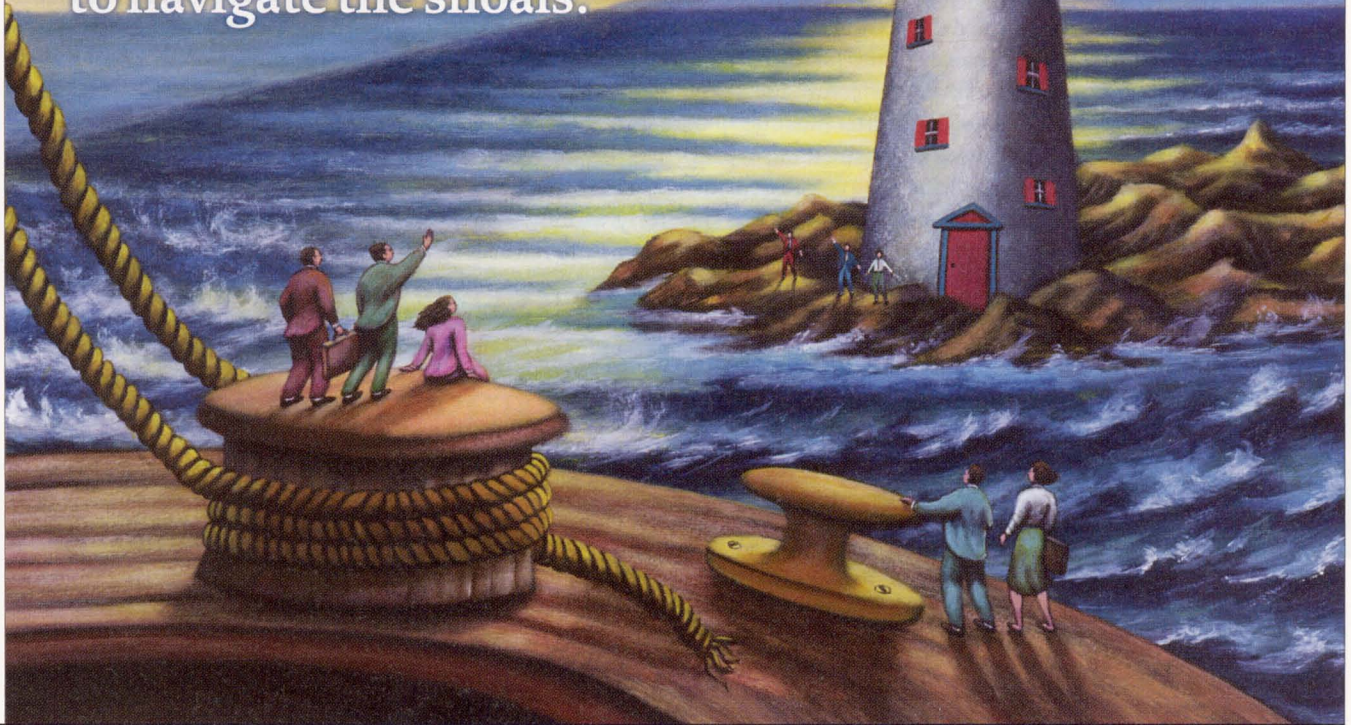


There is more than one way for insider clients to protect themselves, if you know how to navigate the shoals.



By Gregory Taggart

THE SAFE HARBOR CHOICE

INSIDER TRADING HAS A NEW POSTER BOY—FORMER

Qwest CEO Joseph Nacchio, who was sentenced to six years in prison on July 27. He remains free on bail while he appeals, but nevertheless, other executives are wondering what they can do to avoid his fate. And that's good, says Prof. Peter Henning of Wayne State Law School in Detroit. "CEOs and senior management are certainly in the crosshairs today, much more than they were 10 years ago. There is a heightened risk. That means you have to be more careful. Transactions that the government might not have looked at 10 or 15 years ago, they look at now."

What's a cautious insider to do? With electronic SEC filings,

watchdog Web sites like The Corporate Library (www.thecorporatelibrary.com), more active regulators, and an eagle-eyed public, corporate insiders are well-advised to avoid even the appearance of insider trading. Witness the virtually overnight regulatory response to the recent alleged insider trading by a couple in Hong Kong who began buying Dow Jones shares at \$36 just days before Rupert Murdoch's \$60 per share bid for the company. Federal regulators are now looking into the possibility that the couple got their "material non-public information" from a friend who is a Dow Jones director. What happens to them if they're found guilty will depend on the facts, says Gavin Morrissey, advance

planning consultant at Commonwealth Financial Network. "But usually you pay a significant fine, disgorge all the profits, and maybe serve jail time."

That's serious business. So what do you do with clients of yours who fit the definition of insider—virtually any employee including the janitor who is in possession of "material, non-public information"—have concentrated stock and options holdings in their company, and want to do something with those holdings? They may want to diversify. They may want to hedge their positions with puts and calls. Maybe they have tax reasons for selling. Or perhaps they just want to turn things over to a professional money manager. Whatever the reason, they need to keep one eye on the regulators and the other on the two ways to accomplish their objectives: The 10b5-1 pre-established trading plan (PTP) and the blind trust.

"The 10b5-1 plan has been around since 2000," Morrisey explains. "The blind trust has been around for much longer. You just don't hear about them because of the anonymity afforded by the trust."

Named after the SEC rule that created it, 10b5-1 plans open windows of opportunity for insiders to dispose of their holding as they see fit—sort of. Essentially, PTPs provide insiders with an affirmative defense to claims they traded on material

price and date, as well as provide "a written formula or algorithm or computer program for determining amounts, dates and prices," or they must be able to prove that they exercised no influence over the third party who bought or sold company securities for them.

3. Any and all transactions done thereafter must be "pursuant to the contract, instruction, or plan."

Typically, insiders establish PTPs during one of the quarterly windows immediately after their company releases earnings. Thereafter, a PTP "operate[s] like a flesh-and-blood decision maker at the time, except you just sort of set all the parameters in advance," says Tim Kochis, CEO of Kochis Fitz, a San Francisco-based wealth management firm. "Essentially, 10b5-1 plans are a safe harbor for insiders so long as they don't change them once in place," he adds.

Blind trusts are also safe harbors. Virtually any trust—revocable, irrevocable, charitable or personal—can be a blind trust, so long as the blind trustee manages trust investments without the insider/settlor's participation, influence or knowledge.

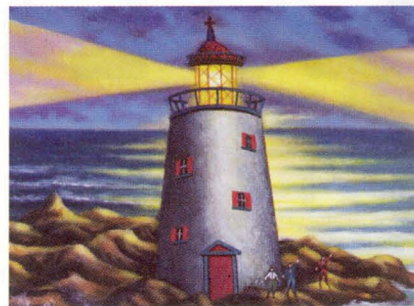
Which is better then? The answer rests largely on the facts of each case. On the one hand, 10b5-1 plans are conceptually simpler and generally less expensive to set up than blind trusts. On the other, blind

controls what happens to your client's investments. With a 10b5-1 plan, your client still makes the investment decisions—albeit in advance. This "who's-in-control?" issue looms large for some insiders, Kochis claims. After all, it's the take-charge people who create or run successful companies. In fact, he reminds us, one 10b5-1 safe harbor is to delegate trading authority to a third party, much like a blind trust. "And I don't know too many successful corporate executives who are eager to do that. They would rather make their own plans."

Additionally, 10b5-1 plans can be short term—as short as six months, Kochis says—at which time your client could survey the investment landscape anew, then establish a new plan with different instructions. The consequent ability of the insider to retain some measure of control gives 10b5-1 plans an apparent advantage.

However, while that may be so with an irrevocable blind trust which, once set up, operates according to its terms until it ends according to those terms—say, if your client ceases to be a director or if the company merges out of existence—it's not the case with a revocable trust. "If your sole objective for setting up the trust is to liquidate or monetize assets and have the trust terminate two years from now, then you want it revocable," says Edmond Ianni, senior vice president and chief strat-

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non-public information, so long as they do three things:

1. They must enter into a binding contract to sell the securities, provide instructions to a third party, or adopt a "written plan for trading securities" before they become aware of the material non-public information.

2. Either they must specify amount,

trusts can do much more for your client at the same time they are providing a safe harbor against insider trading charges. In either case, Henning explains, "You should definitely have legal counsel from somebody experienced in securities matters."

A good attorney will tell you that 10b5-1 plans have one major advantage over blind trusts. In a blind trust, the trustee con-

egy officer at Millennium Wealth Management in Wilmington, Del.

Moreover, no matter how detailed the insider's instructions or the plan's duration, once your client establishes a 10b5-1 plan, it's on autopilot. "Blind trusts are not on autopilot," Morrisey stresses. "Someone is actually making investment decisions. They can say, 'This was a good

quarter; we're going to let this stock ride.' With a 10b5-1, when the stock hits your trigger, you're out."

Both individuals and institutions can act as blind trustees; however, Ianni recommends a corporate trustee for a number of reasons. First, as with any trust, a corporate trustee comes with the experience and back office to add value to the relationship. In addition, corporate trustees—generally banks and trust companies—provide continuity. But probably

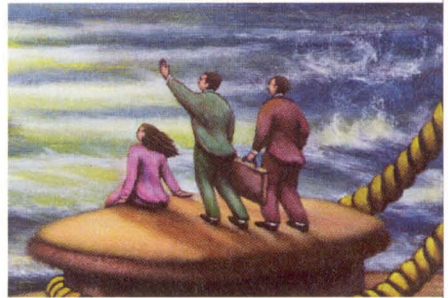
information."

Likewise, blind trusts prevent the market from knowing whose shares are being traded. One reason insiders set up 10b5-1 plans is so that when they do sell, other investors won't get the jitters. In a recent case, The Boston Globe reported that a director of Martha Stewart Living Omnimedia sold 15,000 shares of company stock "under a prearranged 10b5-1 trading plan . . ." That was an Associated Press story, prompted by a company press release—a

properly structured trust whose situs is a state that doesn't impose such taxes."

It's also possible to incorporate a 10b5-1 plan into a blind trust, effectively allowing the grantor to give the trustee instructions when she establishes the trust. For example, your client could state that she is establishing the trust to sell 10,000 shares of her Microsoft stock each quarter to the extent permissible under Rule 144 (e). Though the trustee will likely follow those instructions, "he still retains the discre-

HOW YOUR CLIENT CHOOSES TO SOLVE HIS INSIDER TRADING PROBLEM WILL PROBABLY COME DOWN TO COST AND PURPOSE.



their greatest strength is their actual and perceived independence. "That's an additional protection that a 10b5-1 plan does not provide," Ianni asserts.

Picture this: Your client sets up his PTP with his broker and in accordance with Rule 10b5-1. The broker then follows the directions outlined in the PTP. However, coincident to the sale of a large block of stock pursuant to those directions, the share price drops 20 percent, and your client finds himself in court, answering a prosecutor's questions.

"How long have you used Craig as your broker?" he asks.

"Ten years," your client answers.

"Have you ever talked to him since you set up your 10b5-1 plan with him?"

"Yes, we talk all the time. He handles all my investments," your client answers.

"Did you ever talk about your company's stock before it dropped 20 percent?"

Whether or not your client talked with Craig, the implications of that question will hang in the air for the jury to consider for days after your client responds, Ianni says. "You don't have that with a blind trust. What you have, if you will, is a sort of mutual gag order that prevents ongoing contact that would give rise to the opportunity to share inappropriate

pre-emptive move to allay investor concerns of improper insider trading. Even so, the AP story inadvertently left the impression that the director was improperly trading on inside information, something that could have led unsophisticated investors to sell their shares in spite of the press release.

That won't happen with a blind trust, Morrissey says, because the trust, not the individual, trades the shares. "A blind trust has a neutralizing effect on the market. Investors don't know who is selling because the trade isn't tagged to John Smith, CEO. They just know there is a trust selling; thus, they don't see the sale as a bearish signal." And there's no need for a press release.

In addition, blind trusts offer all the planning opportunities that other trusts afford, from asset protection to estate planning to charitable giving to tax savings. For instance, if your client sets up an irrevocable trust in tax-free Nevada or Wyoming, or if its terms satisfy a Delaware statutory carve-out, he can avoid state income, capital gains and estate taxes. "In New York, the top income tax rate is currently 6.85 percent. In California, it's 9.3 percent," Ianni says. "You can't avoid those taxes with a 10b5-1 plan. You can with a

tion as to how to execute those orders," Ianni says.

Finally, some insiders may want to hold on to their shares but hedge against the risk that they could drop in value. Though they can take steps to do that within a 10b5-1 plan, they have to do it when they're not in possession of material non-public information because trading in puts, calls and other derivatives of the stock on the basis of inside information is prohibited. Instead, they could give similar directions to their blind trustee when they establish their trust "to use some form of legal hedging strategies to preserve the value of the stock," Ianni explains. "But as always, the blind trustee has the discretion to do what they think best."

How your client chooses to solve his insider trading problem will probably come down to cost and purpose. A blind trust can do so much more than a 10b5-1 plan, but the 10b5-1 plan costs less to set up. There is an even less expensive way, Peter Henning says. "To put it colloquially, don't be a pig." Just ask Joseph Nacchio.

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