Alert
September 29, 2022

COZEN O'CONNOR

SEC Finds 10b5-1 Trading Plan was Misused, Charges Tech Company Executives with Insider Trading

SEC Finds 10b5-1 Trading Plan was Misused, Charges Tech Company Executives with Insider Trading

A recent Securities and Exchange Commission (SEC) enforcement action charged two executives with insider trading violations despite the fact that the executives had adopted a purported 10b5-1 trading plan. Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (Rule 10b5-1), provides an affirmative defense to insider trading for individuals and companies that trade securities under plans (10b5-1 plans) entered into in good faith and at a time when the individual or the company does not possess material nonpublic information. The SEC found that the executive's 10b5-1 plan did not shield them from insider trading liability because they adopted the plan soon after they learned of material nonpublic information. This recent enforcement action comes on the heels of SEC Chair Gensler's call for changes to Rule 10b5-1 to address what he calls "cracks" in the rule (see our prior alert with respect to the SEC's proposed changes to Rule 10b5-1).

Background of the Recent Insider Trading Charges

On September 21, 2022, the SEC charged the CEO of Cheetah Mobile Inc. and the company's former President with insider trading for selling American Depository Shares of the Company under their purported 10b5-1 plan.

According to the SEC's order, these executives adopted a 10b5-1 plan through an entity they jointly held in March 2016 soon after they became aware of a significant negative trend in declining advertising revenues from the company's largest advertising partner. Shortly after adopting the 10b5-1 plan, the executives sold their shares. In doing so, they avoided trading losses of over $300,000 before the price drop that followed the company's May 2016 public disclosure about the negative trend in declining advertising revenues.

In the SEC's litigation release announcing the charges against the executives, the chief of the enforcement division's market abuse unit cautioned public company executives and insiders that "[w]hile trading pursuant to 10b5-1 plans can shield employees from insider trading liability under certain circumstances, these executives' plan did not comply with the securities laws because they were in possession of material nonpublic information when they entered into it."

SEC Curtails Significantly Executive's Use of 10b5-1 Trading Plans in the Future

Although the SEC settlement with the executives included the standard monetary civil penalties, perhaps the most interesting part of the case is the undertakings the SEC ordered against the company's CEO. These undertakings serve to significantly curtail the CEO's right to use 10b5-1 plans in the future. For a period of five years following the settlement:

- the CEO must notify the SEC directly by email when entering into any 10b5-1 plan of any kind or modifying or canceling an existing plan, and disclose the material terms of any such establishment, modification, or cancellation;
- the CEO must disclose to the SEC directly by email, within forty-eight hours of the execution, of any transaction in Company securities, the terms of such transaction;
- if the CEO enters into any new 10b5-1 plan or modifies an existing 10b5-1 plan, the

Joseph Dever

Chair, Securities Litigation & SEC Enforcement

jdever@cozen.com
Phone: (212) 453-3916
Fax: (917) 521-5875

Emily M. Fulginiti

Associate

efulginiti@cozen.com
Phone: (212) 453-3974
Fax: (212) 509-9492

Kevin Roggow

Member

kroggow@cozen.com
Phone: (212) 908-1294
Fax: (212) 509-9492

Related Practice Areas

- Business
- Capital Markets & Securities
- Securities Litigation & SEC Enforcement

10b5-1 plan must contain a 120-day cooling off period from the date of adoption or modification to the first trade; and

- the CEO shall only maintain one 10b5-1 trading plan for company securities at any given time.

Key Takeaway: More Regulation by Enforcement

Not surprisingly, the SEC's undertakings against the executives align with a number of reforms to Rule 10b5-1 that SEC Chair Gensler has discussed publicly as a way to fill the cracks in the rule and help level the playing field between public company executives and the investing public. As such, this recent insider trading case can and should be seen as another example of the SEC's efforts to regulate the securities markets through its enforcement program rather than through rule adoption.