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Rule 10b5-1 Trading Plans: Avoiding the Heat





By David B.H. Martin, Keir D. Gumbs, David L. Kornblau, Matthew C. Franker and Stephanie W. Bignon

The authors are attorneys with Covington & Burling LLP. David B.H. Martin is Co-Chair of the firm's Securities and Capital Markets practice and formerly served at the U.S. Securities and Exchange Commission, including as Director of the Division of Corporation Finance. Keir D. Gumbs is a partner and Matthew C. Franker and Stephanie W. Bignon are associates in the firm's Securities and Capital Markets practice. Messrs. Gumbs and Franker previously served at the U.S. Securities and Exchange Commission in the Division of Corporation Finance. David L. Kornblau is Co-Chair of the firm's Securities Enforcement practice and formerly served at the U.S. Securities and Exchange Commission, including as Chief Litigation Counsel in the Division of Enforcement.

A recent series of articles in the *Wall Street Journal* has led to renewed scrutiny of the widespread use of Rule 10b5-1 plans by corporate insiders to trade the stock of their companies.[1] These plans, when properly implemented, are intended to provide insiders with an affirmative defense to insider trading allegations. The recent articles reported that many trades supposedly conducted through Rule 10b5-1 plans occurred shortly before significant changes in the price of the applicable company's stock, resulting in substantial profits or avoided losses for the insiders. Although these profits or reduced losses, in and of themselves, did not mean that the applicable Rule 10b5-1 plans were invalid and that trades thereunder violated anti-fraud rules, the timing of such trades led the journalists to question whether the primary use of these trading plans is to circumvent insider trading laws.

[1] Susan Pulliam, Jean Eaglesham & Rob Barry, *Insider-Trading Probe Widens*, Wall St. J., Dec. 11, 2012, at A1; Susan Pulliam & Rob Barry, *Insider Trades Eyed*, Wall St. J., Nov. 28, 2012, at C1; Susan Pulliam & Rob Barry, *Executives' Good Luck in Trading Own Stock*, Wall St. J., Nov. 28, 2012, at A1.

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The United States Attorney's Office for the Southern District of New York and the SEC opened investigations into some of the alleged abuses described by the news articles.[2] Institutional investors also have expressed concern about the potential misuse of Rule 10b5-1 plans and asked the SEC to provide guidance as to how these plans should be used, or alternatively amend Rule 10b5-1, in order to prevent abuse.[3] This scrutiny is reminiscent of interest that emerged in the wake of a 2006 academic study finding trading under Rule 10b5-1 plans at opportune times.[4] Although this earlier period of inquiry passed without a meaningful increase in SEC enforcement actions involving Rule 10b5-1 plans, there can be no guarantee that renewed focus on this topic will not result in increased enforcement activity or efforts to revise Rule 10b5-1. This article discusses the background and structure of Rule 10b5-1 and practical steps for public companies and their insiders to consider in the formation and management of Rule 10b5-1 trading plans.

Background

Rule 10b5-1 was adopted in 2000 to clarify unsettled case law under Section 10(b) of the Securities Exchange Act of 1934 (the Exchange Act) and Rule 10b-5 thereunder as to what, if any, causal connection must be shown between a trader's possession of inside information and his or her trading. Rule 10b5-1 provides that trading in a security is ''on the basis of material nonpublic information'' if the person making the purchase or sale was aware of the material non-public information when the person made the purchase or sale.

When adopted, this rule was based principally on the SEC's view that the goals of insider trading prohibitions — protecting investors and the integrity of securities markets — are best accomplished through a standard for insider trading liability predicated on ''knowing possession'' of material non-public information, rather than the ''use'' of such information as the basis for a trading decision. ''The awareness standard,'' the SEC said in its adopting release, ''reflects the common sense notion that a trader who is aware of inside information when making a trading decision inevitably makes use of the information.''[5] Nonetheless, and conceding that an absolute standard based on knowing possession of material non-public information could be overbroad in certain respects, the SEC also crafted two affirmative defenses to the knowledge standard, one of which was in Rule 10b5-1(c)(1) for trading under a pre-existing contract, instruction or written plan.

Rule 10b5-1(c)(1) provides an affirmative defense to counter the presumption under the rule that any trade by an insider is ''on the basis of'' any material nonpublic information of which the insider was aware at the time of the trade.[6] In substance, the rule provides that a person does not trade on the basis of material non-public information if such trade occurs under a contract, instruction or written plan to trade the security, so long as such contract, instruction or plan was entered into at a time when the person was not aware of any material non-public information. Taken as a whole, the SEC explained the rule as follows:

> [The] 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. We believe this provision will provide appropriate flexibility to those who would like to plan securities transactions in advance at a time when they are not aware of material nonpublic information, and then carry out those pre-planned transactions at a later time, even if they later become aware of material nonpublic information.[7]

To establish the defense provided by Rule 10b5-1(c)(1), a person (including the company for stock repurchases) who is not then aware of material nonpublic information, may enter into a binding contract, give instructions to another person, or adopt a written plan to buy or sell securities. The contract, instructions or plan must, however:

- specify the amount of securities to be bought or sold, as well as the price and date for the transaction;
- include a written formula or algorithm for determining the amount, price and date of the purchase or sale; or
- not permit the exercise of any subsequent influence over how, when or whether to effect purchases or sales while aware of material non-public information.

Finally, the trade must in fact be conducted under a contract, instructions or plan meeting the conditions described above.[8]

Importantly, in addition to these conditions, the affirmative defense provided by Rule 10b5-1(c)(1) also re-

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[2] Pulliam, Eaglesham & Barry, *supra* note 1, at A1; Susan Pulliam, *SEC Expands Probe On Executive Trades*, Wall St. J., Feb. 5, 2013, at C3. On February 4, 2013, one of the companies referenced in the initial *Wall Street Journal* article disclosed its belief that inquiries by the U.S. Attorney's Office and SEC into the trading of its chief executive officer had concluded without the initiation of any action. *See* VeriFone Systems, Inc., Current Report on Form 8-K (Feb. 4, 2013).

[3] Council of Institutional Investors, Request for Rulemaking Concerning Amending Rule 10b5-1 or Further Interpretive Guidance Regarding the Circumstances under which Rule 10b5-1 Trading Plans May be Adopted, Modified, or Cancelled (Jan. 2, 2013), *available at* http://www.sec.gov/rules/petitions/2013/petn4-658.pdf.

[4] *See* Alan D. Jagolinzer, *Do Insiders Trade Strategically Within the SEC Rule 10b5-1 Safe Harbor?* (Stanford Univ. Graduate Sch. of Business, Working Paper, Dec. 2006), *available at* http://www.thecorporatecounsel.net/HotTopics2007/materials/docs/FAQ/12_06_Jago.pdf (finding that trades pursuant to Rule 10b5-1 plans systematically followed positive and preceded negative disclosures and that plan terminations often preceded positive changes in company stock performance).

[5] *Selective Disclosure and Insider Trading*, SEC Rel. Nos. 33-7881; 34-43,154 (Aug. 15, 2000), *available at* http://www.sec.gov/rules/final/33-7881.htm.

[6] The SEC found it important to set this up as one of two discrete affirmative defenses and rejected requests from commenters to craft a non-exclusive safe harbor or a catch-all defense to allow a defendant to show that he or she did not use any material non-public information known at the time of the trade.

[7] *Selective Disclosure and Insider Trading*, *supra* note 5.

[8] A purchase or sale will not be considered to have occurred under a contract, instruction or plan if the insider altered or deviated from the contract, instruction or plan, whether by changing the amount, price or timing of the transaction, or by entering into or altering a corresponding or hedging transaction or position with respect to those securities. *See* Rule 10b5-1(c)(1)(i)(C).

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quires that the contract, instructions or plan be made in good faith and not as part of a plan or scheme to evade insider trading law.

The affirmative defense in Rule 10b5-1(c)(1) is heavily relied upon by insiders who regularly are aware of material non-public information. This includes senior company personnel who often see Rule 10b5-1 plans as the only safe way to buy or sell stock in their companies and companies which have similar views with respect to routine stock buy-back programs.[9] Clearly, if used properly, Rule 10b5-1 provides a useful prescription for trading by insiders under circumstances that might otherwise raise concerns under insider trading law.[10] In light of these benefits, Rule 10b5-1 plans have proliferated since the adoption of the rule in 2000.

Practical Considerations for Rule 10b5-1 Plans

In light of the importance of Rule 10b5-1 plans as a means to comply with insider trading laws and increasing scrutiny of the potential abuse of such plans, careful consideration of the design and implementation of Rule 10b5-1 plans has renewed importance. The following discussion addresses practical considerations for public companies and corporate insiders to maintain the effectiveness of their Rule 10b5-1 plans. Although these considerations generally are focused on assisting companies in managing the Rule 10b5-1 trading plans of their insiders, they may in many circumstances be useful to public companies seeking to conduct stock buy-back programs under Rule 10b5-1.

1. Active Company Oversight of Rule 10b5-1 Plans

Active company oversight of the use of Rule 10b5-1 plans animates many of the practical considerations discussed in this article. As a general matter, public companies may promote insider trading compliance while permitting insiders to trade by ensuring that oversight of Rule 10b5-1 plans is a meaningful component of their insider trading policies.[11] Such oversight is typically conducted by the general counsel or corporate secretary, or qualified compliance personnel acting under their supervision, and often entails pre-approval of entry into a Rule 10b5-1 plan or use of a pre-approved plan template, as well as review and pre-approval of any changes to established Rule 10b5-1 plans. These measures can significantly increase the likelihood that a trading plan complies with Rule 10b5-1(c)(1) at the time of its adoption. In addition, demonstrated compliance with rigorous internal review procedures prior to entry into a Rule 10b5-1 plan and retention of records relating to the same would provide an insider with an evidentiary record to support his or her later assertion that the plan was established in a good faith effort to comply with the rule.

2. When to Adopt a Rule 10b5-1 Plan

As a matter of first principles, an insider should adopt a Rule 10b5-1 plan only when he or she is not aware of material non-public information. Although not required by the rule, this might be most easy to demonstrate if a plan is adopted when insiders are otherwise permitted to trade under the company's insider trading policy — often called the company's trading window. This would dispel the negative inference that might pertain if a plan were adopted when trading was not otherwise permitted under the company's trading policy.

Two caveats are appropriate in this context, however. First, neither trading in company stock nor the adoption of a Rule 10b5-1 plan are permitted during a company's trading window if the insider is aware of material non-public information. Second, there are many times outside of company trading windows when there is no material non-public information. Trades by insiders during such times may, or may not, violate company policy, but such violations do not necessarily constitute actionable insider trading violations. In fact, many companies provide for waivers or other procedures to permit trading by insiders outside of company trading windows, which are merely prophylactic measures designed to prevent insider trading violations. In any event, insiders entering into Rule 10b5-1 plans and company personnel reviewing such plans must be cognizant of the company's disclosure calendar, as well as any looming irregular disclosure of material information, as the SEC and private litigants are considerably more likely to question the validity of Rule 10b5-1 plans that are established shortly before the release of such information.[12] The analysis with respect to adopting a Rule 10b5-1 plan during a trading window should be no different.

Separately, of course, companies and insiders should consider whether the mere fact that a plan was adopted outside of a company trading window constitutes, in itself, evidence of bad faith or a scheme to evade. Here, facts and circumstances will be critical. If the plan were adopted outside a trading window with company approval, for instance, the likelihood of bad faith would seem substantially lower than where an insider chose to adopt a plan on his or her own. For all of the reasons above, many companies have requirements with respect to who may use Rule 10b5-1 plans and what kinds of approval are required.

3. Waiting Periods Before Trades Can Take Place

Rule 10b5-1 does not impose a waiting period between plan adoption and the initial trade executed under the plan. However, imposition of such a period is one step a company or an insider may take to demonstrate the plan was entered into in good faith. A waiting period requirement also may assist an insider in refut-

[9] Rule 10b5-1(c)(2) provides an affirmative defense for entities which requires that (i) the individual making the investment decision on behalf of the entity was not aware of material non-public information and (ii) the entity had implemented reasonable policies and procedures, taking into account the nature of the entity's business, to ensure that individuals making investment decisions would not violate insider trading laws.

[10] *See, e.g.*, *Elam v. Neidorff*, 544 F.3d 921, 928 (8th Cir. 2008) (''Stock sales pursuant to [Rule 10b5-1] trading plans can raise an inference that the sales were prescheduled and not suspicious.''); *Stiegele ex rel. Viisage Tech., Inc. v. Bailey*, No. 05-10677-MLW, 2007 BL 2646162007 WL 4197496, at *13 12 (D. Mass. Aug. 23, 2007) (''[T]he presence of a [10b5-1] trading plan rebuts an inference of scienter and supports the reasonable inference that stock sales were pre-scheduled and not suspicious.'').

[11] Engaged oversight of Rule 10b5-1 plans is also a useful tool for companies to assist their directors and executive officers in complying with the short-swing profit liability and reporting provisions of Section 16 of the Exchange Act.

[12] *See, e.g.*, *SEC v. Mozilo,* No. CV 09-3994-JFW (MANx), 2009 BL 2948732009 WL 3807124, at *15-16 (C.D. Cal. Nov. 3, 2009); *SEC v. Lent,* No. 04-4088, Docket No. 1 § 39 (N.D. Cal. filed Sept. 24, 2004).

ing an allegation that entry into the plan masked a desire to capitalize on a transitory informational advantage, rather than the legitimate trading motivations that the rule is designed to protect.

The absence of a delay between entry into a written trading plan and the commencement of trading is likely to generate increased scrutiny of the validity of a trading plan purportedly established under Rule 10b5-1. SEC enforcement actions and at least one court decision have taken note of the timing of trades under Rule 10b5-1 plans in relation to the date of adoption of such plans.[13] Although these cases generally involve allegedly defective Rule 10b5-1 plans, or allegations that plans that are established to camouflage illicit trading, imposition of a reasonable waiting period between plan adoption and the commencement of trading thereunder could strengthen an insider's assertion of the affirmative defense, particularly in circumstances where material information is disclosed shortly after the plan's adoption. In this regard, the imposition of a waiting period may be especially useful for situations where the Rule 10b5-1 plan is adopted outside a company's normal trading window.

The duration of a waiting period can range from a few days to as long as several months. For example, one respondent to a Society of Corporate Secretaries & Governance Professionals' survey imposed a 90-day waiting period, while another prohibited execution of trades under a plan during the fiscal period in which the plan had been adopted.[14] Similarly, the Council of Institutional Investors in its recent rulemaking petition expressed a preference of a delay of at least three months.[15] Waiting periods of this duration, or those which restrict trading until after issuance of the next regular earnings release, may assist insiders in demonstrating good faith and that trades under a Rule 10b5-1 plan were not designed to take advantage of material non-public information. However, it is important to remember that imposition of a waiting period is not a substitute for satisfaction of the requirement under Rule 10b5-1(c)(1)(A) that the plan be established before the insider becomes aware of material non-public information.[16] Therefore, a company should not permit an insider to enter into a Rule 10b5-1 plan when the insider possesses material non-public information that the company intends to disclose during an applicable waiting period.

4. Avoid Overlapping Rule 10b5-1 Plans

Companies should discourage insiders from adopting multiple Rule 10b5-1 plans simultaneously or from using plans that overlap. While Rule 10b5-1 does not prohibit the use of such plans, overlapping plans have drawn skepticism.[17] From a practice perspective, the existence of multiple plans may be viewed as indicia of bad faith on the part of the insider. This is particularly likely where plans contain overlapping or inconsistent provisions and permit the insider to cancel one (or more) of the plans at will. Plans of this nature also would fail to qualify for the affirmative defense to the extent they are deemed to establish a corresponding or hedging transaction in the same class of securities, which is prohibited by Rule 10b5-1(c)(1)(i)(C).

In addition, from a corporate housekeeping standpoint, oversight of multiple Rule 10b5-1 plans may be difficult and make plan execution errors more likely. Overlapping Rule 10b5-1 plans also may increase an insider's risk of short-swing profit liability under Section 16(b) of the Exchange Act if the plans provide for open-market purchases and sales, or ''opposite-way transactions,'' of a company's equity securities.

5. Establish Minimum Duration for Plans

Rule 10b5-1 plans with a short duration may lead to questions regarding whether the insider was truly free of material non-public information at the time of adoption and whether the plans were adopted in good faith.[18] While certain plans with a short duration — for example a one-time sale of shares on a future vesting date — are unlikely to arouse suspicion, a series of short-term plans or multiple overlapping plans with brief durations may draw increased scrutiny. Companies therefore may deem it appropriate to impose a minimum duration on Rule 10b5-1 plans. Extending the length of Rule 10b5-1 plans may mitigate concerns that such plans serve as cover for short-term trading decisions tinged by the influence of material non-public information or that were otherwise adopted in bad faith.

Imposing a waiting period before trades can take place, as discussed above, is one method to extend the duration of a Rule 10b5-1 plan. While plans with excessively long durations may meet resistance from insiders and more frequent requests to amend or cancel plans, imposing a minimum duration of at least several

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[13] *In re Novatel Wireless Sec. Litig.*, 830 F. Supp. 2d 996, 1025 (S.D. Cal. 2011) (rejecting a motion for summary judgment and finding that a defendant's sales under a Rule 10b5-1 plan were ''particularly questionable'' because they took place the day after the plan was established.); *SEC v. Mozilo*, No. 09-3994-JFW (MANx), Docket No. 1 §§ 67-71, 112-124 (C.D. Cal. filed June 4, 2009) (noting sales beginning three trading days after the creation of a 10b5-1 plan); *SEC v. Livengood*, No. 09-00159, Docket No. 1 §§ 63-68 (M.D.N.C. filed Mar. 4, 2009) (alleging ''defendants' instructions essentially guaranteed that their Rule 10b5-1 plans would be executed immediately, and all stock identified within their plans promptly sold'').

[14] Society of Corporate Secretaries and Governance Professionals, Executive Officers and Directors 10b5-1 Survey (2005).

[15] Council of Institutional Investors, *supra* note 3, at 3.

[16] *See* U.S. Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretation No. 120.20 (Mar. 25, 2009) (stating that the Rule 10b5-1(c)(1) affirmative defense is not available to an insider who enters into a written trading plan while aware of material non-public information where the plan was structured so that transactions would not occur until after the information was made public).

[17] Linda Chatman Thomsen, Dir., Div. of Enforcement, SEC, Opening Remarks Before the 15th Annual NASPP Conference (Oct. 10, 2007), *available at* http://www.sec.gov/news/speech/2007/spch101007lct.htm [hereinafter ''Thomsen Speech''] (emphasizing that the SEC's enforcement interest in investigating ''multiple and seemingly overlapping 10b5-1 plans''); *see also SEC v. Mozilo*, No. 09-3994-JFW (MANx), Docket No. 1 §§ 112-124 (C.D. Cal. filed June 4, 2009) (emphasizing that one defendant had entered into numerous trading plans within a three-month period).

[18] Rule 10b5-1 does not contain a minimum or maximum duration for a plan established under the rule. Plans with a duration of approximately one year are common. *See, e.g.*, Morgan Stanley Smith Barney LLC, Insider Trading and the Benefits of 10b5-1 Trading Plans, presentation to The National Association of Stock Plan Professionals, Boston Chapter (Sept. 19, 2011), *available at* http://www.naspp.com/ChapterEventFiles/ e3285_Insider_Trading_and_the_Benefits_of_10b5-1_Trading_Plans_-_Sept_Chap_mtg.pdf.

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months may strike an appropriate balance between an insider's desire for flexibility and the need to clearly establish the elements of the Rule 10b5-1(c)(1) affirmative defense.

6. Restrict Plans from Providing for Significant Sales of Securities

Courts evaluating insider trading allegations will consider the amount and percentage of shares sold by insiders when considering whether sales are sufficiently ''unusual'' or ''suspicious'' to support a finding of scienter.[19] The availability of the Rule 10b5-1(c)(1) affirmative defense in response to such a finding is not conditioned on adherence to volume or price limitations on individual or aggregated sales. However, large sales of securities, either in terms of dollar value or as a percentage of the insider's holdings, are likely to result in additional scrutiny of the plan's compliance with the rule.[20] This scrutiny is likely to be especially intense if a significant sale is swiftly followed by the release of negative information, as the timing and significance of the sale would support an inference that it was motivated by a desire to capitalize on material non-public information. In order to insulate trades under Rule 10b5-1 plans from the perception of opportunistic trading, companies may consider imposing time and volume restrictions on sales under such plans. Companies may also consider stock retention requirements or restricting an insider from selling shares under a Rule 10b5-1 plan that exceed a specified percentage of his or her holdings on the date the plan is adopted.

7. Changes to Existing Rule 10b5-1 Plans: Amendments and Cancellations

Insider trading allegations frequently involve changes to Rule 10b5-1 plans when an insider might have been in possession of material non-public information. The affirmative defense of Rule 10b5-1(c)(1) requires an insider's purchases or sales of securities to have occurred under a pre-established contract, instruction or plan and provides that this will not be deemed to have occurred if the insider altered or deviated from the contract, instruction or plan.[21] As a consequence, amendments to Rule 10b5-1 plans should be undertaken with caution and only when the insider satisfies all the requirements of the rule with respect to the creation of a new plan. Despite this requirement, recent high-profile insider trading cases have involved amendments to Rule 10b5-1 plans at times when insiders were, or appeared to be, in possession of material non-public information or were otherwise acting in bad faith.[22]

Rule 10b5-1 does not address the cancellation of a plan established under the rule and the cancellation of such a plan cannot create Rule 10b-5 liability because it involves neither the purchase nor sale of a security. Yet, like amendments, the cancellation of a Rule 10b5-1 trading plan can raise questions regarding the good faith of the insider.[23] Further, the cancellation of an existing Rule 10b5-1 plan may cast significant doubt on post-cancellation trading activity or on the subsequent adoption of a new Rule 10b5-1 plan.[24] For example, when the then-CEO of Quest Communications was charged with criminal insider trading for trades that occurred over a five-month period, he was convicted only on the charges relating to trades that occurred after the cancellation of his initial Rule 10b5-1 plan.[25] On appeal, the court noted that a reasonable jury could conclude that his post-cancellation trades represented a scheme to defraud investors and that his adoption of a subsequent Rule 10b5-1 plan had been an effort to conceal this scheme.[26]

While amendments and cancellations of Rule 10b5-1 plans are not prohibited by the rule, subsequent changes in trading activity will be observed through insiders' Section 16 filings and will generate considerable scrutiny if the trading proves beneficial to the insider. In recognition of this scrutiny and the problems that insiders have frequently encountered regarding changes to Rule 10b5-1 plans, companies should review and preapprove proposed amendments or cancellations to these plans. Companies should not, however, impose blanket prohibitions on amendments and cancellations, as such actions may be necessary in light of unforeseen and legitimate exigencies, such as an amendment or a cancellation to prevent a trade that would result in short-swing profit liability under Section 16(b) of the Exchange Act.

When reviewing these requests to change effective Rule 10b5-1 plans, companies should focus on proposed changes that coincide with landmark events, such as stock price highs or lows, with potential changes in company outlook in response to market or company-specific events, or that are requested outside of open trading windows. Depending on the circumstances, companies also may consider imposing a waiting period before permitting trading under an amended Rule 10b5-1 plan, as discussed above with respect to new plans, or on open window transactions or the creation of a new Rule 10b5-1 plan following the cancellation of an existing Rule 10b5-1 plan.

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[19] *See, e.g.*, *Ronconi v. Larkin*, 253 F.3d 423, 435 (9th Cir. 2001). Other factors include the timing of an insider's sales and whether the sales were consistent with the insider's prior trading history. *Id.*

[20] *Backe v. Novatel Wireless, Inc.*, 642 F. Supp. 2d 1169, 1184-85 (S.D. Cal. 2009) (determining that trades under a Rule 10b5-1 plan did not rebut an inference of scienter where the insider sold more than 90% of his unrestricted holdings over a six-week period and had amended his plan to permit additional sales); *In re Countrywide Financial Corp. Derivative Litigation*, 554 F. Supp. 2d 1044, 1069 (C.D. Cal. 2008) (noting that the small proportion of shares sold ''do[es] not mitigate the inference of scienter given the magnitude and timing of Mozilo's trading''); *see also Nursing Home Pension Fund, Local 144 v. Oracle Corp.*, 380 F.3d 1226, 1232 (9th Cir. 2004) (''[W]here, as here, stock sales result in a truly astronomical figure, less weight should be given to the fact that they may represent a small portion of the defendant's holdings.'').

[21] Rule 10b5-1(c)(1)(i)(C).

[22] *See, e.g.*, *Backe*, 642 F. Supp. 2d at 1184-85; *In re Countrywide Financial Corp. Derivative Litigation*, 554 F. Supp. 2d at 1068-69; *SEC v. Lay*, No. H-04-0284 (S.D. Tex. filed July 8, 2004).

[23] U.S. Securities and Exchange Commission, Division of Corporation Finance, Compliance and Disclosure Interpretation No. 120.18 (Mar. 25, 2009) (noting that a plan cancellation can ''[call] into question whether the plan was 'entered into in good faith and not as part of a plan or scheme to evade' '').

[24] *SEC v. Moshayedi*, No. SACV12-1179 (C.D. Cal. filed July 19, 2012) (insider trading charges related to a secondary offering following cancellation of a Rule 10b5-1 plan).

[25] *United States v. Nacchio*, 519 F.3d 1140, 1147-48 (10th Cir. 2008), *vacated in part on other grounds*, 555 F.3d 1234 (10th Cir. 2009) (en banc).

[26] *Nacchio*, 519 F.3d at 1167.

Disclosure Considerations for Rule 10b5-1 Plans

One of the more controversial issues associated with Rule 10b5-1 plans is whether to disclose their existence and substantive details, as well as whether disclosure should be the obligation of the company or the insider.[27] Shortly after the adoption of Rule 10b5-1, the SEC proposed requiring companies to disclose the adoption, modification or termination of Rule 10b5-1 plans by executive officers or directors on Form 8-K.[28] This proposal met significant opposition, especially regarding the questionable significance to investors of disclosure of the mere existence of Rule 10b5-1 plans and concerns of potential front-running and other manipulative conduct in response to disclosure of the substantive terms of such plans.[29] Perhaps in light of these objections, the SEC abandoned the proposal and did not revive it in subsequent revisions to Form 8-K.

In the absence of mandatory disclosure of Rule 10b5-1 plans, many companies and insiders provide voluntary disclosure as a matter of good optics and to reduce scrutiny of seemingly propitious trades.[30] In addition to deterring litigation, disclosure of a Rule 10b5-1 plan that satisfies the requirements of the rule also may assist insiders in refuting an allegation of scienter.[31] However, notwithstanding the potential advantages of disclosure, companies and insiders generally should refrain from disclosing significant details regarding a plan, including the economic terms and precise timing of trades. If disclosed, investors may view this information as an opinion regarding the company's prospects.

The least intrusive means to disclose trading under Rule 10b5-1 plans is to state that a trade occurred under such a plan, as well as the date of the plan, in the notes to reports filed under Section 16(a) of the Exchange Act.[32] As an alternative, or in addition to such reporting, companies may issue a press release and/or disclose on Form 8-K events relating to Rule 10b5-1 plans by executive officers and directors, or by a subset of executive officers such as the Chief Executive Officer and Chief Financial Officer. Due to concerns regarding asymmetrical disclosure of Rule 10b5-1 plans, companies electing to disclose the adoption of plans by press release or Form 8-K should consider providing similar disclosure with respect to plan modifications or terminations.[33]

Conclusion

Rule 10b5-1 remains a beneficial and frequently utilized provision to permit corporate insiders to sell the securities of their companies while minimizing the risk of engaging in insider trading.

There is a possibility, however, that renewed scrutiny resulting from the recent Wall Street Journal articles will result in legislative or regulatory efforts to impose additional requirements on the use of Rule 10b5-1. This would be an unfortunate overreaction if any such additional requirements burden the rule to the point of restricting its legitimate and practical use.

In light of these developments, public companies and insiders seeking to rely on Rule 10b5-1 should renew their focus on ensuring that their trading plans comply with the requirements of the rule. This may include giving consideration to measures such as those discussed in this article as a means to preserve the affirmative defense the rule affords.

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[27] Disclosure of the existence of, or sales under, a Rule 10b5-1 plan currently is required only for insider sales reported on Form 144.

[28] *Form 8-K Disclosure of Certain Management Transactions*, SEC Rel. Nos. 33-8090; 34-45,742 (Apr. 12, 2002), *available at* http://www.sec.gov/rules/proposed/33-8090.htm. The proposal would have required that a company disclose the name and title of the executive officer or director entering into a Rule 10b5-1 plan, the date of the plan, and a description of the plan, including its duration, the aggregate number of securities to be purchased or sold, and the name of the counterparty or agent. The proposal would also have required a company to disclose an executive officer's or director's modification or termination of a Rule 10b5-1 plan, including a description of the modification that included the specific changes to the plan, including changes to the interval or price at which securities were to be purchased or sold.

[29] *See, e.g.*, Comments of Subcommittee on Employee Benefits, Executive Compensation and Section 16, Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association (July 12, 2002); Comments of Luke Farber, Derivative Products Committee of the Securities Industry Association (June 24, 2002); Comments of Gerald S. Backman, Chairman of Committee, Securities Regulation Committee of the Business Law Section, New York State Bar Association (June 24, 2002).

[30] Allen Horwich, *The Origin, Application, Validity and Potential Misuse of Rule 10b5-1*, 62 Bus. Law. 913, 939 (2007).

[31] *In re Synchronoss Sec. Litig.*, 705 F. Supp. 2d 367, 410 (D.N.J. 2010) (reasoning that the plaintiffs' scienter allegations were insufficient because, among other things, ''the trades at issue were made pursuant to [the defendants'] pre-disclosed trading plans''); *SEC v. Healthsouth Corp.*, 261 F. Supp. 2d 1298, 1322-23 (N.D. Ala. 2003); *Wietschner v. Monterey Pasta Co.*, 294 F. Supp. 2d 1102, 1117 (N.D. Cal. 2003).

[32] Although public companies typically prepare Section 16 reports on behalf of their insiders, the insiders bear responsibility for the accuracy and timeliness of such reports. Adherence to the requirements of Rule 10b5-1(c)(1) is similarly the responsibility of insiders, not the company.

[33] *See* Thomsen Speech, *supra* note 17 (''We're looking at . . . asymmetrical disclosure around plans — that is, disclosure of entry into a 10b5-1 plan, without timely disclosure of related plan modifications or terminations.'').

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