Trouble Brewing for 10b5-1 Trading Plans

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Rule 10b5-1(c) under the Securities Exchange Act of 1934, as amended, is intended to provide a safe harbor from insider trading liability for corporate insiders who trade their company's stock pursuant to certain pre-arranged, automatic trading plans that are adopted when the insider has no material undisclosed information. The plan must specify (or provide an algorithm to determine) the amount, price and timing of the trade, or give the broker or another third party the discretion to determine the amount, price and timing of the trade. 10b5-1 plans are particularly useful for corporate insiders planning for personal liquidity needs, such as a child's tuition payment, or founders and other large holders who seek to diversify by selling a limited amount per quarter, subject to the restrictions imposed on affiliates under Rule 144.

Trouble appeared on the horizon in late 2012, when a series of articles in The Wall Street Journal pointed out some examples of suspiciously profitable trades pursuant to Rule 10b5-1 plans. The Securities and Exchange Commission (SEC) reportedly followed with investigations of the trades featured in the articles. On December 28, 2012, the Council of Institutional Investors wrote a letter to the SEC expressing its concern over the apparent misuse of automatic trading plans and requesting that the SEC provide interpretive guidance or pursue amendments to Rule 10b5-1 that would impose restrictions on the use of these plans. Since that date, both companies and shareholders have become increasingly concerned that regulation will become substantially tighter, or that corporate insiders will face liability for trades made pursuant to automatic trading plans.

Companies and shareholders that follow best practices, however, are unlikely to suffer much in the current climate. Best practices include:

- Adopting the plan only during a company "window period" and only in consultation with company counsel;
- Establishing a significant waiting period between adoption of the plan and the first trade to be made pursuant to the plan;
- Refraining from making frequent amendments or modifications to the plan, and avoiding early plan termination;
- Having only one trading plan at any one time, and making it simple to understand;
- Refraining from trading outside the plan;

- Minimizing the possibility of the insider subsequently influencing trades by using a broker other than the insider's regular broker, or avoiding plans that rely on the broker's discretion; and

- Coordinating planned trading with company window periods.

Public disclosure of the trading plan is often suggested, and may come about anyway through filing of Form 144 or Section 16 forms. Some insiders worry, however, that the announcement of a 10b5-1 trading plan by an important insider may be viewed as a signal that the business is in decline, or may prompt other investors to adopt trading strategies designed to profit from the automatic trades. The SEC is reportedly concerned about asymmetric disclosure: when an insider discloses the existence of the trading plan but then fails to disclose its amendment or termination. If disclosure is initially made, material changes should also be disclosed.

About the Author

Bonnie J Roe is a partner in the Corporate Group of Cohen & Gresser LLP, where she represents publicly and privately held companies and investment funds. Ms. Roe has thirty years of experience advising public companies on disclosure, securities law compliance, corporate governance and acquisitions. She has served as counsel for issuers, underwriters and placement agents in connection with public and private offerings, including PIPE transactions and cross-border offerings. Ms. Roe was named as one of New York's *Super Lawyers* for Securities & Corporate Finance in 2011 and 2012 and is mentioned in Who's Who in America and Who's Who in American Law.

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