

Client Alert: DOJ and SEC Used Data Analytics to Target Insider Trading with 10b5-1 Plans

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The DOJ and SEC have made no secret of their interest in combatting potential insider trading by high-level executives misusing Rule 10b5-1 plans. Those plans provide a potential safe harbor for executives trading their company's stock, but the SEC has expressed concerns in how those plans are used in practice and has provided new rules accordingly. The government has also made no secret that they are using data analytics to root out misconduct.

In recent cases filed, the DOJ and SEC both brought charges^[1] specifically targeting trading on material non-public information (MNPI) through a Rule 10b5-1 plan. There, Ontrak's Chairman, Terren Peizer, was selling millions of dollars of the company's stocks while he allegedly knew that the company's relationship with its key customer was in peril. After that customer relationship was publicly severed, the stock price went down by over 40%, and the government alleges that Peizer saved \$12 million for exiting the stock early.

This is the first criminal case involving 10b5-1 plans. The agencies highlighted that it was the result of an ongoing effort to specifically identify potential misconduct related to 10b5-1 plans. The SEC press release highlighted that "the investigation arose from a data-driven initiative into executive trading pursuant to 10b5-1 plans."^[2] The DOJ similarly credited its "data-driven initiative . . . to identify executive abuses of 10b5-1 trading plans."^[3] In a speech at the American Bar Association's National Institute on White Collar Crime in Miami, Assistant Attorney General Kenneth Polite, Jr. highlighted the case and indicated it may be a part of a coming wave, telling the audience to "take note. Because I expect others will follow."^[4] This article describes what happened in this case and key takeaways for companies and high-level executives at Fortune 500 companies.

Background on 10b5-1 Plans

Rule 10b5-1 is the codification of the SEC's position that the purchase or sale of a security on the basis of MNPI and in breach of a duty of trust constitutes a manipulative or deceptive device prohibited by Section 10(b) of the Exchange Act and Rule 10b5-1 thereunder.^[5] Rule 10b5-1 also provides a safe harbor in the form of an affirmative defense against allegations of insider trading

when a Rule 10b5-1 plan is used.^[6] In December 2022, the SEC adopted several rule and form amendments, adding additional conditions to the availability of 10b5-1 plans in an effort to “address critical gaps in the SEC’s insider trading regime.”^[7] Among other new requirements, 10b5-1 plans now require a mandatory cooling-off period between entering the plan and executing securities transactions, as well as additional disclosures certifying that the transactions are not based on MNPI and that the company has anti-insider trading policies in place.^[8]

Background on Case

These actions highlight that the government is focused on identifying potential misconduct arising from 10b5-1 plans. In the charging documents, the government alleged a relatively straightforward insider trading scheme in which Peizer, as Chairman of Ontrak, knew that the company’s agreement with its key customer was in peril. Peizer allegedly participated in dialogue with Ontrak’s CEO and consultants to try and salvage the customer relationship, which represented over half of Ontrak’s annual revenue.^[9] Because of these conversations, Peizer received information as to how the attempts to repair the relationship were not going well. For example, the government alleges that in July 2021, an Ontrak consultant sent a text message to Peizer stating that the customer had drastically reduced its business with Ontrak and that business from the customer was “a trickle at this point.”^[10] A month later, Peizer allegedly called an Ontrak executive, who was tasked with leading the contract renegotiations with the key customer, to find out about the likelihood of Ontrak retaining the customer.^[11] That executive allegedly told Peizer it was likely that the customer would formally terminate its relationship with Ontrak.^[12]

At the same time Peizer was privy to this non-public information, he allegedly entered into 10b5-1 plans providing for the immediate sale of securities, and through those plans sold \$20 million worth of stocks. The government alleges that Peizer entered into one of these plans the same day that Peizer spoke to the Ontrak executive and learned that it was likely Ontrak would lose its key customer.^[13] For each plan he entered into, Peizer began selling his shares immediately, allegedly ignoring warnings from multiple brokers that industry best practice was to implement a 30-day cooling-off period between entering into the 10b5-1 plan and selling his stocks. The SEC has stated that the “longer the period of time between the date that a trading plan is adopted and the date of the first transaction to be executed under the plan—the ‘cooling off period’—the less likely that a corporate insider can benefit” from MNPI.^[14] Peizer ignored the brokers’ warnings that skipping such a cooling-off period, together with “rapid transaction executions subsequent to plan adoption,” might “create an appearance of impropriety and call into question whether a plan adopter had MNPI at the time of plan adoption.”^[15]

After Peizer had sold his shares, Ontrak announced that its largest customer had terminated their contract, resulting in the stock price falling more than 44%. Through his timely sales, the

government alleges that Peizer avoided over \$12.7 million in losses as a result of selling his stock early based on insider information.

Implications for Executives and Companies

The SEC and DOJ's focus on 10b5-1 plans has important implications both for the companies that administer those plans and the executives that make use of them.

First, companies can use the DOJ and SEC's focus on these issues to highlight the importance of following best practices relating to these plans. As referenced above, the DOJ and SEC are specifically looking for insider trading by high-level executives and are using data analytics to do so. Gurbir S. Grewal, the Director of the SEC's Division of Enforcement, stated in the SEC's announcement of the charges against Peizer, "Few things undermine trust in the markets more than insiders abusing their positions for personal advantage: the SEC remains committed to investigating such abuse and holding bad actors accountable."^[16] The DOJ echoed this statement in its own press release about the case, with Assistant Attorney General Polite saying that the indictment of Peizer demonstrates that the DOJ "will not allow corrupt executives to misuse 10b5-1 plans as a shield for insider trading" and that the DOJ has "embraced the use of data to proactively identify and investigate fraud" in order to "ensure that ordinary investors are on an equal playing field with corporate insiders."^[17]

Second, the SEC will closely scrutinize representations about people not having insider information. Public companies, of course, are not required to instantly announce all inside information. But when an executive sells stock right before a market-moving announcement, the DOJ and SEC will closely look at both the companies' approach to disclosure and the executives' representations. Even if the government has no basis to second-guess the timing of disclosure material, it can make the case that sales done in advance of that announcement involved MNPI. As the SEC stated in its complaint against Peizer, the shorter the period of time between the date of a 10b5-1 plan adoption and the first transaction executed under that plan, "the more likely an insider could benefit from material nonpublic information."^[18]

Third, the case highlights the importance of companies ensuring that they are complying with the recently adopted changes to Rule 10b5-1. As detailed above, the new rule requires a mandatory cooling-off period, disclosure of company insider trading policies, and certifications that executives are entering into the plan in good faith and not transacting based on MNPI. Although this case involved conduct well before the adoption of the new rules, it highlights how the amendments can help companies prevent insider trading. For example, in *Peizer*, following the 90-day cooling off period may have helped avoid or at least mitigate the misconduct.

In the end, this does not mark the end of the government’s focus on 10b5-1 plans. As companies prepare for this upcoming scrutiny, they should follow 10b5-1 best practices and learn the lessons from *Peizer*.

Footnotes

[1] Press Release, Sec. Exch. Comm’n, “SEC Charges Ontrak Chairman Terren Peizer with Insider Trading,” (Mar. 1, 2023), <https://www.sec.gov/news/press-release/2023-42>.

[2] *Id.*

[3] Press Release, U.S. Dep’t of Just., “CEO of Publicly Traded Health Care Company Charged for Insider Trading Scheme,” (Mar. 1, 2023), <https://www.justice.gov/opa/pr/ceo-publicly-traded-health-care-company-charged-insider-trading-scheme>.

[4] Kenneth A. Polite, Jr., Asst. Att’y Gen., U.S. Dep’t of Just., Keynote Address at the ABA’s 38th Annual National Institute on White Collar Crime (Mar. 3, 2023).

[5] See 17 C.F.R. § 240.10b5-1.

[6] 17 C.F.R. § 240.10b5-1(c)(1).

[7] See U.S. Sec. & Exch. Comm’n, “SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures” (Dec. 15, 2021), available at <https://www.sec.gov/news/press-release/2021-256>; Rule 10b5-1 and Insider Trading, Release No. 33–11013 (Jan. 13, 2022), available at <https://www.sec.gov/rules/proposed/2022/33-11013.pdf>.

[8] Brian R. Boch, Hannah Schwab, and Bill Erlain, *Client Alert: SEC Adopts Amendments Regarding Rule 10b5-1 Insider Trading Plans and Disclosures for Equity Awards and Gifts*, Jenner & Block LLP (Dec. 21, 2022), <https://www.jenner.com/en/news-insights/publications/client-alert-sec-adopts-amendments-regarding-rule-10b5-1-insider-trading-plans-and-disclosures-for-equity-awards-and-gifts>.

[9] See *Securities and Exchange Commission v. Terren S. Peizer and Acuitas Group Holdings, LLC*, C.D. Cal., 2:23-cv-01511, ECF No. 1 (Complaint), (Mar. 1, 2023), <https://www.sec.gov/litigation/complaints/2023/comp-pr2023-42.pdf>.

[10] *United States of America v. Terren Scott Peizer*, C.D. Cal., 2:23-cr-00089, ECF No. 1 (Indictment) at 10, (Feb. 24, 2023), <https://www.justice.gov/opa/press-release/file/1570711/download>.

[11] *Id.* at 10-11.

[12] *Id.* at 11.

[13] *Id.*

[14] *SEC v. Peizer et al.*, ECF No. 1 at ¶ 67.

[15] *U.S. v. Peizer*, ECF No. 1 at 8.

[16] Press Release, Sec. Exch. Comm’n, *supra* note 1.

[17] Press Release, U.S. Dep’t of Just., *supra* note 2.

[18] *SEC v. Peizer et al.*, ECF No. 1 at ¶ 67.

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