

Stock Buybacks Under 10b5-1 Plan Draw SEC Rebuke

October 19, 2020

In first-of-its-kind case, SEC focuses on company's accounting controls around Rule 10b5-1 buybacks and imposes a \$20 million fine.

On October 15, the SEC announced a **settlement** stemming from a company's series of stock buybacks undertaken pursuant to a Rule 10b5-1 plan. Although the SEC concluded that the company initiated the 10b5-1 plan at a time when it possessed material nonpublic information (MNPI), the SEC did not charge the company or its executives with fraud or insider trading. Instead, the SEC zeroed in on the company's accounting controls, and found them inadequate to ensure compliance with the board of directors' stock buyback authorization, which required the company to execute buybacks in accordance with its insider-trading policy.

The novel theory in this first-of-its-kind case highlights the need for policies and procedures around stock buyback authorizations and the entry into of 10b5-1 plans, including procedures a company needs to follow to determine that it is not in possession of MNPI when it enters into a 10b5-1 buyback plan.

Stock Buybacks

Stock buybacks are an ordinary feature of the corporate landscape and are governed by state corporate law and the federal securities laws. The SEC first adopted a safe-harbor rule in 1982 to make it easier for companies to repurchase stock. Rule 10b-18 protects a company from manipulation charges based solely on the time, price or amount of the purchases, or the number of brokers or dealers used for the purchases. A company must meet certain conditions to benefit from the safe harbor, such as not trading around the market open or close, staying within price and volume restrictions, and using one broker per day. The SEC adopted a second rule in 2000, Rule 10b5-1, to provide an affirmative defense to insider trading. In the case of a corporate stock buyback, the defense is against a charge that the buyback was executed while the company or its executives possessed MNPI. Although not required, companies often structure their stock buybacks to comply with both Rule 10b-18 and Rule 10b5-1.

Stock buybacks have received increased scrutiny in recent years. In 2019, Senator Tammy Baldwin **reintroduced legislation** to repeal the Rule 10b-18 safe harbor. The same year, Senator Sherrod Brown **introduced a bill** to require public companies to issue a "worker dividend" to all non-executive employees based in part on the total amount spent on stock buybacks. And as explained in our **client memorandum**, coronavirus legislation includes provisions restricting companies from engaging in stock buybacks after participating in certain relief programs.

SEC Enforcement Case

Andeavor LLC is a Texas-based oil refiner and marketer that engaged in discussions about being acquired by another public company in 2017. According to the SEC's order, the companies suspended discussions in October of that year, but on January 30, 2018, the acquirer's CEO asked Andeavor's CEO to resume their talks.

Two days before a meeting between the CEOs, Andeavor's CEO directed a repurchase of \$250 million of Andeavor shares pursuant to board authorization from several years prior that the company had used from time to time. On February 23, the company executed a 10b5-1 plan and repurchased 2.6 million shares over the next two months at an average price of \$97 per share. On April 30, 2018, Andeavor announced that it would be acquired in a deal that valued Andeavor's stock at more than \$150 per share.

The SEC did not assert manipulation, insider trading, or other fraud charges, but instead alleged that Andeavor violated the internal controls requirements of Exchange Act Section 13(b)(2)(B). This provision requires accounting controls that provide “reasonable assurances that transactions are executed in accordance with management’s general or specific authorizations,” and that “access to assets is permitted only in accordance with management’s general or specific authorization.” The SEC said that Andeavor lacked sufficient controls to insure compliance with its policy prohibiting repurchases if the company was in possession of MNPI. Andeavor’s legal department approved the plan, but the SEC alleged that the company used an abbreviated and informal process that did not include conferring with people, like the CEO, with information about the likelihood of a takeover deal. The SEC concluded that the legal department mistakenly believed that the acquisition discussions were not MNPI. Andeavor did not admit wrongdoing, and agreed to pay a \$20 million penalty.

Takeaways

SEC enforcement cases involving stock buybacks and 10b5-1 plans are rare, and companies may not think of buyback decisions as subject to their internal accounting controls. This case demonstrates the need for controls around stock buybacks, despite the safe harbor of Rule 10b-18 and affirmative defense of Rule 10b5-1. Andeavor’s CEO and legal department both approved the buybacks, yet the SEC still alleged a controls violation because of the process used to approve the 10b5-1 plan.

Companies contemplating stock buybacks should ensure the decision is subject to a controls process, especially during discussions of potentially significant corporate transactions. Buybacks that precede control transactions or major acquisitions or dispositions are likely to be questioned in light of concerns about repurchases influencing transaction economics and lost opportunities for stockholders who sell back to the company before the transaction.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

| | | |
|----------------------------------|-----------------|--|
| Greg D. Andres | +1 212 450 4724 | greg.andres@davispolk.com |
| Martine M. Beamon | +1 212 450 4262 | martine.beamon@davispolk.com |
| Maurice Blanco | +1 212 450 4086 | maurice.blanco@davispolk.com |
| Angela T. Burgess | +1 212 450 4885 | angela.burgess@davispolk.com |
| Robert A. Cohen | +1 202 962 7047 | robert.cohen@davispolk.com |
| Joseph A. Hall | +1 212 450 4565 | joseph.hall@davispolk.com |
| Betty Moy Huber | +1 212 450 4764 | betty.huber@davispolk.com |
| Michael Kaplan | +1 212 450 4111 | michael.kaplan@davispolk.com |
| Linda Chatman Thomsen | +1 202 962 7125 | linda.thomsen@davispolk.com |
| Richard D. Truesdell, Jr. | +1 212 450 4674 | richard.truesdell@davispolk.com |

© 2020 Davis Polk & Wardwell LLP | 450 Lexington Avenue | New York, NY 10017

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's [privacy notice](#) for further details.