

Question 120.09

Question: At a time when he is not aware of material nonpublic information and satisfies all applicable conditions of Rule 10b5-1(c)(1)(ii), a person obtains a \$1 million loan from a brokerage firm and places \$2 million of stock in a margin account with the broker. The stock price falls and the broker issues a margin call. The person does not deposit additional securities in the margin account (although he could have), so the broker sells sufficient margined securities to satisfy the margin call. Is the Rule 10b5-1(c)(1)(i)(B)(3) defense available to the person for the broker's sales?

Answer: No. Where the person retains any discretion to substitute or provide additional collateral, or to repay the loan before the pledged securities may be sold, Rule 10b5-1(c)(1)(i)(B)(3) does not provide a defense. This is because the terms of the margin account contract would permit him to exercise subsequent influence over how, when, or whether to effect purchases or sales.

If the margin account contract did not permit the insider to exercise any subsequent influence over how, when, or whether to effect purchases or sales, and the broker did not in fact give the person the opportunity to substitute or provide additional collateral or cash, a defense would be available under Rule 10b5-1(c)(1)(i)(B)(3) if the broker is not aware of material nonpublic information in selling the margined securities. [MarApr. 25, 2009~~2025~~]