Top 10 Practice Tips: Stock Repurchase Programs

A Practical Guidance® Practice Note by
Anna T. Pinedo, Brian Hirshberg, and Colleen Dunn, Mayer Brown LLP

Anna T. Pinedo
Mayer Brown LLP

Brian Hirshberg
Mayer Brown LLP

Colleen Dunn
Mayer Brown LLP

This practice note includes 10 practice tips that may help you, as counsel to a public company or a repurchase agent, in implementing a stock repurchase program on behalf of your client. A stock repurchase program enables a company to buy back a certain number of its outstanding securities. In recent years, the repurchase activity undertaken by U.S. public companies has significantly increased, in part as a result of the tax reforms implemented in 2018. When considering adoption of a share repurchase program, companies should consider the sharp public criticism of such programs, which has become more heightened immediately after the commencement of the COVID-19 pandemic. Nonetheless, share repurchase activity increased substantially in 2021. Many companies that have completed recent significant strategic transactions have concurrently undertaken sizeable share repurchases. Shares repurchased by a company are either canceled or kept as treasury stock, which thereby reduces the number of outstanding shares and usually has the effect of increasing the company's earnings per share.

For additional information on stock repurchase programs, see Share Repurchase Programs and Dividends, Redemptions, and Stock Repurchases.

1 **Understand applicable legal requirements.** Rule 10b-18 (17 C.F.R.§ 240.10b-18), which was adopted in 1982 and amended in 2003, provides public companies with a voluntary, nonexclusive safe harbor from liability for manipulation under Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934, as amended (Exchange Act), and Rule 10b-5 (17 C.F.R.§ 240.10b-5) under the Exchange Act when the company bids for or purchases shares of its common stock in accordance with the Rule's manner, timing, price, and volume conditions. As a result, most repurchases of common stock in the open market are made in reliance on the Rule 10b-18 safe harbor in order to avoid manipulations claims. The safe harbor does not immunize the company and its insiders from making repurchases at a time when they are in possession of material nonpublic information. The Rule 10b-18 safe harbor is only available for repurchases of common stock (or the equivalent) and is not available, for example, in connection with repurchases of preferred stock, warrants, or convertible debt securities (or other nonvoting securities). Nonetheless, many companies

implement a repurchase program for equity-linked securities subject to conditions analogous to those set forth in Rule 10b-18.

To come within the safe harbor, a company's repurchases must satisfy (on a daily basis) each of the rule's four conditions (manner of purchase, timing, price, and volume) summarized below:

- **Manner of purchase condition.** Open-market repurchases may be undertaken by the company directly or by a repurchase agent (a broker-dealer) on the company's behalf. However, pursuant to the manner of purchase condition, the company is only permitted to engage one repurchase agent per day to bid for or purchase its common stock. Nonetheless, a company may use a different repurchase agent during an after-hours trading session from the repurchase agent used during regular trading hours. The company may make repurchases if these repurchases are not solicited by or on behalf of the company or its repurchase agent (such as following a shareholder reverse inquiry).
- **Timing condition.** The company's repurchase may not be the opening transaction on its principal trading market. The company may not conduct the repurchase during the 10 minutes before the scheduled close of the primary trading session in the principal market for its common stock or the last 10 minutes before the scheduled close of the primary trading session in the market where the repurchase is effected. These 10-minute restrictions are extended to 30 minutes if shares of the company's common stock do not have an average daily trading volume ("ADTV") of at least $1 million and a public float of at least $150 million. Under certain circumstances, a repurchase can be effected by the company or its repurchase agent following the close of the primary trading session in the principal market.
- **Price condition.** Repurchases of listed shares must be made at a price per share not exceeding the highest independent bid or last transaction price, whichever is higher. For shares that are not listed, the company must use the highest independent bid obtained from three independent dealers. The offer price is irrelevant for purposes of determining the maximum permissible price.
- **Volume condition.** Daily repurchases may not exceed 25% of the ADTV during the preceding four weeks (as a result, a new public company must wait at least four weeks after its shares begin trading in order to claim the safe harbor). However, a company may include its block-size purchases when calculating its four-week ADTV. Rule 10b-18 provides companies with a choice when making any particular block purchase. Either the block purchase must comply with the 25% ADTV volume condition, like any other repurchase, or the block purchase need not comply with the volume condition, but the company can make no other repurchases on that day, and all other block purchases effected during that week must comply with the 25% volume condition.

Failure to meet any of the four conditions will render the safe harbor unavailable for repurchases that day. Certain types of repurchases are not covered by Rule 10b-18 due to the heightened risk of manipulation, such as repurchases made by or for an employee benefit plan by an independent agent or repurchases made in connection with a merger or a tender offer. Repurchases by an affiliated purchaser may be attributable to the company under Rule 10b-18 if the affiliate controls the company's Rule 10b-18 purchases or the affiliate and the company are under common control. Repurchases made by persons (even if unaffiliated) acting in concert with the company for the purpose of acquiring the company's outstanding shares will also be attributed to the company. All purchases made by such persons will be aggregated with the company's direct purchases to determine compliance with the Rule 10b-18 safe harbor. This is an important consideration for a financial institution that has an affiliated broker-dealer that is consummating repurchases on behalf of the institution. In addition to the federal securities laws, counsel should consider whether a proposed repurchase program complies with applicable state law. For a Delaware corporation, Section 160 (8 Del. C. § 160) of the Delaware General Corporation Law allows a company to repurchase or redeem its outstanding securities from shareholders so long as its capital is not and would not become impaired. A determination by the company's board of directors is typically sufficient. The board of directors must also consider whether the proposed repurchase program, if fully implemented, would cause the company to become insolvent.

Finally, counsel should also consider the applicability of any share repurchase restrictions imposed by the Coronavirus Economic Stabilization Act of 2020 under the Coronavirus Aid, Relief, and Economic Stability Act (CARES Act), which was enacted in connection with the onset of the COVID-19 pandemic. Under the CARES Act, the federal and state governments offered relief and financing programs to assist businesses contingent on an agreement to restrict any share repurchase activity. Recipients may not execute share repurchases if a loan or guarantee was obtained under such a program and for the 12 months after the loan or guarantee is no longer outstanding. However, the share repurchase restrictions are not applicable for recipients with existing contractual share repurchase obligations that precede the enactment of the CARES Act.

2 **Consider repurchase authority.** Any purchase of a company's securities, including a repurchase program, must be approved by the company's board of directors. The authorization should include an affirmation of the repurchase program's intended objective and a determination that the program is in the best interest of the company and its shareholders. In order to arrive at this conclusion, the board of directors should assess the company's capital position. The board of directors should also consider the repurchase alternatives available to the company and the impact of the repurchase program on the company. The company should identify any provisions in its organizational documents or contractual agreements that limit its ability to repurchase its securities and obtain any required third-party consents prior to undertaking any repurchase. As part of this repurchase authorization, the board of directors should impose specific parameters with respect to the timing, dollar amount, and/or share size of any repurchases that are to be conducted. Generally, the board of directors should consider how repurchases will be monitored and reported. For a form of board resolutions that can be used by a company seeking to repurchase outstanding company securities pursuant to a stock repurchase plan, see Board Resolutions: Stock Repurchase Plan Approval.

3 **Consider potential repurchase structures.** Companies have significant flexibility with respect to choosing a particular repurchase structure ranging from open market repurchases to repurchases that are subject to tender offer rules. A company may structure its repurchase as an accelerated stock repurchase (ASR). An ASR may result in faster execution and more price certainty; however, repurchases made pursuant to an ASR do not benefit from the Rule 10b-18 safe harbor. An ASR is a privately negotiated transaction, usually documented as a forward contract, in which a repurchase agent agrees to sell a predefined amount of stock to a company at a price per share based on the volume-weighted average price during the specified period. A repurchase agent acts as the seller of the company's shares in an ASR, and the company acts as the purchaser buying back its own shares. ASRs provide numerous benefits, including transaction efficiency, an immediate share count reduction, certainty as to the timing and quantity of the repurchase, and possible accounting advantages. Notwithstanding these benefits, ASRs have been the subject of some criticisms. As a result, a company should consider carefully its alternatives.

4 **Understand how an ASR works.** At the beginning of the ASR, the company generally pays a predefined dollar amount to the repurchase agent for a specified number of securities. The repurchase agent generally borrows securities from stock lenders and delivers those securities to the company. Over time, the repurchase agent will buy securities in the market to cover its borrow and has the option to complete the ASR at any time within a pre-agreed period. The purchase period will have fixed starting and end points, though the repurchase agent will have the right, upon notice to the company, to shorten the period. An average price is determined for the purchase period, which is typically based on the Rule 10b-18 pricing condition minus an agreed discount or price adjustment. At the ASR's final settlement, the total number of securities purchased by the company generally equals the ASR dollar size divided by the discounted average price. If the repurchase agent did not deliver a sufficient number of securities at inception, it must deliver incremental securities to the company at the end of the term. Conversely, if the repurchase agent delivered too many securities, the company must settle with the repurchase agent in cash or stock on the settlement date.

5 **Understand disclosure obligations.** Public companies must announce repurchase programs and report their repurchase activity in accordance with Item 703 (17 C.F.R.§ 229.703) of Regulation S-K. The securities exchange on which the company's securities are listed will require public disclosure if the company's board of directors authorizes a repurchase program. The company may satisfy these public disclosure requirements by filing a Current Report on Form 8-K under Item 7.01. The filing must disclose the authorization date, the number of shares that were authorized to be repurchased, and the expiration date of the program, if any. Going forward, the company will also be required to disclose repurchases in its Exchange Act filings, including the total number of shares purchased, the average price paid per share, the total number of shares purchased as part of the repurchase program, and the maximum number of shares yet be purchased under the repurchase authority. For additional information regarding the disclosure requirements of Form 8-K, see Form 8-K Drafting and Filing.

6 **Consider potential impact on upcoming issuances of securities.** A company should generally avoid purchasing its outstanding securities at any time that its insiders (directors, officers, and affiliated shareholders) are selling the company's securities other than through a Rule 10b5-1 program as described below. Similarly, insiders should consider and discuss with the company

and counsel whether it is prudent to sell the company's securities they hold when the company is purchasing its securities. The company also will want to consider the applicability of Regulation M to the extent that the company is engaged in activity that would be considered a distribution under the Regulation and the company has an active repurchase program. Repurchase agreements typically include provisions to the effect that the company is not engaged in any issuance of securities that would cause the repurchase agent to violate any securities law and that at all relevant times during the repurchase program the company will not make any such issuance of securities. The representations and covenants in the repurchase agreement generally place the burden on the company to monitor its activities during the term of the repurchase program.

7 **Address insider transaction concerns.** Repurchase programs have recently been at the center of some controversy, and there have been calls by members of Congress to rescind or significantly amend Rule 10b-18, as well as to address insider transactions in proximity to announced repurchases. In March 2020, now-President Joe Biden tweeted: "I am calling on every CEO in America to publicly commit now to not buying back their company's stock over the course of the next year. As workers face the physical and economic consequences of the coronavirus, our corporate leaders cannot cede responsibility for their employees." Although no new laws have been passed limiting a public company to repurchase their own shares, it has become the subject of intense political debate and Congress is currently considering imposing a federal tax on repurchase activity. Critics of repurchase programs argue that they primarily benefit the company's senior management and that the cash used for repurchases should instead be used to grow the company's business or increase the wages of the company's employees. As a result of the heightened scrutiny, a company's management and board of directors should consider closely the types of concerns that may be raised. The company also can consider establishing a Rule 10b5-1 trading plan for a repurchase agent to buy its securities at a time when the company is not aware of any material nonpublic information. For example, Andeavor LLC, a U.S refiner, recently agreed to pay $20 million in penalties to the SEC for inadequate controls over a stock buyback plan. Andeavor's internal accounting controls failed to ensure that the buyback adhered to a company policy prohibiting repurchases while it held material non-public information. The company would provide the repurchase agent with specific timing and size parameters for buying its securities at the outset of the program, and the repurchase agent would thereafter consummate repurchases on the company's behalf. The company would not have any subsequent influence over how, when, or whether the repurchase agent effects purchases of securities. For further information on Rule 10b5-1 plans, see Rule 10b5-1 Plans.

8 **Consider restrictions on use of cash for repurchases.** The company and its counsel should ensure that there are no conflicts with loan agreements (or other similar agreements) with respect to the proposed repurchase program or that the repurchase program is compliant with a permissible bucket under an applicable loan agreement. Additionally, the company and its counsel should assess the impact that a repurchase program can be expected to have on any applicable financial ratios or covenants to which the company is subject. A restricted payments covenant in a loan agreement limits the borrower's (or its parent company's) ability to make payments in the form of dividends, distributions, equity redemptions, and repurchases from its shareholders. The provision is designed to ensure that a company's shareholders are not paid before the loans are repaid to the company's creditors. Nonetheless, loan agreements typically include a negotiated basket that permits the borrower to make share repurchases up to a certain specified amount based upon a fixed dollar amount per year or over the life of the loan agreement. Carry -overs of unused amounts may typically be used by the borrower to increase the size of the basket for subsequent years. While creditors have historically limited the ability of companies to make share repurchases through the imposition of these covenant restrictions, as a result of heightened competition in the credit markets, many recent loan agreements only include a covenant-lite package that does not restrict a company's ability to make share repurchases.

9 **Consider applicable tax and accounting issues.** Companies should involve tax counsel and its accountants when considering a share repurchase program. Share buybacks may have tax and accounting impacts and these should be well understood before a decision is taken.

10 **Negotiate the repurchase agreement.** Repurchase agreements that document traditional open market purchases are typically short -form agreements. Most repurchase agents have a form of repurchase agreement that will serve as a starting point. The form repurchase agreement will incorporate the applicable Rule 10b-18 provisions in setting out the mechanics of the repurchase. The repurchase agreement appoints the

repurchase agent and authorizes it to make open market purchases on the company's behalf in accordance with the terms and conditions set forth in the agreement. As part of the agreement, the repurchase agent agrees to use commercially reasonable efforts to purchase the company's outstanding shares and comply with the pricing, timing, and volume guidelines that are provided to the repurchase agent by the company. The repurchase agent typically disclaims responsibility for complying with Rule 10b-18(b)(4) (volume of purchases) to the extent that the company or any affiliated purchaser of the company has separately purchased securities without informing the repurchase agent. The agreement will include customary company representations and warranties. Unlike the repurchase agreement for traditional open market repurchases, the documentation for ASRs has not become fully standardized. A company typically pre-negotiates forms of ASR documents with members of its lending syndicate. Typically, either a master confirmation or agreement is used with supplemental confirmations containing economic terms for individual transactions or stand-alone long-form confirmations that incorporate or reference an International Swaps and Derivatives Association, Inc. (ISDA) Master Agreement are used. The master confirmation structure is more prevalent as it allows for multiple transactions to be consummated using the same legal terms.

Anna T. Pinedo, Partner, Mayer Brown LLP

Anna Pinedo is a partner in Mayer Brown's New York office and co-leader of the Global Capital Markets practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer and specialty finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

Anna regularly speaks at conferences and participates in panel discussions addressing securities law issues, as well as the securities issues arising in connection with derivatives and other financial products. She is the co-author of the leading capital markets treatise, *Corporate Finance and the Securities Laws*, published by Wolters Kluwer (6th Ed., updated 2020); co-author of *A Deep Dive Into Capital Raising Transactions*, published by the International Financial Law Review (2020); co-author of *JOBS Act Quick Start* (International Financial Law Review, 2013; updated 2014, 2016); contributor to *OTC Derivatives Regulation Under Dodd-Frank: A Guide to Registration, Reporting, Business Conduct, and Clearing* (Thomson Reuters, first ed. 2014, second ed. 2015, third ed. 2016, fourth ed. 2017); co-author of *Considerations for Foreign Banks Financing in the US* (International Financial Law Review, 2012; updated 2014, 2016); co-author of *Liability Management: An Overview* (International Financial Law Review, 2011, updated 2015); co-author of *Structuring Liability Management Transactions* (International Financial Law Review, 2018); co-author of *Covered Bonds Handbook*, published by Practising Law Institute (2010, updated 2012-2014); co-author of the treatise *Exempt and Hybrid Securities Offerings*, published by Practising Law Institute (2009, second ed. 2011, updated 2014, third ed. 2017); and co-author of *BNA Tax and Accounting Portfolio: SEC Reporting Issues for Foreign Private Issuers* (BNA Accounting Policy and Practice Series, 2009, second ed. 2012, third ed. 2016, fourth ed. 2020). Anna is also a contributing author to *Broker-Dealer Regulation* (2011, second ed. 2012, updated 2020), published by Practising Law Institute. She co-authored "The Approaches to Bank Resolution," a chapter in *Bank Resolution: The European Regime* (Oxford University Press, 2016). Anna contributed to *The Future of Bank Funding and Capital: Solutions for Issuers, Opportunities for Investors* (IFR Market Intelligence, 2009). Additionally, Anna co-authored "The Ties that Bind: The Prime-Brokerage Regulation," a chapter in *Global Financial Crisis* (Globe Law and Business, 2009); "The Law: Legal and Regulatory Framework," a chapter in (Bloomberg, 2006); and "The Impact Security: Reimagining the Nonprofit Capital Market," a chapter in *What Matters: Investing in Results to Build Strong, Vibrant Communities* (Federal Reserve Bank of San Francisco and Nonprofit Finance Fund, 2017). Anna is a contributor to Practising Law Institute's "BD/IA: Regulation in Focus" blog.

Anna is a member of the American Bar Association's (ABA) Committee on the Federal Regulation of Securities, a member of the subcommittee on Disclosure and Continuous Reporting, chair of the subcommittee on Securities Registration, chair of the subcommittee on Annual Review, and a member of the task force on the future of securities regulation.

She has participated in the drafting committee for the ABA's comment letters on such topics as securities offering reform, revisions to the definition of accelerated filer and smaller reporting company, amendments to the accredited investor definition; amendments to the exempt offering framework; and various JOBS Act-related and disclosure effectiveness related matters. Anna also is a member of the ABA Committee on the Regulation of Futures and Derivatives Instruments. Anna is a chair of the Structured Products Association Legal, Regulatory and Compliance Executive Committee. She is a member of the Mortgage Bankers Association's Mortgage REIT Council and a member of the MBA's Secondary & Capital Markets Committee.

Anna is an adjunct professor at the George Washington University School of Law and member of the George Washington University Center for Law, Economics & Finance Advisory Board. She is a member of the Visiting Committee of the Law School of the University of Chicago. Anna was a member of the University of Chicago Legal Forum during her time at the University of Chicago Law School.

Brian Hirshberg, Partner, Mayer Brown LLP

Brian Hirshberg is a partner in Mayer Brown's New York office and a member of the Capital Markets practice. He focuses on representing US and foreign private issuers, sponsors, and investment banks in registered and unregistered securities offerings, including initial public offerings, follow-on offerings, private placements (including Rule 144A and PIPE transactions), at-the-market offerings, registered direct offerings, liability management transactions, preferred stock and debt offerings, and secondary offerings on behalf of issuers in a variety of industries. Brian has particular experience working on specialty finance, real estate and real estate investment trusts (REITs), business development companies (BDCs), and life sciences company deals. He also assists public company clients with ongoing securities law compliance requirements, listing standards of the major US stock exchanges, SEC public reporting obligations, shareholder-related disputes, and governance matters.

Brian is a thought leader and frequently authors articles relating to capital markets trends and topics published by *Thomson Reuters'* Practical Law Company, the *Practicing Law Institute*, *Bloomberg* and *LexisNexis*. The *IFLR1000* 2022 guide ranks Brian as a "Rising Star Partner" in the United States for Capital Markets: Equity, and he is also a recommended lawyer by *The Legal 500 US*.

Colleen C. Dunn, Associate, Mayer Brown LLP

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.