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Conviction in Insider Trading Case Brings New Attention to 10b5-1 Plans

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On June 23, the U.S. Department of Justice [announced](#) that Terren Scott Peizer, founder of Ontrak Inc., a Miami-based publicly traded health care company, has been sentenced to three and one half years in prison by a California federal judge. This conviction is notable for its focus on the misuse of 10b5-1 trading plans, which are designed to allow corporate insiders to schedule stock transactions in advance, ensuring that decisions are not influenced by undisclosed material information. Alongside the prison sentence, Peizer has been ordered to pay a \$5.25 million fine and forfeit over \$12.7 million in gains deemed illicit.

Background

The case against Peizer is unique due to its focus on his 10b5-1 trading plans, plans that are commonly employed by executives to manage stock transactions with transparency intended to protect against insider trading accusations. Peizer's conviction stems from allegations that he exploited the rules by entering into plans at a time when he possessed material non-public information about Ontrak's business dealings, particularly its troubled relationship with its major client.

Specifically, in May 2021, Peizer entered into his first 10b5-1 trading plan shortly after learning that the relationship between Ontrak and the client was deteriorating. In August 2021, Peizer entered into his second 10b5-1 trading plan approximately one hour after Ontrak's chief negotiator confirmed that the contract with the client would likely be terminated. The indictment alleged that, in establishing his 10b5-1 plans, Peizer refused to engage in any "cooling-off" period (which was not required under the rule at the time but is required now), despite warnings from two brokers, and began selling shares of Ontrak on the next trading day after establishing each plan. On August 19, 2021, six days after Peizer adopted his August 10b5-1 plan, Ontrak announced that the client had terminated its contract, and Ontrak's stock price declined by more than 44%.

Peizer's counsel countered that Peizer could not have committed insider trading because he fully disclosed his trading plans to Ontrak, and the management team, including the insider trading compliance officer, approved of his plans before he traded.

Court's Decision on Gain Calculation

Judge Dale Fischer determined that the appropriate measure of Peizer's gain is the total difference between the amount received from the share sales and the residual value of the shares post-revelation. This decision aligns with the Eighth Circuit's approach, emphasizing that Peizer's illegal trades allowed him to avoid losses that he

would have otherwise incurred. This method assumes that, absent the illegal trades, the defendant would have held the shares through the period of loss.

Appeal

The same day as his sentencing, Peizer filed an appeal.

Takeaways

- **10b5-1 Plan Requirements:** This case serves as a timely reminder for corporate insiders and those charged with ensuring compliance about the strict requirements involved in 10b5-1 trading plans. Ensuring compliance with these requirements is crucial to avoid legal pitfalls when 10b5-1 plans are being relied on.
- **Scrutiny of Plan Intentions:** When approving 10b5-1 sales plans, it may be beneficial to inquire about the reasons for entering into the plan. This proactive approach can help identify potentially problematic plans and ensure they are not being used to circumvent insider trading regulations.
- **The Real Issue:** While the focus on 10b5-1 plans makes this case significant, it also can be treated as a straightforward insider trading case rather than a broader indictment of 10b5-1 plans themselves. That is because adoption of the first 10b5-1 plan was essentially irrelevant given the trading the next day and this pattern carried forward to the second plan and sales under it before Ontrak announced its bad news. The question then becomes whether Peizer had material nonpublic information when he sold his shares since the information base was the same when he adopted the 10b5-1 plans and then ostensibly sold under them.
- **Lessons for Inside Counsel and Others Responsible for Compliance:** Inside counsel, compliance officers and others charged with ensuring compliance should take the lessons from this case to heart. If 10b5-1 plans are to be relied upon to protect subsequent sales from charges of insider trading, their requirements, mostly the importance of the absence of material nonpublic information at the time of their adoption and their being adopted in good faith, must be strictly complied with. That is why 10b5-1 plans are best adopted during trading window periods. When trading by insiders is taking place without a 10b5-1 plan, it continues to be important to ensure the absence of material nonpublic information.

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