Blogs
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Last week, the DOJ unsealed an **indictment** against the CEO of a publicly traded healthcare company (the Executive) relating to charges of an insider trading scheme. The indictment represents the first time the DOJ has brought criminal insider trading charges stemming from an executive's use of a Rule 10b5-1 trading plan. The investigation is part of a data-driven initiative led by the **DOJ's Fraud Section** to identify executive abuses of 10b5-1 trading plans.

Rule 10b5-1 Plans

Rule 10b5-1 trading plans offer an affirmative defense from insider trading liability on the basis of material nonpublic information (MNPI) under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. This is an affirmative defense whereby insiders can set up future trades pursuant to a binding contract adopted in compliance with the rule. However, the defense is unavailable if the insider is in possession of MNPI at the time the insider adopts the trading plan. Additionally, a plan does not protect an insider who does not enter into a plan in good faith or uses a plan as part of an effort to evade the prohibitions of Rule 10b5-1.

DOJ's Criminal Indictment for the Insider Trading Scheme

The DOJ alleges that the Executive allegedly avoided more than $12.5 million in losses by entering into two Rule 10b5-1 trading plans while in possession of MNPI concerning the likelihood that the healthcare company's then-largest customer would terminate its contract. In May 2021, the Executive allegedly entered into his first 10b5-1 plan shortly after learning that the relationship between the healthcare company and the customer was deteriorating. Then, in August 2021, the Executive allegedly entered into his second 10b5-1 trading plan approximately one hour after the healthcare company's chief negotiator for the contract confirmed to the Executive that termination was likely.

In establishing the 10b5-1 plans, the Executive allegedly refused to engage in any "cooling-off" period—the time between entering into the plan and selling the stock—despite warnings from the Executive's brokers. Instead, the Executive allegedly began selling shares of the healthcare company on the next trading day after establishing each plan. On August 19, 2021, just six days after the Executive adopted his August 10b5-1 plan, the healthcare company announced that the customer had terminated its contract and the company's stock price declined by more than 44%. The Executive is charged with one count of engaging in a securities fraud scheme and two counts of securities fraud for insider trading.

Renewed Focus on Rule 10b5-1 Plans by SEC and DOJ

This first criminal indictment comes immediately on the heels of **recent amendments** to Rule 10b5-1 by the SEC, which went into effect on February 27th. The amendments made a number of key changes to Rule 10b5-1 summarized in more depth **in this blog.** Key elements of the newly amended Rule 10b5-1 include:

- Mandatory cooling-off periods for directors and nondirectors.
- Restrictions on overlapping and single-trade plans.
- Written certifications when entering into Rule 10b5-1 plans.
- Annual reporting of insider trading policies and procedures and quarterly reporting on use of trading plans.
- Narrative and tabular disclosure about timing of option grants.

Implications for the Digital Asset Industry

The DOJ's indictment relating to insider trading should interest digital asset issuers, trading platforms, and other digital asset intermediaries. As the SEC continues to take the **stance** that "a vast majority" of digital assets are securities, the DOJ's case demonstrates that the relevant risks relating to securities offerings and subsequent transactions may involve criminal as well as civil charges. Serious consideration should be given by digital asset industry participants to the value of implementing insider trading policies including the use of 10b5-1 plans.

What's Next

DOJ's criminal case against the Executive is now proceeding in federal court in California. If convicted, the Executive faces a maximum penalty of 25 years in prison on the securities fraud scheme charge and 20 years in prison on each of the insider trading charges. Meanwhile, the indictment is an indication of the DOJ's Fraud Section and federal law enforcement's focus on executive abuses of Rule 10b5-1 plans. To rely on the rule's affirmative defense, strict adherence to the rule is necessary.

We first blogged about this in our **"Asset Management ADVocate" blog.**..

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