SEC Issues Updated Guidance on Rule 10b5-1 Trading Plans

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On March 25, 2009, the SEC’s Division of Corporation Finance updated its Compliance and Disclosure Interpretations relating to Rule 10b5-1 under the Securities Exchange Act of 1934. While these interpretations are mostly consistent with previously expressed Division positions, they do present some significant new information for companies in assessing their policies toward Rule 10b5-1 plans.

Exchange Act Section 10(b) and Rule 10b-5 under that Section generally prohibit the purchase or sale of securities “on the basis of” material nonpublic information. Rule 10b5-1(b) provides that a purchase or sale of a security is considered to be “on the basis of” material nonpublic information if “the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.” However, Rule 10b5-1(c) offers an affirmative defense to a Rule 10b-5 claim where a person trades in securities at a time when he or she is aware of material nonpublic information, provided:

- before becoming aware of the material nonpublic information, the person had entered into a binding contract to trade, instructed another person to trade, or adopted a written plan for trading the company security;
- the contract, instruction, or plan either specifies or provides a written mechanism to determine the amount, price, and date of the trade(s) or prohibits the person from exercising any subsequent influence over how, when, or whether to effect the trade(s);
- purchases or sales are made in compliance with the plan; and
Since its 2002 adoption, Rule 10b5-1 has prompted numerous corporate insiders to adopt trading plans, often referred to as “Rule 10b5-1 plans,” that conform to the rule’s requirements by specifying in advance when and on what terms trades (generally sales) in company stock will occur. As part of a responsible insider trading policy, most companies have adopted guidelines regarding the entry into such plans by their officers and directors.

**Waiting Periods in Rule 10b5-1 Plans**

A fundamental element of the Rule 10b5-1 affirmative defense is that the person entering into a Rule 10b5-1 plan must not be in possession of material nonpublic information and must enter into the plan in good faith and without the intent to evade the prohibition against trading while in possession of material nonpublic information. To assure compliance with these broad, subjective requirements, company guidelines often include a number of specific, objective standards that go beyond the language of Rule 10b5-1. These objective standards generally include, among others:

- required pre-clearance of Rule 10b5-1 plans;
- a required delay on any trading under the Rule 10b5-1 plan for some “cooling-off” period after its adoption;
- a maximum number of plans that an officer or director may adopt; and
- a required waiting period after a prior plan’s termination before additional trades may be undertaken or new plans may be adopted.

Company guidelines requiring a waiting period -- often referred to as a “cooling-off” period -- are intended to maintain the availability of the affirmative defence by assuring that, before any trades are made, the person adopting the Rule 10b5-1 plan is not in possession of any material nonpublic information and, if that person was in possession of such information at the time the plan was adopted, that information has been made public before any sales are made. According to new CDI 120.20, however, a new Rule 10b5-1 plan adopted while a person is aware of material nonpublic information will not benefit from the Rule 10b5-1(c) affirmative defense even if the material nonpublic information is made public before any trades under the plan are made. The SEC’s interpretation that a waiting period will provide no benefit to the person entering into the plan is likely to cause companies to reconsider the necessity of requiring such a waiting period.

While the SEC’s new interpretation eliminates the potential benefit under Rule 10b5-1(c) of a waiting period between entry into a plan and the first sale under that plan, such a waiting period guideline for Rule 10b5-1 plans should continue to be a part of a responsible company insider trading policy. Specifically, such a waiting period will continue to provide companies with added certainty that their insiders...
Effect of Cancellation of a Plan Trade

As a general matter, Rule 10b5-1 plans will provide that the person entering into the plan must follow the terms of that plan. Consistent with existing market understanding, the SEC’s new CDI 120.19 makes clear that any cancellation of a scheduled trade under a Rule 10b5-1 plan has the effect of terminating that plan automatically. Further, after the plan is so terminated, if a person wants to initiate a new trade and still benefit from the affirmative defense of Rule 10b5-1, he or she must adopt a new Rule 10b5-1 plan. These steps are required even if the terms of the new plan are exactly the same as the terms of the terminated plan. CDI 120.19 also specifically emphasizes the importance of examining the “period of time between cancellation of the old plan and the creation of the new plan” to determine the adopting person’s good faith. This emphasis highlights the importance of pre-clearance and a required waiting period between termination and adoption of Rule 10b5-1 plans as necessary provisions in a company’s insider trading policy.

Replacing a Broker that Ceases Operations

The SEC’s new guidance discusses the application of Rule 10b5-1 in the current economic climate. CDI 220.01 addresses the situation where a person enters into a Rule 10b5-1 plan with a broker and that broker later goes out of business. Under this interpretation, even at a time when the person is aware of material nonpublic information, his or her Rule 10b5-1 plan may be transferred to a new broker so long as there is not any cancellation of a scheduled trade and the new broker continues to effect trades in accordance with the plan’s original terms.

Rule 10b5-1 and Company Repurchase Plans

Similar to the Rule 10b5-1(c) defense for individuals, Rule 10b5-1(c)(2) provides an affirmative defense for institutions. CDI 120.25 states clearly the staff’s previously expressed position that this affirmative defense is available to an issuer of securities that adopts a repurchase plan. CDI 220.02 provides useful guidance on the manner in which companies should effect a repurchase plan in accordance with Rule 10b5-1(c)(2). CDI 220.02 addresses a specific factual situation, but is most useful for its reminder that a company adopting a Rule 10b5-1 repurchase plan may not retain any ability -- direct or indirect -- to modify the operation of that repurchase plan.