans can be customized for each individual's unique situation and circumstances. This flexibility can greatly aid in wealth transfer and investment planning for corporate insiders. We expect that 10b5-1 will increasingly be embraced as a valuable resource for corporate officials.

William Blair & Company has been active in the use of SEC Rule 10b5-1 programs since its inception. We have designed a wide range of plans for executives, from a simple, one-time transaction to more complex plans with multiple price points, dates, and share amounts. We have counseled boards of directors of companies on the nuances of 10b5-1, and we have worked with a variety of company counsel and trading compliance officers. 

DAN GRANT

Daniel Grant has seventeen years of investment experience in the high net worth and institutional equity arena. He began his career on Wall Street in 1986 at Salomon Brothers, covering institutional equity accounts. In 1995, he joined William Blair & Company's Private Investor Department. Dan has handled William Blair's Corporate and Executive Services, created its hedging and monetization practice and developed an expertise in liquidity and wealth services. As a speaker and author on SEC Rule 10b5-1, Dan has helped structure 10b5-1 trading programs for a wide range of corporate clients. Dan graduated from the University of Illinois with a B.A. in Economics and an M.B.A. with an emphasis on Finance.

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