



Outside Counsel

## Avoiding Insider Trading Issues: Rule 10b5-1 Plan Requirements

Seth I. Rubin and Ron Ben-Bassat, New York Law Journal

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Insider trading is once again a focus of federal regulators. As a result, insiders and large shareholders of publicly traded corporations are faced with potential liability—and unwelcomed scrutiny—when trading in shares of public company stock. This is particularly true where there may be a question as to whether the individual was aware of any material, non-public information at the time a trade took place.

Section 10(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act) prohibits "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." The Securities and Exchange Commission has relied on Section 10(b) in prosecuting enforcement actions for insider trading cases which involve the purchase or sale of a security on the basis of material non-public information. However, an individual or entity possessing material non-public information may still trade in a public company's securities if such trades are made pursuant to a 10b5-1 plan.

### Plan Requirements

Rule 10b5-1 provides officers, directors and other insiders an affirmative defense to allegations of insider trading. In order to avail oneself of the protections afforded by this affirmative defense, a 10b5-1 plan must be entered into in good faith when the person or entity does not possess material non-public information and must not be a part of a plan or scheme to evade securities laws. Generally, officers and directors of public companies may enter into these 10b5-1 plans during an "open window" permitting trading of securities by insiders. A plan should also take into account the following factors:

- The 10b5-1 plan must be specific in its methodology for trading by either:
- Specifically referencing the amount of securities to be traded and the price at which and the date on which the securities are to be traded; or

- Including a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities are to be purchased or sold; or
- Permitting a third party to determine the price and quantity of securities to be traded, without the insider being able to exercise any influence on such decision.
- A 10b5-1 plan must not allow the plan creator to exercise any subsequent influence over how, when or whether to make purchases or sales.
- All purchases or sales must be executed and made according to the 10b5-1 plan's terms.

## Best Practices

While the list above includes the basic elements required to create and implement a 10b5-1 plan, other practical considerations should be weighed as well, including: (i) the number of securities issued under the plan; (ii) the duration of the plan; (iii) the timing of adoption of the plan; (iv) required Section 16 filings relating to transactions made under the plan; (v) modifications to a plan; and (vi) public announcements of the plan.

**Number of Securities:** There is no restriction on the number of securities that may be included in a 10b5-1 plan. However, a plan creator should consider personal needs when determining how many securities to include in a plan. Including too few securities may require a plan creator to constantly modify a plan, while including too many securities may make it difficult for a plan creator to take advantage of legitimate trading opportunities available outside of the plan.

**Duration:** When determining a 10b5-1 plan's duration, one should consider the total number of shares being sold under the plan as well as a duration that will not require constant modifications of the plan. Depending on circumstances surrounding the company and the insider, a plan with a duration of more than 12 months may not provide the plan creator with the necessary flexibility to respond to market conditions. Alternatively, a shorter duration will require constant modifications and may subject the plan creator to allegations of manipulation, thus defeating the purpose of implementing a 10b5-1 plan.

**Timing of Adoption of Plan:** A 10b5-1 plan may only be adopted during an "open window" as may be determined by the company's insider trading policy. Generally, an "open window" is available soon after a company's earning announcement. In addition, once a 10b5-1 plan is implemented, a reasonable waiting period before implementing a trade under the plan should be observed.

**Section 16 Filings:** Importantly, all Section 16 filings (including Forms 3, 4 and 5, as well as Schedule 13D and Schedule 13G) must be filed when a transaction under a 10b5-1 plan is made. However, an insider should note on such Section 16 filing that the trade was made pursuant to a 10b5-1 plan.

**Modifications:** Numerous modifications to a 10b5-1 plan are discouraged. Constant modifications to a 10b5-1 plan may subject the plan creator to allegations of manipulation and thus defeat the purpose of implementing a 10b5-1 plan.

**Public Announcements:** A plan creator is not required to publicly announce the implementation of a

10b5-1 plan, though companies may choose to issue a press release announcing the implementation when a high-profile insider is involved. If a company does elect to announce a 10b5-1 plan publicly, it is common for modifications or the termination of such plan to be announced.

## Careful Planning Required

While a 10b5-1 plan does not provide insiders with a "safe harbor" for trades made while possessing material, non-public information, it may provide insiders with an affirmative defense to insider trading allegations. In addition, the use of a 10b5-1 plan provides greater certainty to insiders planning stock transactions.

A 10b5-1 plan also provides insiders with more opportunities to sell their company securities, particularly during blackout periods where such trades are generally prohibited by company insider trading policies. The use of a properly designed trading plan can be a valuable and sound tool for trading for executives and issuers alike. We strongly recommend that companies whose executives are considering a 10b5-1 plan contact counsel experienced with the issues involved.

**Seth I. Rubin** is a partner at *Ruskin Moscou Faltischek* and chair of its health care finance practice group. **Ron Ben-Bassat** is an associate at the firm.

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