



THE PLANNER NEWSLETTER

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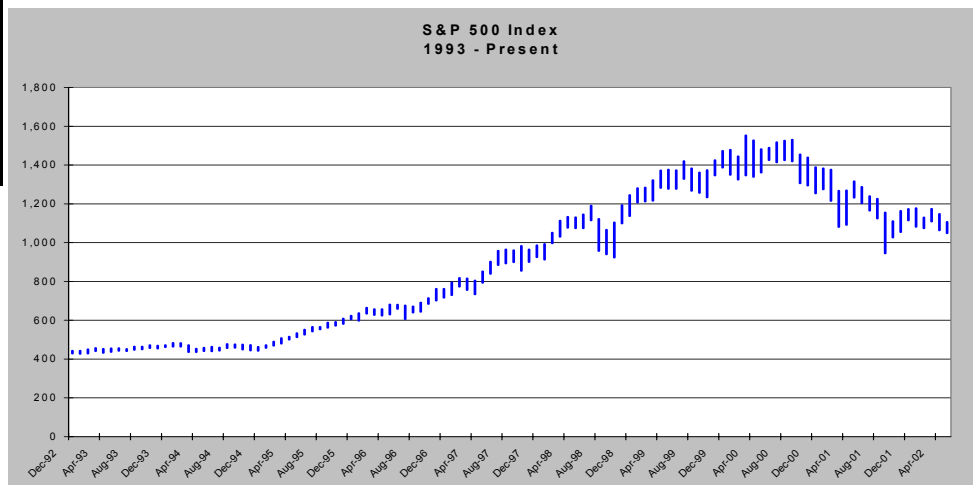
JULY—AUGUST 2002

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Although the stock market continues to vacillate, the opportunity for financial advisors to grow their practice still abounds. This edition of *The Planner* seeks to provide you with information to empower you to look beyond the daily ticker and convey value to your clients.

In this issue we continue with the theme of tapping the high value stock option planning opportunity with two feature articles. Stock option guru John Barringer explains how SEC Rule 10b5-1 will change the way executives diversify their company stock holding and Corey Rosen, Executive Director of the National Center for Employee Ownership (NCEO) describes the 5 common myths about stock options.

We believe there is a 6th myth regarding stock options; “the vast majority are currently under water.” A number of advisors have voiced this opinion so we began doing research to seek out the truth. The chart shown below shows that the S&P 500 is up significantly (230%+) over the past 10 years. Consequently many options issued 8 to 10 years ago are not only in the money, but are rapidly approaching expiration.



Additionally, we have done research to identify specific companies that give options and whose split-adjusted price is significantly in the money over the past 7-9 years. We have published this information for a limited number of companies in the Western and Southern states. Our plan is to develop this into a comprehensive database. Our current research can be accessed via the following links:

<http://www.networthstrategies.com/stockopter/docs/WesternStatesCompanies.asp>
<http://www.networthstrategies.com/StockOpter/docs/SouthernStatesCompanies.asp>

In other news, this month's StockOpter Tip addresses the issue of utilizing both a minimum tax credit carryforward on previously exercised ISO shares and a capital loss carryforward. We are also pleased to announce that an updated and enhanced version of our Determinator Suite of retirement distribution planning tools is now available.

As always we hope you enjoy this edition of *The Planner* and encourage your feedback. Our next edition should be available by the middle of August.

Bill Dillhoefer,
The Planner Editor

HVSOP BUSINESS DEVELOPMENT PROGRAMS	
Date	Location
June 19-21	San Francisco
July 17-19	Houston
July 29-31	Chicago
Aug 14-16	San Francisco
Aug 28-30	Boston
Sept 11-13	Dallas
Sept 23-25	Atlanta
Oct 7-9	Las Vegas
Oct 23-25	New York

For info about these classes or to enroll call 877-728-5964 or visit: www.NetWorthStrategies.com

Planning Article of the Month:**New Rule Will Change The Way Executives Transact Company Stock**

By John Barringer

SEC Rule 10b5-1 will likely have a significant impact on how directors, officers and other employees who are subject to “blackout” periods diversify their company stock holdings. Adopted concurrently with Regulation FD, the Selective Disclosure Rule, 10b5-1 encompasses two major provisions. The first addresses the appropriate standard for insider trading liability under the anti-fraud provisions of the federal securities laws. Prior to the enactment of 10b5-1, the courts were split on whether insider trading liability simply required proof that the person engaging in the securities transaction was in “knowing possession” of material nonpublic information at the time of the trade, or whether it was necessary to prove that material nonpublic information was actually “used” as the basis for the trade. The latter being a much more rigorous standard. Rule 10b5-1 now provides that a person is deemed to have traded on the basis of material nonpublic information if he was simply “aware” of the information when the purchase or sale was made. There is no need to prove that the information was “used”.

The second provision of 10b5-1 establishes the basis for an affirmative defense in connection with trades by insiders. This new defense is designed to cover situations in which a person can demonstrate that the material nonpublic information was not a factor in the trading decision. In order to satisfy this affirmative defense a person must establish that:

- Before becoming aware of the material nonpublic information the person had entered into a binding contract to trade, instructed another person to trade or adopted a written plan;
- The contract, instruction or plan either specifies the amount, price and date of the proposed transaction(s), provides a written formula or mechanism for determining such amounts, prices or dates or does not allow the insider to exercise any subsequent influence over how, when and whether to effect purchases or sales (and that the person who does exercise such influence is not aware of material nonpublic information) and
- The purchase or sale that occurred was in fact pursuant to the prior contract, instruction or plan.

In response to these changes, affiliates are slowly beginning to adopt 10b5-1 compatible plans that I call Structured Diversification Programs (SDPs) and a number of public companies have implemented optional SDPs for the benefit of the company’s executives. This new rule will very likely impact the way in which corporate executives and other employees subject to “blackout” periods diversify their holdings of company stock. In fact, at some companies these plans are beginning to take the place of blackout periods for executives. Such periods are voluntarily imposed by

companies to diminish the risk of insiders being the subject of shareholder lawsuits based on allegations of insider trading. To avoid the appearance of impropriety, they can be adjusted at the discretion of the company. Substituting an SDP plan generally make more sense than the typical very restrictive blackout period.

The parameters of 10b5-1 allow a wide variety of ways in which an SDP can be designed. Issues that need to be addressed in a typical plan include:

- The number of shares to be transacted or some means by which the number can be derived
- The selling method
- The frequency of transactions
- The duration of the plan specified by a particular contract, instruction or plan

A simple plan could provide that the broker transact a specified amount of shares (e.g. 1000) at the market (or a specified price [limit]) with a set frequency (say, each Wednesday) and duration (perhaps a year). A more

“...Executives may welcome the opportunity to delegate the diversification of their holdings, freeing them to concentrate on their day-to-day responsibilities and discipline.”

sophisticated plan could establish a formula for the determination of the minimum conditions necessary to enact a transaction. Such a formula might provide that the broker sell more shares if the stock is up and fewer if it is down or that the broker “work” a block of stock over a shorter period of time (say, two months) with the objective of maximizing the gross

proceeds. If a formula is used, it is important that the formula not constitute a “device” that allows the insider to exercise plan influence or control.

Additional benefits of these plans include convenience. Executives may welcome the opportunity to delegate the diversification of their holdings, freeing them to concentrate on their day-to-day responsibilities. For an executive who felt it was prudent to sell a set number of shares on a regular basis in order to achieve a specified level of security holdings by a target date, an SDP could allow them to meet their objective without the temptation to exploit short term price fluctuations.

Planning Article of the Month continued:**New Rule Will Change The Way Executives Transact Company Stock**

By John Barringer

Executives who receive large stock option grants may find it much more convenient to use an SDP and be free of limited trading windows to dispose of the shares acquired by those options. Especially as options get closer to expiration the need to avoid the risk of forfeiture makes the systematic nature of an SDP attractive.

Whether an SDP is adopted individually by an executive or is part of a model plan adopted by the company, each participant must submit the specific plan he adopts for the approval of the company's compliance officer. Plans must remain consistent in every regard with any company-wide policies regarding insider transactions. Companies may reserve the right to suspend a plan in certain instances (e. g., an underwriting of additional equity or convertible debt).

“SDP strategies will be as varied as the shareholders who adopt them but some general tactical rules should probably be applied to all plans...”

If the executive is an affiliate for the purposes of Section 16 reporting, the plan will not eliminate the need to comply with the “Short Swing Profit Rule.” Affiliates who are deemed to be a “control person” for purposes of Rule 144 must also comply with the volume and “manner of sale” provisions of the Rule. Unregistered certificate shares that the plan anticipates selling will need to have any restrictive legends lifted prior to the date on which it is anticipated the shares will be sold. This process requires additional paperwork, which may need to be made part of the plan documents. And if the company prepares Form 4 for the affiliate, it may be necessary for there to be a third-party reporting provision in the plan so that the broker can report transaction by the insider promptly to the company in order to facilitate this reporting.

Generally it is necessary for the executive adopting an SDP to not be in possession of material nonpublic information at the time he adopts the plan. Most companies will require a waiting period after the adoption of the plan before it's conditions go into effect to address the potential concern by shareholders that the plan is being adopted in order to exploit insider information. While it is not required, many companies choose to disclose the fact of a plan's implementation to shareholders to send a message that the executive's sales are part of a prudent effort to diversify his holdings, not a sudden change in the executive's

commitment to ownership.

SDP strategies will be as varied as the shareholders who adopt them but some general tactical rules should probably be applied to all plans whose purpose is to reduce, to any significant degree, the executive's single-security concentration. A well-designed plan should consider:

- Incorporating all of the client's corporate holdings in the pool of diversifiable assets. Be sure to consider the qualified plan's holdings, previously exercised and unsold shares, and any other vested stock holdings. Using an SDP ensures compliant tracking and reporting of all form 4-type transactions for both the client and the company. These are often overlooked for qualified plan shares.
- Key price levels for transactions so that the long-term strategic goal is met. Such considerations might include a minimum market price, a key price level that would trigger additional diversification, or a ladder approach that increases the number of shares being sold as the price rises.
- Provide for the exercise of ISOs to minimize the AMT burden. A well designed plan will also provide for strategically scheduled ISO exercises that avoid creating “wash sales” within 30-days of schedule sales.

John P. Barringer is a *StockOptioner* user and financial advisor with a major national brokerage firm who has 16 years of experience assisting clients plan their employee stock options and restricted stock transactions. He is an Advisory Board member and contributing editor at myStockOptions.com. He is also President of the Denver Chapter of the *National Association of Stock Plan Professionals* (NASPP.com) John can be reached at jpbarr@attglobal.net.



Building Your Practice Article:**Five Common Myths About Stock Options**

By Corey Rosen, NCEO Executive Director

During the 1990s, according to our research here at the National Center for Employee Ownership, the number of employees getting stock options ballooned from less than one million at the start of the decade to about 10 million by the end. Stock options provide employees the right to buy shares of company stock at a price fixed today (usually the market price) for a number of years (usually 10) into the future. So if the stock price goes up, you can buy shares at a very cheap price. The press was full of reports of "optionnaires," employees who struck it rich when their company's stock skyrocketed. Then the market collapsed, and instead stories were being written about option tax disasters, precipitous declines in morale of option-laden employees, and a rapid move away from compensating employees with equity. While much of the reporting on stock options was accurate and insightful, much of it subscribed to common myths that distorted what was happening, both during the market's rise and after its fall. For a variety of reasons, options granted to most or all employees have become an institutionalized part of compensation at many companies. It is important, then, to separate the myth from the reality about how these plans work.

Myth #1: Most People Getting Options Worked for Dot-Coms

One of the most prevalent and misleading misperceptions was (and still is) that most employees getting options work (or now worked) for dot-com companies, most of whom were small, pre-IPO ventures. This was never even close to true. There were a lot of dot-coms, to be sure, and most of them did give most or all their employees options, but most also employed well under 100 people. The total employment at all the pre-IPO dot-com companies never amounted to more than a few percent of the 10 million people getting options. In fact, almost all the employees getting options work (and worked) for publicly traded companies, and most of these work for large employers. Verizon, for instance, makes most of its over 200,000 employees eligible for options. It would take 5,000 dot-coms with 40 employees each to have that many employees.

Myth #2: OK, Well at Least They Worked for High-Tech Companies

The large majority of high-technology companies do make most of their employees eligible for stock options, but even the highest estimates for the technology sector place employment at about five million. If 60% of these get options (a reasonable guess), then only three million employees getting options are technology workers. In fact, about 15% to 20% of all public companies give employees options, and many of these are outside the technology sector. Many large

banks provide broad options, for instance, as do a number of large pharmaceutical companies. Retailers like Whole Foods, Walgreens, and Starbucks give out broad options. So do PepsiCo and Procter & Gamble.

Myth #3: Most People Give Up Pay to Get Options

Economists tell us there is no free lunch, so if someone gets options they must be giving up pay or benefits. To be sure, some employees have done just that. There are lots of people who were lured to start-up companies at lower salaries in return for substantial option packages. But these people are the exceptions. For the most part, they are at the managerial level or higher, or people with special skills, such as programmers. Altogether, they comprise only a tiny portion of all the employees getting options. Data from Professors Joseph Blasi and Douglas Kruse at Rutgers University indicate that, overall, employees getting options are paid about seven percent more in wages than comparable employees in comparable companies that do not give out options. The fact is that with a tight labor market -- and we still have a labor market that is tighter than historical standards -- it is very difficult to lure all but a handful of risk-takers to jobs whose

"The total employment at all the pre-IPO dot-com companies never amounted to more than a few percent of the 10 million [option-holders]."

base pay and benefits are not comparable to what could be earned elsewhere. Options are gravy to help companies distinguish themselves. In the tech sector, they are not even that -- everyone gives out options widely, so they are just part of the ante to the game.

Myth #4: Options Are Worthwhile Only If Your Company Is Publicly Traded

Many stories advised employees that if their company was not on a public stock market, their options were worthless and would be until the company did an IPO -- which very few ever would do. In fact, most closely held companies giving out options are sold (assuming they don't close first), at which time the options are usually exchanged for cash or for stock in the acquiring company at the sale price.

Five Common Myths.....

Myth #5: Options Are the Last Decade's Compensation

Surely, this myth goes, no one wants options any more. Lots of employees have lots of options deeply "underwater," meaning the price at which the employee can buy shares is way above the current price, making the option probably worthless. So who wants more? Employees do, and employers want them to have them. Data from the National Center for Employee Ownership show that most companies with broad-based stock options plans have no plans to change, much less eliminate them. Most of these companies now dole out the options over a period of years, rather than all at once. So employees got some options at a very high price, but will get some more at what seems like a very low one. These new options could be worth a lot one day. Moreover, many employees have options in companies that have been more stable, and their options either are still worth something, or are close to that point.

To be sure, people and companies are now more realistic about what options can mean. They are probably not going to make more than a handful of people rich, but, for most option holders, they provide a worthwhile additional benefit. And for most option granting companies, they provide a way to link employee and corporate fortunes for the long term. Options are not the ready path to riches they may have seemed to some, nor the magic elixir for corporate recruitment, retention and motivation problems they seemed to others, but they have too many advantages to both sides to go the way of hula hoops and pet rocks.

Corey Rosen is the executive director and cofounder of the National Center for Employee Ownership (NCEO). He received a Ph.D. in politics from Cornell University and worked as a staff member in the U.S. Senate, where he helped draft some of the legislation governing employee ownership. He has coauthored five books on employee ownership and written over 100 articles on the subject for business, professional, and trade publications. Corey can be reached at CRosen@nceo.org



StockOpter Tip of the Month:

Recapturing Carryforwards

By Bill Summers, CPA, CFP, MST

Many clients currently hold previously exercised Incentive Stock Option (ISO) shares. The exercise of the options behind these shares may have caused your client to pay alternative minimum tax in a prior year. In most cases, this will lead to the client having a minimum tax credit carryforward at the inception of your option planning. In addition, due to the recent stock market difficulties, your client may also have a capital loss carryforward that could be utilized.

Described below are instructions on how to efficiently utilize StockOpter to take advantage of those carryforwards for your client.

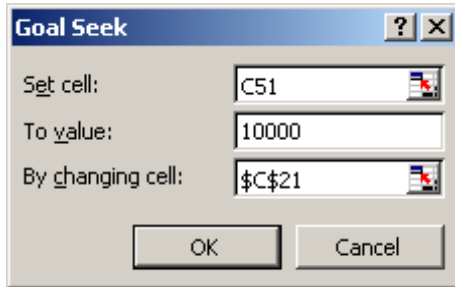
Utilizing the Minimum Tax Credit Carryforward

If your client has a minimum tax credit carryforward (MTC), it can be utilized to the extent that their regular income tax liability exceeds their tentative minimum tax (TMT) liability. If that difference is not great enough to fully utilize the MTC, then there are two ways to increase the difference. The first is to increase the client's ordinary income. This would cause their regular income tax to grow at a faster rate than their TMT, thus increasing the spread. However, using this method will cause the current net tax burden to increase substantially overall, which may not be the best result for the client. The second method is to sell ISO shares that have met the holding periods for tax preferential treatment. Since ISO shares generally have a higher AMT cost basis than regular tax cost basis, this could lead to a rapid increase in the necessary spread for MTC utilization without a substantial increase in the overall tax burden. The steps below describe how to quickly figure out how many ISO shares need to be sold to utilize the MTC.

1. Utilize a very simple formula to calculate the current difference between regular income tax and TMT. This formula can be entered in the cell just below the regular income tax. If regular tax is computed in cell C50 and TMT is in cell C67, then you would enter a formula in cell C51 that reads =C50-C67.
2. If the result of this calculation is less than the client's MTC, then use goal seek to figure out how many ISO shares need to be sold to increase the spread to the amount of your MTC. For example:

(Continued on page 6)

(Continued from page 5)



In this example, cell C51 represents the formula you entered; 10000 is the amount of the MTC; and cell C21 is the sale strategy for the ISO shares.

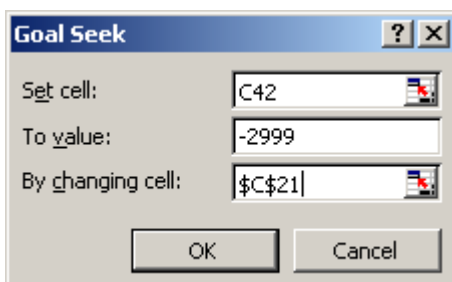
3. Check the resulting sale strategy to verify that more shares were not sold out of that lot than were held. If so, sell all shares in that lot and go to the next available lot and re-do the goal seek.

Keep in mind that AMT capital losses are restricted like regular capital losses. Therefore, beware that if the ISO shares that you are selling have depreciated substantially from when they were exercised, the client may have a substantial built-in AMT capital loss. This could limit the amount of MTC that can be utilized.

Utilizing Capital Loss Carryforwards

If the client has substantial capital loss carryforwards from a prior year but is holding company shares with built-in capital gains, StockOpter will efficiently help you determine how many shares they need to sell to utilize the capital loss carryforward. The effect of this of course is the ability to liquidate shares with no additional tax burden other than the utilization of the capital loss carryforward. The steps below describe how to quickly figure out how many shares need to be sold to utilize the capital loss carryforward.

1. Select the cell in which the Net long-term capital gain (loss) is calculated.
2. Select goal seek and set the value in that cell to -2999 by changing the number of shares to sell out of the desired capital gain lot. For example:



In this example, cell C42 calculates the Net long-term capital gain (loss). Target some number slightly less than the maximum deductible capital loss. The reason for this is that if you are not otherwise utilizing the capital loss carryforward, you will already be at the maximum deductible capital loss and goal seek will not find your solution. After the goal seek, round down the result to utilize the maximum \$3,000 deductible capital loss. Cell C21 represents the sale strategy for held shares with built-in capital gain.

3. Check the resulting sale strategy to verify that more shares were not sold out of that lot than were held. If so, sell all shares in that lot and go to the next available lot and re-do the goal seek.

William E. Summers, CPA, CFP, MST is the senior HVSOP educator and consultant at Net Worth Strategies, Inc. He has taught numerous stock option planning courses around the country for financial planners and CPAs. Mr. Summers has provided expertise in the field of option planning to mutual fund companies, wirehouses, investment firms, financial trade publications, and the national media. He may be contacted at bsummers@networthstrategies.com.

Determinator Suite Incorporates New IR\$ Regulation; and More

Both MRD-Determinator and PRE-Determinator have been updated with the latest IRS tables from this past April. In addition to the latest tax tables a number of new features have been added to each program.

MRD-Determinator (maximizes distributions from IRAs):

- Calculates both spousal rollovers and a spouse's election to treat an inherited IRA as the spouse's own IRA
- Projects cumulative distributions and after tax NPV
- Estate & IRD tax calculations assuming: estate tax repeal, sunset the law or sunset but extend larger exemptions
- All projections include life expectancy and income tax calculators
- Stores name, birth date, relationship and benefit percentage for all primary and contingent beneficiaries

PRE-Determinator (calculates premature distributions):

- Recalculates annual payments available using the amortization method
- Includes new life expectancy tables for the minimum distribution and amortization methods
- Includes mortality tables for the annuity factor method

For more information visit our website or contact Guerdon Ely at 530-895-0636.