

CONVICTION OF INSIDER IN CONNECTION WITH 10B5-1 TRADING PLAN

Jun 28, 2024

WHAT HAPPENED

As discussed in our [March 3, 2023 post](#), the DOJ and SEC brought an insider trading case against the founder and former CEO and Executive Chairman of Ontrak, Inc. based upon the former executive failing the “clean hands” requirement in connection with the implementation of two 10b5-1 trading plans. Specifically, the DOJ and SEC alleged that the former executive had been aware of material nonpublic information (MNPI) at the time of establishing the trading plans, and therefore, committed insider trading with respect to trades made prior to the disclosure of adverse information regarding Ontrak. On June 21, 2024, a federal jury found the former executive guilty of insider trading. In [announcing the verdict](#), the DOJ indicated that this action was the Justice Department’s initial criminal prosecution “based exclusively on the use of a trading plan, but it will not be our last.”

Interestingly, the DOJ and SEC brought the charges against the former executive within a short period after effectiveness of recent amendments to rules for 10b5-1 plans. The amendments added requirements for mandatory cooling off periods and that 10b5-1 plans adopted by directors or officers include an express representation that any such party is (i) not aware of any MNPI about the security or issuer, and (ii) adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1.

TAKEAWAYS

This verdict follows on the heels of the recent [insider conviction for “shadow insider trading.”](#) Together, they evidence the willingness of the SEC and DOJ to aggressively pursue insider trading actions.

Additionally, the DOJ indicated that the 10b5-1 trading plan prosecution is “part of a data-driven initiative by the Fraud Section to identify executive abuses into 10b5-1 plans.”

Based on these actions, companies should:

- Remind insiders and employees of the prohibition on trading while in possession of MNPI.
- Ensure that insiders are aware of the new requirements to adopt a valid 10b5-1 trading plan.
- Emphasize to insiders and employees that the SEC and DOJ use data analytics to identify potential cases of insider trading.
- Remind insiders and employees of the potential civil and criminal penalties, including disgorgement of profits, in connection with insider trading (as well as potential adverse employment action by an employer).

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According to the DOJ announcement regarding the conviction:

The former executive avoided more than \$12.5 million in losses by entering into two Rule 10b5-1 trading plans while in possession of MNPI concerning the serious risk that Ontrak's then-largest customer would terminate its contract with Ontrak.

In May 2021, the former executive entered into his first Rule 10b5-1 trading plan shortly after learning that the relationship between Ontrak and the customer was deteriorating and that the customer had expressed serious reservations about continuing its contract with Ontrak. The former executive later learned that the customer informed Ontrak of its intent to terminate the contract.

In August 2021, the former executive entered into his second Rule 10b5-1 trading plan approximately five minutes after Ontrak's chief negotiator for the contract informed him that the contract would likely be terminated.

In establishing his trading plans, the former executive refused to engage in any "cooling-off" period, despite warnings from brokers, the company's compliance officer, and several attorneys. Instead, he began selling shares of Ontrak on the next trading day after establishing each plan.

On August 19, 2021, six days after the former executive adopted his second Rule 10b5-1 plan, Ontrak announced to the public that the customer had terminated its contract and Ontrak's stock price declined by more than 44%.

The jury convicted the former executive of one count of securities fraud and two counts of insider trading. He faces a maximum penalty of 25 years in prison on the securities fraud count and 20 years in prison on each of the insider trading counts.

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