



### *Here's the deal:*

- A Rule 10b5-1 plan is a written securities trading plan that is designed to comply with Rule 10b5-1(c) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").
- Any person or entity executing pre-planned transactions pursuant to a Rule 10b5-1 plan that was established in good faith at a time when that person or entity was unaware of material non-public information has an affirmative defense against accusations of insider trading, even if actual trades made pursuant to the plan are executed at a time when the person or entity may be or is aware of material, non-public information.
- Rule 10b5-1 plans are especially useful for those presumed to have inside information, such as officers, directors and other affiliates.

### What's the Deal?

Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder prohibit, among other things, the sale of a security on the basis of material non-public information. Rule 10b5-1 specifies that a sale constitutes trading on the basis of material non-public information when the person making the sale was aware of material non-public information at the time the sale was made. Rule 10b5-1, adopted in August 2000, codifies the position of the Securities and Exchange Commission ("SEC") that awareness, not use, of material non-public information is sufficient to establish liability in insider trading cases. Importantly, the rule creates a mechanism whereby any person or entity can enter into a trading plan (a "Rule 10b5-1 plan") that will provide an affirmative defense to a claim that a trade occurred "on the basis of" material non-public information. An affirmative defense allows a person to refute allegations of wrongdoing – in this case, trading on the basis of material non-public information. Rule 10b5-1 plans benefit both issuers and their insiders by offering greater clarity and certainty on how plan participants can structure securities transactions in order to avoid incurring insider trading liability.

### Purpose of a Rule 10b5-1 Plan

A Rule 10b5-1 plan provides the following two affirmative defenses against allegations of insider trading so long as the person trading can demonstrate that the purchase or sale occurred pursuant to the terms of the plan.

- The first affirmative defense, available to both persons and entities, provides that trades pursuant to such a plan are not made "on the basis of" material non-public information.

- The second affirmative defense, available only to entities, provides that an entity will not be liable if it demonstrates that the person making an investment decision on behalf of the entity was not aware of material non-public information and that the entity had implemented reasonable policies and procedures to prevent insider trading.

Once violations are alleged, the insider will need to set forth all of the elements of the defense, demonstrate that the Rule 10b5-1 plan was properly designed, and show that the trades at issue complied with the terms of the plan.

## Benefits of a Rule 10b5-1 Plan

Rule 10b5-1 plans provide the following benefits:

- An affirmative defense to insider trading allegations as described above;
- Greater certainty to insiders in planning securities transactions;
- More opportunities for insiders to sell their securities, especially if the issuer's trading policy permits trading under such a plan during a blackout period;
- Less negative publicity associated with insider sales; and
- Decreased burden on counsel or trading compliance officers who otherwise would have to make subjective determinations about the availability or possession of material non-public information each time an insider seeks to effect a securities transaction.

While not a requirement, an issuer may choose to disclose the existence of certain Rule 10b5-1 plans in order to mitigate any negative press associated with insider securities transactions. An issuer making such a disclosure generally will disclose the existence of a plan but not the specific trading details. Disclosure of this information is typically made by way of a press release followed by a Form 8-K filing with the SEC or solely through a Form 8-K filing. The applicable Form 8-K item is Item 8.01, although Item 7.01 may be used under appropriate circumstances.

## Establishing a Rule 10b5-1 Plan

Any person, including non-insiders, can establish a Rule 10b5-1 plan to effect securities transactions at a time when the person is not aware of material non-public information, so long as the plan is not part of a plan or scheme to evade the insider trading prohibitions of the rule. For example, an executive who receives a significant portion of his or her compensation in stock options may establish a Rule 10b5-1 plan to diversify his or her holdings or a director may establish a Rule 10b5-1 plan to purchase issuer securities to satisfy stock ownership guidelines. Either example is acceptable, so long as the person establishing the plan did not have access to material non-public information at the time the plan was established.

## Elements of a Rule 10b5-1 Plan

A Rule 10b5-1 plan provides an affirmative defense only if the following elements are met:

1. The plan was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1.

2. The plan was adopted at a time when the person trading was not aware of any material non-public information.
  - Rule 10b5-1 makes clear that trades are made “on the basis of” material non-public information when the person making the purchase or sale was merely “aware” of material non-public information, rather than “using” such information, when the purchase or sale was made.
3. The terms of the plan specified the amount, price, and date of the transaction(s) (or included a written formula, algorithm, or computer program for determining the amount, price, and date).
  - A simple plan may authorize trades on specified dates or at specified prices. A more complicated plan may utilize targets based on the performance of the stock relative to various market or industry indices or even relative to certain selected competitors.
  - The plan itself must sufficiently identify the calculation of the relevant prices and triggers so there is no discretion on the part of the insider. If desired, the plan should incorporate different trading strategies in order to provide flexibility.
4. The person trading under the plan did not exercise any subsequent influence over how, when, or whether to make purchases or sales.
  - Typically, the insider establishing the plan designates an administering broker who executes the trades pursuant to the plan.
  - Once the Rule 10b5-1 plan is adopted, there should be no communications between the insider and the administering broker (other than notices that trades have been executed).
  - Rule 10b5-1 prohibits both the insider or the appointed administering broker from entering into or altering a corresponding or hedging transaction or position with respect to securities subject to the plan.
5. The purchase or sale was made pursuant to the plan.
  - Rule 10b5-1(c)(1)(i)(C) specifies that a purchase or sale is not made pursuant to the plan if, among other things, the insider altered or deviated from the plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale).

## Trading under a Rule 10b5-1 Plan

*Securities Covered Under a Rule 10b5-1 Plan:* There is no restriction on the amount of securities that may be covered by a Rule 10b5-1 plan. A plan may be designed to cover all or a small portion of a person’s holdings. The plan should be carefully constructed to include an amount that is suited to the purposes of the person trading. A plan that covers too few securities may require frequent modifications, and a plan that covers too many securities may make it difficult for the insider to take advantage of legitimate trading opportunities outside of the plan.

Rule 10b5-1(c)(1)(iii)(a) defines “amount” as either a specified number of securities or a specified dollar value of securities. Rule 10b5-1(c)(1)(iii)(b) defines “price” as the market price on a particular date or a limit price, or a particular dollar price. A Rule 10b5-1 plan can be set up to execute trades with minimum or maximum prices or with prices that change over time, so long as the price targets or the method for determining the price targets are set forth in the plan. Rule 10b5-1(c)(1)(iii)(c) defines “date” as, in the

case of a market order, the specific day of the year on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution). In the case of a limit order, "date" is defined as a day of the year on which the limit order is in force.

*Trade Frequency Under a Rule 10b5-1 Plan:* A plan can be tailored to the specific needs of the person who sets it up. For example, the plan can specify that trades will be made on a regular basis or the plan can be designed to initiate transactions upon certain trigger events. The SEC does not require a limit on the term of a Rule 10b5-1 plan. A series of short-term plans may subject the insider to allegations of manipulation. On the other hand, plans covering more than a year may deprive the insider of the ability to control the disposition (or acquisition) of securities or to react to significant changes in the issuer's condition or changes in the insider's financial circumstances.

*Trades Deemed Outside a Rule 10b5-1 Plan:* Trades may be made outside of the Rule 10b5-1 plan. However, the Rule 10b5-1 affirmative defense will not apply to trades made outside of the plan. Additionally, an insider should not sell securities that have been designated as plan securities because any such sale may be deemed a modification of the plan. Further, if the insider is subject to the Rule 144 volume limitations, the sale of securities outside the plan could effectively reduce the number of shares that could be sold under the plan, which could be deemed an impermissible modification of the plan.

## Changes to, or Termination of, Rule 10b5-1 Plans

*Modifying a Rule 10b5-1 Plan:* While amendments to Rule 10b5-1 plans are permitted as long as the modifier does not possess material non-public information at the time of the modification and meets all of the elements required at the plan inception, modifications should be avoided, because they may create the perception that the person is manipulating the plan to benefit from material non-public information, jeopardizing the good faith element and the availability of the affirmative defense.

*Suspending a Rule 10b5-1 Plan:* The affirmative defense will be unavailable if it appears that the person trading under the plan is exerting subsequent influence over the plan. In addition, suspension of a Rule 10b5-1 plan can lead to the same issues as modification of a plan: it may appear that the plan is being manipulated, jeopardizing the good faith element and the availability of the affirmative defense. When reinstating the ability to trade under the plan, all of the elements required at the inception of the plan must be met again.

*Terminating a Rule 10b5-1 Plan:* Termination of a plan, by itself, is not a violation of Rule 10b-5, because the termination does not occur in connection with the sale or purchase of securities. However, termination of a plan may jeopardize the good faith element and the availability of the affirmative defense.

Once a Rule 10b5-1 plan is terminated, the affirmative defense may not apply to any trades that were made pursuant to that plan if such termination calls into question whether the good faith requirement was met or whether the plan was part of a plan or scheme to evade Rule 10b5-1. The problem is increased if the insider terminates and establishes plans serially.

*Automatic Suspension or Termination of a Rule 10b5-1 Plan:* To allow persons to make decisions in connection with major corporate transactions and to avoid potential problems under other provisions of the federal securities laws, Rule 10b5-1 plans often include a provision that automatically terminates or suspends trading under the plan upon, among other occurrences, the issuer's announcement (or notice

from an issuer's general counsel or compliance officer) of a merger or acquisition transaction or an underwritten public offering.

## Impact on other Federal Securities Laws

A person trading pursuant to a Rule 10b5-1 plan still must comply with other regulatory reporting requirements. If a person is selling securities without registration under the Securities Act of 1933, the person may need to file a Form 144. On Form 144, the seller should indicate that the sale is being made pursuant to a Rule 10b5-1 plan. In addition, the seller may need to comply with the aggregation and volume restrictions of Rule 144.

For U.S. issuers, the Forms 4 and 5 filing requirements also apply to trades made pursuant to a Rule 10b5-1 plan. It is advisable to specifically note on the Form 4 or 5 that the trades were made pursuant to a Rule 10b5-1 plan to ensure that investors or analysts monitoring sales by insiders will know that the trades do not represent a current investment decision by the insider. Additionally, trades made pursuant to a Rule 10b5-1 plan must be reported under the applicable requirements of Schedule 13D and/or Schedule 13G.

Officers, directors, and 10% shareholders utilizing Rule 10b5-1 plans should be careful about trading in violation of Section 16(b) of the Exchange Act. If such a person conducts a purchase and sale, in any order, within a six-month period and realizes a profit, then the profits must be disgorged to the issuer.

## Insider Trading Policies

Trades made pursuant to Rule 10b5-1 plans are subject to issuer-specific trading restrictions and may not be permitted under an issuer's trading policy. Typically, an issuer's insider trading policy indicates whether an employee or director may establish a Rule 10b5-1 plan. Some insider trading policies require that a Rule 10b5-1 plan is approved or, at a minimum, that the plan has been established for its securities. An issuer may also require notice if an employee or director establishes a plan to trade securities of a significant customer or supplier. An employee or director should review the issuer's insider trading policy to determine whether the issuer permits establishment of a plan during a blackout period or permits trades during a blackout period pursuant to a plan.

## Best Practices

To avoid the appearance that insiders are engaging in abusive practices issuers should adopt the following requirements for Rule 10b5-1 plans by their directors, officers, and other employees:

- Establishment of a Plan: Require issuer approval of any Rule 10b5-1 plan and permit plans to be established only during an open trading window to avoid the appearance of establishing a plan while in possession of material non-public information and to bolster the good faith element.
- Waiting Period: Impose a mandatory waiting period between the establishment of a plan and the date the initial trade is made.
- Term of Plan: Consider minimum and maximum terms for plans, such as a minimum of six or 12 months and a maximum of two years. This will enable users to establish new plans over time while preventing the need for any voluntary modifications, terminations, or suspensions.
- Form Plan: Consider adopting a pre-approved form of plan.

- One Broker: Consider requiring all insiders to use a pre-selected broker.
- Trading Parameters: Consider prohibiting large sales at initiation of the plan or plans that give the implementing broker discretion on sales.
- Modifications, Terminations, Suspensions: Disallow any modification, termination, or suspension other than during open trading windows. In the event of any modification, termination, or suspension, issuers should impose a waiting period before trades can be reinstated under a plan.
- Disclosure: Disclose all events in the lifecycle of a Rule 10b5-1 plan: adoption, modification, termination, or suspension, either through a press release or by a Form 8-K.
- Multiple Plans: Prohibit insiders from adopting multiple overlapping Rule 10b5-1 plans.
- Trades Outside of the Plan: Once a plan is established, limit transactions outside of the plan.

In addition, the issuer should develop robust training programs regarding its insider trading and disclosure policies and the use of Rule 10b5-1 plans, and should consider periodic reviews of insiders' trading plans to ensure compliance with the securities laws and issuer policies.

### *Checklist of Key Questions*

- Does the issuer require approval of a Rule 10b5-1 plan?
- What is the duration of the Rule 10b5-1 plan?
- Does the issuer require all insiders to use a pre-selected broker?
- Does the issuer prohibit large sales at initiation of the plan or plans that give the implementing broker discretion on sales?
- Does the issuer prohibit any modification, termination, or suspension other than during open trading windows?
- If there is a modification, termination, or suspension to the plan, has the issuer imposed a waiting period before trades can be reinstated under a plan?
- Does the issuer publicly disclose the existence of insider Rule 10b5-1 plans?
- Once a plan is established, does the plan limit transactions outside of the plan?