

The First Criminal Rule 10b-5-1 Case

Background

The Commission created Rule 10b5-1 plans two decades ago. The rule essentially creates a safe haven for those who in good faith trade securities and are not in possession of inside information. Thus, the plans provide a mechanism for trades to be executed at designated times in the future – essentially the decision-making process to buy or sell transfers to the plan from the trader. Since the plans are created when the person does not have inside information and provide for the execution of a transaction in the future under the plan, they can constitute an affirmative defense to insider trading claims.

The First Criminal Case

While the Rule has been popular, there have been abuses. This is illustrated by the first criminal prosecution tied to the Rule and illustrated by the actions filed first by the U.S. Attorney's Office for the Central District of California and later the SEC. *U.S. v. Terren Peizer*, Case No. 2:23-cr-89 (C.D. Cal. Filed February 23, 2023); *SEC v. Peizer*, Civil Action No. 2:23-cv-01511 (C.D. Calif. March 1, 2023).

Each case names as Defendant Terren S. Peizer, the founder and Executive and Chairman of the Board of Ontrak, Inc., a virtualized outpatient healthcare treatment company. The SEC action also includes Acuitan Group Holdings, LLC, an entity controlled by Mr. Peizer. The cases center on trading while in possession of material non-public information in the shares of Ontrak.

Onrak is a behavioral health firm, according to the allegations in the SEC complaint. It contracts with health plans to identify members whose chronic disease will improve with behavior change. The company provides the members with solutions. Ontrak has suffered significant losses since its founding in 2003. By March 2021 its business was dependent on three large customers.

Related Capabilities

- Anti-Corruption
- Government Enforcement & Corporate Investigations
- Securities & Financial Services Litigation & Enforcement

From May through August 2021 Mr. Peizer adopted two Rule 10b-5-1 trading plans. He used those plans to sell 641,357 shares of Ontrak. At the time of the transactions Mr. Peizer knew that in August 2021 when a large customer left Ontrak the share price dropped significantly. He also knew prior to the adoption of the two Rule 10(b)-5-1 trading plans that another large shareholder was considering leaving Ontrak. The criminal case contains counts of securities fraud, insider trading and criminal forfeiture. SEC case alleges violations of Securities Act Section 17(a) and Exchange Act Section 10(b). The cases are pending.

Amendments to the Rule

The Commission crafted amendments to the Rule in an effort to avert abuses like the one at the center of the case above. The amended rule must meet several new requirements which include:

- *Cooling off periods:* These apply to directors and officers and generally require waiting 90 days after the adoption of the plan or two business days following disclosure in certain periodic reports of the issuer's financial results for the fiscal quarter in which the plan is adopted or modified; for persons other than issuers or directors and officers the period is 30 days before trading can commence.
- *Representation:* Officers and directors must represent that they are not aware of any inside information and adopted the plan in good faith.
- *Overlapping plans:* Only issuers can use multiple overlapping plans.
- *Good faith:* All persons entering into a plan must act in good faith regarding it.
- *Disclosures:* Registrants must make quarterly disclosure regarding the use of a plan and certain other written trading arrangement.
- *Policies:* A registrant is also required to annually disclose its insider trading policies and procedures.
- *Tabular and narrative disclosures:* Certain tabular and narrative disclosures about awards of options close in time to the release of inside information must also be disclosed.
- *Form 4 & 5 filers:* These files must indicate that they intend to satisfy the affirmative defense conditions of the Rule.

The effective date of the new Rule is 60 days following publication of the modifications.

Conclusion

Rule 10b-5-1 plans have proven popular. At the same time some have abused the rule as illustrated by the case discussed above. The amendments are designed to tighten the rules governing the plans and add disclosure. Accordingly, the new provisions are designed to give better definition to the manner in which the plans are to be implemented and maintained and, for the first time, add transparency to their use.