BYBEL RUTLEDGE LLP

LEGAL ALERT

February 1, 2023

SEC Amends Rule 10b5-1
Insider Trading Affirmative Defense and Related Disclosure

On December 14, 2022, the Securities and Exchange Commission (the "SEC") issued a final rule which amends Rule 10b5-1 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and certain related disclosure obligations for public companies and insiders. **In particular, the amendments update Rule 10b5-1(c)(1) which provides an affirmative defense to insider trading liability under Section 10(b) of the Exchange Act and Rule 10b-5. Further, the amendments require enhanced disclosure by issuers and insiders of Rule 10b5-1 trading plans.**

Background

Among other things, Section 10(b) of the Exchange Act and Rule 10b-5 generally prohibit the purchase or sale of securities on the basis of material nonpublic information which is usually referred to as insider trading. Rule 10b5-1 provides an affirmative defense to Section 10(b) and Rule 10b-5 insider trading liability if a person satisfies all of the following:

- First, before becoming aware of the material nonpublic information, the person had:
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  - ◊ Entered into a binding contract to purchase or sell the security;
  - ◊ Instructed another person to purchase or sell the security for the instructing person's account; or
  - ◊ Adopted a written plan for trading securities.

These arrangements are collectively referred to as a "Rule 10b5-1 Plan."

- Second, the Rule 10b5-1 Plan:
  - ◊ Specified the amount of securities to be purchased or sold and the price at which, and the date on which, the securities were to be purchased or sold;
  - ◊ Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which, and the date on which, the securities were to be purchased or sold; or
  - ◊ Did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the Rule 10b5-1 Plan, did exercise such influence must not have been aware of the material nonpublic information when doing so.

- Third, the purchase or sale that occurred was pursuant to the Rule 10b5-1 Plan. A purchase or sale is not pursuant to a Rule 10b5-1 Plan if, among other things, the person who entered into the plan altered or deviated from the plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale), or entered into or altered a corresponding or hedging transaction or position with respect to those securities.

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- Fourth, the Rule 10b5-1 Plan must be or entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Rule 10b-5.

Out of concerns that some corporate insiders were using Rule 10b5-1 Plans in ways inconsistent with the original objectives of the rule and that may harm investors and the integrity of the securities markets, the SEC adopted the amendments to Rule 10b5-1 and additional disclosure requirements. Below is a brief summary of the changes and disclosures adopted under the final rule.

Amendments to Rule 10b5-1

Cooling-off Period. Rule 10b5-1 as originally adopted did not include a waiting period between the date a trading plan was adopted and the date the first transaction could occur under the Rule 10b5-1 Plan. Under the final rule, a director or officer of an issuer would not be able to rely on the affirmative defenses of Rule 10b5-1 through the use of a Rule 10b5-1 Plan unless the plan provides that trading under the plan would not occur until the later of:

1. 90 days after the adoption of the plan; or
2. Two (2) business days after the disclosure of the issuer's financial results on a Form 10-Q or Form 10-K that discloses the issuer's financial results (but, in any event, this required cooling-off period is subject to a maximum of 120 days after adoption of the plan).

Further, under the final rule, a person (other than the issuer, director or officer) could not purchase or sell under the Rule 10b5-1 Plan until the expiration of a cooling-off period that is 30 days after the adoption of the plan.

Any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a Rule 10b5-1 Plan is a termination of such plan, and the adoption of a new plan. Such modifications will trigger a new cooling-off period. The final rule does not adopt a cooling-off period for issuers.

Certifications. The final rule requires that on the date of the adoption of a Rule 10b5-1 Plan that a director or officer must include a representation in the plan certifying that (1) the individual director or officer is not aware of any material nonpublic information about the security or issuer, and (2) the individual director or officer is adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Rule 10b-5.

Prohibition on Overlapping Rule 10b5-1 Plans and Single-Trade Arrangements. With limited exceptions, the final rule eliminates the Rule 10b5-1 affirmative defense for trading under multiple overlapping Rule 10b5-1 Plans. The final rule also restricts the availability of the Rule 10b5-1 affirmative defense for "single trade" Rule 10b5-1 Plans to one such plan during a 12 month period. Excepted from this provision are securities acquired from the issuer not executed in the open market such as dividend reinvestment plans or employee stock purchase plans.

Good Faith Condition. The original rule required that a Rule 10b5-1 Plan be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Rule 10b-5. The final rule now adds the condition that the person entering the Rule 10b5-1 Plan must also act in good faith with respect to the plan creating an ongoing requirement with respect to a plan.

New Company and Insider Disclosures

Company Disclosures. Previously, there were no required disclosures with respect to Rule 10b5-1 Plans. The final rule adopts new Item 408 of Regulation S-K and certain amendments to Forms 10-Q and 10-K relating to Rule 10b5-1 Plans.

Companies will be required to disclose quarterly whether any director or officer adopted or terminated a Rule 10b5-1 Plan or any other trading arrangement. The disclosure must provide a description of the material terms of the trading arrangement including the name and title of the director or officer, the date the trading arrangement was adopted or terminated, the duration of the trading arrangement, and the aggregate number of securities to be purchased or sold. However, the pricing of trading arrangement is not required to be disclosed.

Companies must annually disclose if they have adopted insider trading policies reasonably designed to promote compliance with insider trading laws, rules and regulations, and any listing standards applicable to the company. If the company has not adopted such insider trading policies, it must explain why it has not

done so. Companies with insider trading policies will be required to file them as an exhibit to their Form 10-K.

The final rule adds new disclosures regarding executive compensation under new Item 402(x) of Regulation S-K. Item 402(x) requires companies to discuss their policies and practices on the timing of awards of options in relation to the disclosure of material nonpublic information. Further, 402(x) provides new tabular disclosure of options awarded to a named executive officer in the period beginning four business days before the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K that discloses material nonpublic information, and ending one business day after the filing or furnishing of such report. The disclosure will be required to be included annually on Form 10-K and proxy and information statements. Smaller reporting companies are not exempted from this requirement.

Forms 4 and 5 Amendments. Section 16 filers will be required to disclose on Forms 4 or 5 if a transaction was made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) by checking a box. In addition, the final rule requires "bona fide gifts" of equity securities to be reported on Form 4 within two business days following the gift. Previously, gifts were only required to be reported on Form 5.

Inline XBRL Tagging. The amendments require issuers to tag the required disclosures in Inline XBRL.

Effective Dates

The final rule goes into effect on February 27, 2023. However, compliance with certain aspects of the rule is delayed.

Rule 10b5-1 Amendments. The amendments to Rule 10b5-1 go into effect on February 27, 2023.

Company Disclosure Requirements. Smaller Reporting Companies must comply with public disclosure requirements under the final rule including Inline XBRL tagging, disclosure under Item 408 and Item 401(x) with periodic reports covering the first full fiscal period beginning on or after October 1, 2023

All other public companies must comply with public disclosure requirements under the final with periodic reports covering the first full fiscal period beginning on or after April 1, 2023.

Therefore, these public disclosures will not be required for Form 10-K or the 2023 proxy statement.

Section 16 Disclosures. Section 16 reporting persons must comply with the amendments to Forms 4 and 5 for reports filed on or after April 1, 2023.

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