SEC and DOJ Bring Landmark Securities Fraud Cases Following Rule 10b5-1(c)(1) Amendments, Signaling Increased Scrutiny of 10b5-1 Plans

Key Points

- On March 1, 2023, the SEC and DOJ filed insider trading charges against a public company executive alleging he traded pursuant to 10b5-1 trading plans he adopted while he was in possession of material nonpublic information. Rule 10b5-1, first adopted in 2000, established an affirmative defense to insider trading whereby corporate insiders can set up automatic plans for future trades so long as they do so in good faith when they are not in possession of MNPI. Recent amendments to Rule 10b5-1 contain new disclosure obligations and require a new "cooling off" period between the adoption of a plan and trading pursuant to the plan.
- The defendant here adopted a plan that called for trading the day after adoption. While he adopted the plans before the new amendments to Rule 10b5-1 were added by the SEC, the enforcement actions signal the government's enhanced focus on 10b5-1 trading plans, used for decades by public company insiders to manage their holdings.
- The SEC and DOJ announced that the cases against the defendant were a result of both agencies' "data-driven initiative[s]" into executive abuses of Rule 10b5-1 trading plans. The government can be expected to continue to use data analytics to identify suspicious trading following the adoption of Rule 10b5-1 plans going forward.

The Complaint

On March 1, 2023, the Securities and Exchange Commission (SEC) filed a complaint in the United States District Court for the Central District of California against Terren S. Peizer and Acuitas Group Holdings, LLC (the "Complaint").[1] Just a few days prior, a grand jury sitting in the Central District of California indicted Peizer on three securities fraud-related counts.[2] Peizer is the founder, Executive Chairman and Chairman of the Board of Directors of Ontrak, Inc. (the "Company"), a health care treatment company based in Santa Monica, California. Acuitas is a personal investment vehicle that was established by Peizer; Peizer owns 100% of Acuitas and is its Chairman and sole member.

The Complaint alleges that Peizer engaged in insider trading when he established two Rule 10b5-1 trading plans through Acuitas—one in May 2021 and one in August 2021—while in possession of material, nonpublic information (MNPI) regarding Ontrak, and subsequently sold Ontrak stock pursuant to those plans.

Peizer's trades pursuant to these two plans allegedly facilitated his avoiding over $12.7 million in losses. According to the Complaint, at the time Peizer established the two Rule 10b5-1 trading plans, he knew of negative MNPI relating to Ontrak. In particular, Peizer allegedly knew that Ontrak's then-largest customer, Cigna, had expressed its

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dissatisfaction with Ontrak and had indicated to key Ontrak personnel that it was likely to terminate its contract with Ontrak. Peizer allegedly created the August 2021 trading plan just days before Cigna formally notified Ontrak that it was officially terminating its contract effective December 31, 2021. The Complaint alleges that, at this time, Ontrak's business was dependent on its three largest customers, one of which was Cigna. And, as Ontrak informed the market in its March 2021 disclosure, the loss of any of those customers would have "a material adverse effect" on Ontrak's business.

The SEC's complaint places considerable emphasis on Peizer's failure to adopt a plan with a cooling off period, even though it was not a requirement of Rule 10b5-1 at the time. According to the SEC, in May 2021, Peizer allegedly approached one broker who advised Peizer that the brokerage firm's policy required at least a 14-day cooling off period before any shares could be sold under the trading plan. Peizer then contacted a second broker. And while the second broker advised that it was "industry best practice" to include a 30-day cooling off period between when the trading plan is executed and the commencement of trading, the cooling off period was not required by that firm's policy. Peizer then executed a Rule 10b5-1 trading plan with no cooling off period through the broker with the more permissive policy. The plan directed the broker to begin selling a set number of Peizer's Ontrak shares the day after the trading plan was established. In the May 2021 trading plan, Peizer also allegedly represented that he was not aware of any MNPI concerning Ontrak.

In August 2021, Peizer created another trading plan with the second broker. In doing so, Peizer once again declined the broker's recommendation that the plan include a 30-day cooling off period. Peizer also again represented that he was not aware of MNPI regarding Ontrak or its securities.[3]

Rule 10b5-1 and the SEC's December 2022 Amendments

These enforcement actions come at a time when trading pursuant to 10b5-1 plans is under intense scrutiny, with the SEC recently adopting broad-based amendments to the rule.[4]

Rule 10b5-1 was adopted by the SEC in 2000 to provide more clarity on what was prohibited with respect to trading on the basis of MNPI and to provide insiders with an affirmative defense when trading public company securities. Rule 10b5-1(c) established an affirmative defense whereby insiders can set up future trades pursuant to a binding contract or plan adopted in good faith while the insider does not have MNPI, and the plan can be carried out even if the insider later acquires MNPI. This affirmative defense shifts the insider trading analysis (i.e., whether the insider has MNPI) from the time the securities are purchased or sold to the time when the Rule 10b5-1 plan is put into place.

In an attempt to address criticisms that 10b5-1 plans allowed for manipulation by insiders, the SEC amended Rule 10b5-1 on December 14, 2022. Under the December 2022 amendments, the following additional conditions must be met in order to claim the affirmative defense:

- Mandatory cooling off periods for newly adopted or modified Rule 10b5-1 plans;
- Representations in the newly adopted or modified Rule 10b5-1 plan from directors and officers certifying that they are not aware of MNPI when adopting a new or modified Rule 10b5-1 plan and that they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5;
- No overlapping Rule 10b5-1 plans for anyone other than issuers (other than in limited circumstances);

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- Only one single-trade plan in a 12-month period for anyone other than issuers; and
- Good faith actions with respect to the Rule 10b5-1 plan by all persons entering into that plan.

Following these amendments, Rule 10b5-1 plans of directors and section 16 officers now require a cooling off period of the later of (1) 90 days following plan adoption or modification and (2) two business days following the disclosure in periodic reports on Forms 10-Q, 10-K, 20-F or 6-K (as applicable) of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification). Rule 10b5-1 plans of persons other than issuers or directors and section 16 officers now require a 30-day cooling off period. The cooling off periods are intended to ensure that even if an insider holds information not known to investors at the time of a plan adoption or modification, that information will be stale by the time trades are made under the plan.

Takeaways

Although Peizer's 10b5-1 plans were established before the amendments to Rule 10b5-1 were even proposed by the SEC, this case presents the SEC with another platform to continue to highlight its focus on trading by corporate insiders. Indeed, this particular case should turn on the basic question of whether Peizer was in possession of MNPI when he adopted his two trading plans.

Yet the timing of the action against Peizer—just months after the SEC amended Rule 10b5-1(c)(1)—indicates that it will continue to scrutinize Rule 10b5-1 plans in the future. While the amendments to Rule 10b5-1(c)(1) do not affect the affirmative defense available under an existing plan entered into prior to the amendment's effective date, they will apply to the extent that such a plan is modified or changed in the manner described in Rule 10b5-1(c)(iv) after the effective date of the final rules.

Both the SEC and DOJ have also implemented data-driven initiatives to identify executive abuses of 10b5-1 trading plans, like the alleged abuses by Peizer. Although neither agency has publicly commented on how their data analytics operate, they are likely to focus on circumstances where executives have made especially successful trades not long after plans have been adopted or modified, or where plan-based trading fails to adhere to the cooling off periods or other requirements of the current iteration of Rule 10b5-1. Companies should consider examining their own 10b5-1 trading plans, and the plans of their executives, directors and other insiders, for similar fact patterns.

[1] The SEC's Complaint is captioned *SEC v. Peizer, et al.*, 23-cv-01511 (C.D. Cal.), and can be found at https://www.sec.gov/litigation/complaints/2023/comp-pr2023-42.pdf.

[2] The Department of Justice's (DOJ) indictment was unsealed on March 1, 2023, and can be found at https://www.justice.gov/criminal-vns/file/1570641/download.

[3] Notably, the Complaint is silent as to whether Peizer's trading plans were approved by Ontrak. But the DOJ's indictment alleges that Peizer falsely certified to Ontrak's Chief Financial Officer, pursuant to Ontrak's insider trading policy, that the Rule 10b5-1 trading plans were not established as a result of Peizer's access to, or receipt of, MNPI.

[4] Akin's client alert on the SEC's December 2022 amendments to Rule 10b5-1 can be found at https://www.akingump.com/en/insights/alerts/sec-amendments-regarding-rule-10b5-1-insider-trading-plans-and-related-disclosures.