

# Life Sciences Webinar

Building Effective 10b5-1 Trading Plans

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# Speakers



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## Landscape Facing Life Sciences Insiders

- Attractive valuations have created opportunities for directors and employees to sell stock
- BUT the window for trading is often shut
  - quarterly blackouts
  - planned and unplanned developments
    - clinical trial developments
    - data/industry conferences
    - FDA communications
    - execution of evolving strategic plans
    - capital raising, acquisitions and divestitures
- 10b5-1 trading plans offer a potential solution to closed trading windows



## Are 10b5-1 Plans the Answer?

- Alleged abuse of Rule 10b5-1 plans has led to scrutiny
  - Wall Street Journal series instigated regulatory and criminal investigations
  - Council of Institutional Investors and others have asked SEC to issue guidance or rules imposing additional conditions on use of 10b5-1
  - 2007: Speeches by then SEC Enforcement Director Thomsen highlight enforcement interest in academic studies showing that executives who trade within 10b5-1 plans outperform peers who trade outside of plans
  - 2009: Prominent enforcement action alleging that CEO established a series of 10b5-1 sales plans while aware of MNPI



## Discussion Overview

- How do Rule 10b5-1 plans work and how do issues arise?
- Best practices
- Pros and cons of using 10b5-1 plans and key questions
- Q & A

## The SEC's Insider Trading Equation

**Awareness of MNPI + Trading =  
Liability**

**Leaves insiders with two choices:**

1. Only sell when not aware of material nonpublic information (MNPI)  
or
2. Make sales that satisfy Rule 10b5-1's "affirmative defenses"



## Rule 10b5-1: Affirmative Defenses

- No liability if, **while not aware of MNPI**, insider:
  - Entered into a binding **contract** to buy or sell;
  - Gave **instructions** to another person to buy or sell for the insider's account; or
  - Adopted a written **plan** for trading securities
- Allows transactions to be carried out even if the insider has MNPI at the time of the transaction
- The contract, instructions or plan must meet one of three alternative requirements:
  - Amount, price and date (APD) requirement
  - Formula requirement
  - Delegation requirement



# Rule 10b5-1: Affirmative Defenses

- Alternative 1: APD Requirement
  - The contract, instructions or plan must specify the amount, price and date of the transaction
    - **Amount** can be a specified number of shares or a specified dollar amount
    - **Price** means the market price on a particular date, a limit price or a fixed price
    - **Date**
      - Market Order– the specific day on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution)
      - Limit Order– a day on which the order is in force



## Rule 10b5-1: Affirmative Defenses

- Alternative 2: Formula Requirement
  - The contract, instructions or plan must include a written formula, algorithm or computer program for determining the amount, price and date
  
- Alternative 3: Delegation Requirement
  - The contract, instructions or plan cannot permit the insider to exercise any subsequent influence over the transactions
  - The person to whom discretion is delegated cannot be aware of MNPI



## Rule 10b5-1: Affirmative Defenses

- Other Requirements
  - Transaction must be carried out in accordance with the contract, instructions or plan
  - Must be acting in good faith
  - Can't use the affirmative defense as part of a plan or scheme to evade Rule 10b-5's prohibitions
  - Can't enter into or alter a hedging or corresponding transaction or position



# How Do Issues with 10b5-1 Plans Arise?

- Securities class action suits
  - Stock sales are claimed to evidence scienter (i.e. intent for the alleged fraud)
- Regulatory investigations and enforcement action
  - Civil and criminal enforcement possible – SEC, FBI, USAG
- Company policies
  - Use of plans must comply with all relevant policies, or waivers and amendments may be needed
    - Insider trading
    - Stock ownership and retention policies
- Issues about use of plans can also result in negative publicity, distraction and expense



## It Seemed Like a Good Idea

- Chief Scientist adopts 10b5-1 plan shortly after IPO
  - Plan calls for sale of all her shares at various prices between \$25 and \$50
  - Post-IPO, the stock trades in the \$20 range
  - No sales occur and unsold shares carry-over to next period
  - A few months later, favorable interim data for a Phase 2 clinical trial for the company's lead product is announced during a regularly scheduled quarterly blackout
  - Stock spikes to \$52, and all shares are automatically sold under the 10b5-1 plan
  - One week later, in another ongoing trial, FDA imposes clinical hold
  - Stock sinks to \$10



## Best Practices: Establishing a Plan

- All 10b5-1 plans should be in writing
- Enter into 10b5-1 plans shortly after filing 10-K or 10-Q, rather than right before a blackout period begins
- Do not enter into 10b5-1 plans during corporate blackout periods (the rule itself already prohibits entering into a plan while aware of MNPI)
- Require company review of all 10b5-1 plans to confirm compliance with company's insider trading policy and any other applicable company policies
- Consider using someone other than your regular broker to manage the 10b5-1 plan



## Best Practices: Plan Structure

- Have a waiting period (typically 30-90 days) between when the plan is entered into and trading begins
- Conduct true discretionary market sales outside of a 10b5-1 plan
- Avoid additional out-of-plan sales while a plan is in effect
- Plans should contemplate sales occurring in more than one single transaction
- Limit maximum sales in any one year to a maximum percentage (often 15-30%) of an insider's holdings
- Avoid multiple, overlapping 10b5-1 plans
- Plans should typically have a minimum duration of 6 months and a maximum duration of 24 months
- Keep it simple to minimize risk of implementation errors



## Best Practices: Selling Terms

- Avoid plan structures that may result in extra-large sales on a single day
  - If a plan with limit pricing allows unlimited carryover of previously unsold shares, consider capping the amount that can be sold in any single future sale period
  - Be careful about the appearances caused by provisions that increase the number of shares sold when high limit prices are hit
- Establish a consistent pattern of trading
  - Spread sales out at regular intervals
  - BUT also consider perceptions caused by numerous Form 4 filings
- Avoid or limit sales during regularly scheduled quarter end blackout periods
  - If plan sales are scheduled to occur once a quarter or less frequently, the sales should not be scheduled to occur during normal quarter end black-out periods
  - Avoid sales shortly before known scheduled announcements



## Best Practices: Amendment

- Amendments should be subject to the same best practices that apply when establishing a new plan
  - A new waiting period should apply if the plan is amended in a way that affects the amount, price or date of trades
  - Amend during open windows
  - Require company review
- Amendments should be considered with care
  - Do not enter into a plan thinking you can amend it
  - Ideally, any amendment should be explainable by an objective change in circumstances after the plan was put into place



## Best Practices: Termination

- Any planned termination should be reviewed with counsel to consider whether termination may call into question the insider's good faith in initially establishing the plan
- If a plan is terminated, the insider should not enter into a new 10b5-1 plan until after an appropriate cooling-off period
- Discretionary transactions should also be avoided for a period of time after termination of a plan
- When picking an end date for a plan, avoid dates that are during a regularly scheduled blackout



## Best Practices: Disclosure

- Forms 144 must disclose date plan was adopted
- Forms 4 should reflect use of plan
- Providing voluntary pre-sale disclosure can help demonstrate that insider is acting in good faith
- Disclosure can serve an effective IR purpose by helping get ahead of future questions about sales
- Disclosure in an SEC filing may allow a court to take judicial notice of the plan, which could be useful in seeking early dismissal of securities law claims
- Schedule 13D filings may need to be amended



## 10b5-1 Plans: Pros and Cons

Pros:	Cons:
<ul style="list-style-type: none"><li>• May reduce risk of being found to violate federal insider trading laws</li></ul>	<ul style="list-style-type: none"><li>• Insider loses some control over trading activity</li></ul>
<ul style="list-style-type: none"><li>• Allows transactions to take place when insider is aware of MNPI (or at other times when trading would be blacked out under company policy)</li></ul>	<ul style="list-style-type: none"><li>• Insider must meet burden of proving affirmative defense is available (including showing good faith)</li></ul>
<ul style="list-style-type: none"><li>• Provides opportunity to head off adverse investor and media reaction to transactions</li></ul>	<ul style="list-style-type: none"><li>• Failure to follow through on 10b5-1 plan could lead to questions</li></ul>
<ul style="list-style-type: none"><li>• Might reduce likelihood of company becoming target of private shareholder litigation</li></ul>	



## Should 10b5-1 Plans be Permitted?

### Yes

- Rule 10b5-1 was created to facilitate trading by insiders
- If used correctly, plans provide an effective affirmative defense against claims of insider trading and can help negate any inference of scienter
- Determining the absence of MNPI once (upon entry into a plan) should be easier than assessing materiality on a case-by-case basis for every sale

### No

- Plans may be attracting more scrutiny and negative attention these days than outright sales
- Plans create the risk of inopportunistically timed sales that:
  - look bad in hindsight
  - create headline/reputational risk, and
  - may be pointed to as demonstrating scienter
- Administering plans may be burdensome for company

## Should 10b5-1 Plans be Required?

### Yes

- A well-structured plan that follows best practices can help negate an inference of scienter and could lead regulators to end a probe – both of which would benefit the company

### No

- Forces 10b5-1 to be used for short-term and one-off transactions that can appear to be inconsistent with the spirit of the rule
- Restricts insiders' flexibility and control over their stock sales



## Should Best Practices be Required?

- Insiders should be educated as to steps they can take to reduce the risks associated with using 10b5-1 plans
  - Consider how far down in the organization educational efforts should be conducted
- The company's Board should be involved in deciding which, if any, best practices, will be mandated as a matter of company policy
- Best practices most commonly addressed in policies are:
  - Minimum waiting period before first sale
  - Any limitations on sales during regularly scheduled quarter end blackout periods
  - Requiring company review of plans before they are entered into



# Questions?

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