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Navigating Public Company Equity Buybacks

Counsel to public companies must consider a number of issues in connection with equity buybacks. These include the reasons for authorizing a buyback, the common buyback methods, and the disclosure implications.

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The year 2011 has been an active one for stock buybacks. Through the first half of 2011, component companies of the S&P 500 repurchased approximately $200 billion of their equity securities, with the second quarter of 2011 marking the 8th consecutive quarterly increase for stock buybacks.[1] Market icons in disparate industries such as Exxon Mobil, International Business Machines, and JP Morgan Chase & Co. spent $16.6 billion, $11.5 billion, and $8.0 billion, respectively, on buybacks over the nine months ended September 30, 2011.[2] Small and mid-cap companies have also been active on the buyback front.

The prominence of buybacks can be attributed to a number of factors, including attempts by issuers to support their financial metrics such as earnings per share, low interest rates and issuer convictions that their stock is significantly undervalued due to market conditions. Warren Buffett, the world-renowned investor and Chairman of Berkshire Hathaway Inc., went so far as likening that company's buyback program announced in September 2011 to buying U.S. dollars at a discount, stating "If I can buy dollar bills for 90 cents, I'll buy them."[3]

Despite the common use of buybacks and the typically accompanied investor enthusiasm, buybacks may involve the expenditure of a significant amount of corporate assets, and, if handled poorly can subject an issuer and its board of directors to investor criticism and, potentially, litigation. As a primer for counsel to companies considering a buyback, set forth below is a discussion of three common buyback methods, their implementation by public company boards and management, their disclosure implications, and certain related matters.

Steps Prior to Establishing a Buyback Program

Before establishing a buyback program, the underlying goals with respect to the program should be identified by the issuer's management and board of directors and discussed at the board level. This process will reflect the board's business judgment and support its decision to authorize the repurchase. It also will affect the determination

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of which, if any, buyback method best suits the issuer's goals. The board's decision to establish the program generally will be entitled to the protections afforded by the business judgment rule under applicable state law.[4]

Reasons for Buybacks

Various reasons given by issuers, privately or publicly, for their establishment of buyback programs are set out below.

Investment in undervalued stock/signal confidence to market. It is common for an issuer to state that it is establishing a repurchase program because its stock is undervalued and therefore is an attractive investment opportunity that will provide superior returns for stockholders. In making this investment, the issuer also signals to the market (implicitly or explicitly) that its board of directors has confidence in its prospects.

Support financial metrics/minimize dilution. A reduction in the number of shares outstanding through the distribution of cash that would otherwise remain on the balance sheet generally is considered to have a positive or sustaining effect on certain financial metrics often used to evaluate the issuer, particularly earnings per share. Issuers may consider this type of support for its financial metrics necessary or desirable as a result of market conditions, or to counter the dilutive impact of share issuances in an acquisition or upon exercise of employee stock options. Although this reason frequently is cited in articles analyzing the use of stock buybacks, it is important to note that the accounting implications of a buyback should not be the sole grounds for board authorization of a repurchase program.

Distribute cash to investors. Buyback programs are used, alone or in conjunction with dividends, as a means of distributing cash to investors. Buybacks generally provide the issuer with more control over the distribution process than dividends because the issuer can control a buyback up to the date of the expenditure, compared with a dividend that must be announced a certain period of time before it is paid (although use of a 10b5-1 plan or tender offer will to some extent negate this advantage). Additionally, repurchases present certain tax planning advantages for stockholders over dividends in that a stockholder can decide whether or not to participate in a repurchase (and experience the tax consequences) and a seller is only taxed on gain on the sale. In contrast, a stockholder does not have a choice whether to receive a dividend at a given time and is taxed on the entire amount of the dividend.

Provide liquidity. Issuer repurchases may provide a measure of liquidity for minority investors in a stock suffering from a low trading volume, allowing them a chance to exit their investment. This may be particularly appealing for an issuer considering an action that will further reduce liquidity, such as terminating its obligation to file reports under the Securities Exchange Act of 1934 (Exchange Act).

Reduce the number of stockholders. An issuer may use a buyback program to help reduce its number of holders of record below the threshold for eligibility to terminate the registration of a class of its securities under Section 12(g) of the Exchange Act, after which the issuer may no longer be required to file periodic reports with the Securities and Exchange Commission (SEC). If this is a goal, the issuer should pay careful attention to the additional disclosure requirements under Rule 13e-3 under the Exchange Act (discussed below).

Restrictions on Buybacks

After an analysis of its underlying goals, the issuer's board of directors should consider restrictions that may apply to the buyback. Key concerns include compliance with the issuer's

organizational documents, its obligations under existing agreements (particularly covenants under loan and security agreements and any anti-dilution or change in control provisions), and applicable federal and state laws[5] and stock exchange rules.[6] The board also needs to consider certain financial and accounting implications of share repurchases, including: (1) the size of the buyback necessary to accomplish its underlying goals; (2) the effect of the proposed level of repurchases on the issuer's cash position in light of its working capital needs; (3) the effect of the repurchases on the issuer's balance sheet and financial metrics (*e.g.,* earnings per share and book value); and (4) the relative profitability of potential alternative uses for the funds.

The board also should authorize and approve the terms of the buyback program, which should include the following: (1) the total number or dollar amount of shares to be repurchased; (2) the maximum price for any repurchase, or a formula or algorithm for determining the maximum price; (3) the time period during which the repurchases will be made; (4) the source of funds for the repurchases; (5) the use/treatment of repurchased shares (retire or move into treasury); and (6) the identity of any broker selected to conduct the buyback. Additionally, the board should consider whether the repurchases should be made under a Rule 10b5-1 plan (discussed below).

Buyback Methods

Open Market Purchases

The most commonly used buyback method is the open market purchase program. Generally, issuers make such purchases in compliance with Rule 10b-18 under the Exchange Act, a safe harbor from liability under certain rules prohibiting market manipulation.[7] Issuers will sometimes seek the added benefit of a 10b5-1 purchase plan to further insulate themselves from liability.

Rule 10b-18 Safe Harbor

Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act prohibit actions designed to manipulate the market price of an issuer's stock. The SEC adopted Rule 10b-18 to provide a non-exclusive safe harbor to shield issuers and their affiliates from liability under those provisions of the Exchange Act due to the manner, timing, price, and volume of repurchases if they comply with the manner, timing, price, and volume conditions of the rule. Compliance with Rule 10b-18 is determined on a daily basis, so failure to meet any one of these conditions on a given day will deprive the issuer of the protections of the safe harbor for all purchases made that day. Although there is no presumption of market manipulation should an issuer make open market purchases outside of Rule 10b-18, it generally is recommended that an issuer take advantage of the certainty provided by the safe harbor.

One broker or dealer. An issuer may use only one broker or dealer on any single day for Rule 10b-18 purchases, other than with respect to transactions that are not solicited by or on behalf of the issuer or its affiliated purchasers.[8] If Rule 10b-18 purchases are effected by or on behalf of more than one party on a single day (whether the issuer and an affiliated purchaser, or multiple affiliated purchasers), all parties must use the same broker or dealer. Issuers and affiliated purchasers are permitted to use different brokers to effect the repurchases on different days—complicating, but permissible.

Timing of purchases. Generally, no Rule 10b-18 purchases may be made at the opening of trading or during the 30-minute period before the scheduled close of the primary trading session. If the issuer has an average daily trading volume (ADTV)[9] of $1 million or more and a public float value of $150 million or more, the restricted period prior to market close is reduced to 10 minutes. After-hours trading by the issuer is

allowed provided that the issuer's purchase is not the opening transaction of the session following the close of the primary trading session.

Purchase price. Generally, the price limitations imposed by Rule 10b-18 prohibit the purchase price from exceeding the highest independent bid or last independent transaction price, whichever is higher, reported at the time of the Rule 10b-18 purchase. If the issuer engages in after-hours trading, such purchases must be effected at prices that do not exceed the lower of the closing price of the primary trading session in the principal market[10] for the security and any lower bids or sale prices subsequently reported in the applicable consolidated transaction or quotation reporting system.

Volume of purchases. The purchases effected on any single trading day by an issuer and any affiliated purchasers are aggregated and may not exceed 25 percent of the issuer's ADTV. Once each week, in lieu of any other Rule 10b-18 purchases on a given day, the issuer may make a "block" purchase outside of the ADTV-based volume limitation. A block is a quantity of stock that (1) has a purchase price of $200,000 or more, (2) is at least 5,000 shares and has a purchase price of at least $50,000, or (3) is at least 20 round lots of the security and totals 150 percent or more of the trading volume for that security.[11] A block purchase made under this exception is not included when calculating ADTV.

In order to ensure compliance with the single broker and volume requirements under Rule 10b-18, an issuer needs to monitor the activities of its affiliated purchasers. Under Rule 10b-18, "affiliated purchasers" are persons acting, directly or indirectly, in concert with an issuer for the purpose of acquiring the issuer's securities and affiliates of the issuer who, directly or indirectly, control the issuer's purchases of such securities, whose purchases are controlled by the issuer, or whose purchases are under common control with those of the issuer. An "affiliate" is a person who controls, is controlled by, or is under common control with the issuer. Common examples of affiliated purchasers include executive officers, members of the board of directors and large stockholders.

The safe harbor protection afforded by Rule 10b-18 does not apply to certain types of repurchases, including: (1) purchases made outside of the United States; (2) purchases made in a tender offer under the SEC's tender offer rules (discussed below); (3) purchases effected by or for an employee plan by an agent independent of the issuer; (4) purchases of fractional security interests; and (5) certain purchases during the period starting at the public announcement of a merger, acquisition, or similar transaction involving a recapitalization, and ending at the earlier of the completion of such transaction or the vote by target shareholders. It also is important to note that the safe harbor protection of Rule 10b-18 is not available if repurchases are considered to be fraudulent or manipulative.

Rule 10b5-1 Plans for Issuers Engaging in Stock Buybacks

While Rule 10b-18 affords an issuer limited protection from market manipulation claims, an issuer also needs to consider the insider trading rules, which prohibit an issuer from repurchasing its securities while in possession of material non-public information. A Rule 10b5-1 plan is a written agreement between a stockholder and a broker prepared in accordance with Rule 10b5-1(c) under the Exchange Act that is designed to enable the stockholder to take advantage of affirmative defenses to allegations of insider trading under Rule 10b5-1(c). While a Rule 10b5-1 plan does not eliminate liability (unlike the Rule 10b-18 safe harbor), it can provide the issuer with more comfort in planning its open market share repurchases. It also may provide the issuer with additional opportunities to make open market repurchases (*i.e.,* when the issuer may be in possession of material non-public information).

Rule 10b5-1(c) provides for two affirmative defenses to allegations of insider trading. The first defense (available to individuals and entities) is that trades made pursuant to a rules compliant Rule 10b5-1 plan are not made "on the basis of" material non—public information, even if the party is actually aware of material non-public information at the time of the transactions made under the plan. In order to make this defense available: (1) the Rule 10b5-1 plan must be adopted at a time when the issuer is not aware of any material non-public information; (2) the plan must specify the amount, price (can be a range), and date of the transactions under the plan, or include a formula, algorithm, or computer program for determining the amount, price, and date; (3) the plan may not permit the issuer, or any other person with knowledge of any material non-public information, to exercise any subsequent influence over how, when, or whether to effect transactions under the plan; (4) the plan must be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1; and (5) the transaction at issue must be made in accordance with the plan.

The second defense (available to entities only) is that the party is not liable if it can demonstrate that the individual making the investment decision on behalf of the party is not aware of material non-public information at the time the decision is made, and that the party has implemented reasonable policies and procedures to prevent insider trading. It is important to note that the affirmative defenses do not require that all trades by the issuer be made under the 10b5-1 plan (although trades outside the plan are not covered by the defense).[12]

There are certain best practices with respect to the drafting and implementation of Rule 10b5-1 plans to prevent from giving the appearance that the issuer adopted or modified the plan while in possession of material non-public information, or is using the plan in bad faith to evade the prohibitions of Rule 10b5-1, including those below.

Timing of adoption, modification, termination, or suspension. It is best to adopt the plan during an open trading window under the issuer's insider trading policy. Whether within or outside of an open trading window the issuer needs to be certain that it is not in possession of material non-public information at the time of adoption. The issuer also should not allow for the modification, termination, or suspension of a plan outside of an open trading window (or while the issuer is in possession of material non-public information).

Waiting periods. Establish a waiting period for some time after a plan's adoption or modification or suspension during which trading under the plan is not permitted. While not cast in stone, a waiting period of 30 days or more is a reasonable timeframe.

Duration. Adopting a plan that will only last a short period of time (such as less than six months) may give the impression that the issuer is only using the plan to capitalize on a short term price swing resulting from the expected dissemination of material non-public information. On the other hand, adopting a plan with an especially long duration (such as over two years) makes it more likely that the issuer will need to adopt a new plan or modify, suspend or terminate the existing plan as a result of changes in the issuer's business or financial markets, which may give the impression that the issuer is acting based on material non-public information.

Communications with broker. The issuer and the broker administering the plan should not communicate with each other except for broker notices that trades are executed and issuer instructions to modify, suspend or terminate the plan.

Automatic suspension or termination. To allow an issuer to make decisions in connection with major corporate transactions and avoid potential problems under other securities laws, the plan should include a provision that automatically

terminates or suspends trading under the plan upon, among other things, the issuer's delivery of notice to the broker of a potential merger, acquisition or public offering.

Multiple plans. The issuer should not maintain multiple Rule 10b5-1 plans because doing so may give the impression that the issuer is not acting in good faith. As an alternative, an issuer may incorporate multiple trading strategies into a single plan.

Issuer Tender Offers

Open market stock repurchase programs generally are meant for the purchase of a relatively small percentage of an issuer's outstanding stock. While an issuer could always disregard the safe harbor restrictions on volume found in Rule 10b-18, very few would be willing to accept the inherent risk. Consequently, an issuer seeking to purchase a large percentage or all of its shares may choose to go directly to its stockholders through a tender offer.

Rules Governing Issuer Self Tenders

Section 13(e) of the Exchange Act governs the repurchase of securities by an issuer through use of a tender offer. It states, in part, that "[i] t shall be unlawful for an issuer that has a class of securities registered pursuant to Section 12 of this title….to purchase any equity securities issued by it if such purchase is in contravention of such rules and regulations as the [Securities and Exchange] Commission may adopt…"[13] Pursuant to that authority, the SEC adopted Rule 13e-4 as the primary regulation governing how an issuer self tender offer must be effected.[14] Rule 13e-4 applies both to tender offers for classes of securities registered under Section 12 of the Exchange Act and any securities convertible into the class of securities registered under Section 12. In addition to Rule 13e-4, all issuers, whether or not subject to Section 12, are subject to Regulation 14E of the Exchange Act, which provides that all tender offers must comply with relevant anti-fraud provisions.

Rule 13e-4 requires issuers engaging in self tender offers to file certain materials with the SEC, disclose certain information to stockholders and abide by certain regulations governing the manner in which the issuer makes the tender offer. Issuers are required to file with the SEC (1) all written communications made by the issuer or affiliate relating to tender offer, from and including the first public announcement,[15] as soon as practicable on the date of the communication, (2) a Schedule TO, and (3) amendments to the Schedule TO reporting material changes and final results of the tender offer.

Schedule TO

A Schedule TO, which contains issuer and offer information, is the primary tender offer document filed by the issuer with the SEC. Typically, an issuer complies with most of the informational requirements of Schedule TO by preparing an Offer to Purchase, which is filed with the SEC as an exhibit to the Schedule TO and usually is mailed to stockholders simultaneously with the filing of the Schedule TO.[16] Certain disclosure items in the Schedule TO of particular interest, and issues inherent in those items, include the following.

Number of shares to be purchased. When establishing the number of shares to be purchased, issuers should consider (1) whether to include a "minimum condition" in the tender offer, which provides that no shares will be accepted for purchase if fewer than a threshold number of shares are tendered, and (2) whether holders of the issuer's options should be permitted to exercise such options in connection with the tender offer. If one of the issuer's reasons for authorizing the buyback is to decrease the number of shares outstanding, allowing option holders to exercise in connection with the tender offer may have the opposite effect if too many

options are exercised and the tender offer results in proration.

Tendering intention of officers, directors and affiliates. The issuer must state whether any securities are to be purchased from any officer, director or affiliate of the issuer and the details of each transaction. While inquiry may be made of officers and directors without much difficulty, obtaining information from stockholder affiliates may prove problematic, as the mere inquiry of stockholder affiliates as to their intent with respect to a yet-undisclosed tender offer constitutes the sharing of material non-public information in potential violation of Regulation FD.[17]

In order to comply with Regulation FD, the issuer may request that the stockholder affiliate enter into a confidentiality agreement with the issuer before the issuer shares its plans regarding a potential tender offer. Such stockholder affiliates, however, may not want to be informed of a potential tender offer so they are not prohibited from trading in the issuer's stock due to possession of material non-public information. The issuer also may comply with Regulation FD by publicly announcing its intention to commence a tender offer prior to its inquiry of the stockholder affiliate.[18] The stockholder affiliate, of course, is under no obligation to inform the issuer of its intention.

Purpose of the transaction. The issuer also must state its purpose in pursuing the transaction and whether it has established certain future plans, including the sale of a material amount of assets, mergers or reorganizations, changes to the board or any plans to delist from an exchange or suspend filing reports with the SEC. Ongoing negotiations or discussions regarding acquisitions or dispositions, terms of employment arrangements and other material plans are items that need to be analyzed for disclosure.

If the SEC chooses to review the Schedule TO, the SEC may delay the offer until its review is complete and the issuer has provided adequate disclosure. Material changes to the disclosed information will require an amendment to the Schedule TO and corresponding changes to the offering materials, potentially extending the expiration date of the tender offer. A change in the intention of a director, executive officer, or an affiliate may be considered material. The SEC may permit the issuer to amend the Schedule TO without conducting a supplemental mailing of its amended offering materials.

Certain other issues related to tender offers are discussed below.

Pre-commencement communications. Any pre-commencement communications are required to be filed with the SEC on Schedule TO as soon as possible on the date of the communication and must include a prominent legend advising security holders of the importance and availability of the issuer documents when filed.

Purchases following the tender offer. For a period of 10 business days following the termination of the tender offer, issuers are prohibited from purchasing additional shares of the security subject to the tender offer.

All holders\best price rules. The tender offer is required to be made to all holders of the security subject to the tender offer and the consideration paid to any stockholder for securities tendered must be the highest consideration paid to any other security holder in the tender offer.

Proration. To the extent that more shares are tendered than are offered for purchase in the tender offer, the issuer is required to pro rate the number of shares to be purchased from each tendering holder. Proration may have a negative tax impact on option holders because option holders who exercise options and cannot sell all of the underlying shares tendered due to proration may be forced to hold those unsold shares and pay tax on inherent profit without

the benefit of the receipt of cash from their sale. To address this, an issuer may consider a separate tender offer for outstanding options so its officers, directors, and employees are not forced to hold shares underlying exercised options that they sought to sell in the tender in the event of proration.

Privately-Negotiated Repurchases

A third means for an issuer to repurchase its securities is privately negotiated repurchases accomplished through share purchase agreements with individual stockholders. This method provides advantages over an open-market repurchase program in that sizable repurchases can be completed quickly, and over a tender offer in that administrative costs for entering into a small number of stock purchase agreements are relatively low. However, the Rule 10b-18 safe harbor does not apply to privately-negotiated repurchases, and they can only be completed with a limited number of stockholders without incurring large administrative costs.

The terms of share repurchase agreements vary substantially depending on the identity of the seller. In addition to representations and warranties seen in garden-variety stock purchase agreements, repurchase agreements in this context may include representations related to the seller's (1) financial sophistication, (2) access to adequate information concerning the business and financial condition of the issuer to make an informed investment decision, and (3) independent evaluation of the transaction and absence of any representations and warranties of the issuer or its employees, affiliates or advisors regarding the value of the shares sold. Representations like these may serve as evidence undermining the basis for private common law or securities law fraud claims against an issuer.[19] The issuer also may seek a limited or general release from the seller of claims it may have against the issuer, its shareholders, officers, directors, employees, agents, or any of their affiliates.

If the issuer provides the seller with access to confidential information during the course of negotiating the repurchase, it should be done pursuant to a confidentiality agreement or provision covering that information. The issuer otherwise may be required to publicly disclose the information under Regulation FD. A confidentiality agreement also may be desirable to keep the terms and/or existence of the agreement confidential so the issuer can maintain negotiating leverage over other potential sellers. In addition, a standstill provision may be sought prohibiting market transactions in the issuer's shares based on any material non-public information obtained by the seller in connection with the repurchase.

Disclosure Implications of Buybacks

Establishment of a Repurchase Program

Although compliance with Rule 10b-18 protects an issuer from Rule 10b-5 liability based upon manner, timing, price, and volume of purchases, it does not shield the issuer from liability based on trading while in possession of material non-public information. As a result, issuers should, and generally do, publicly disclose the establishment of an open market stock repurchase program. This disclosure is commonly made in the form of a press release, which also may be filed on Form 8-K. Disclosure should include not less than the following information: (1) the total number or dollar amount of shares to be repurchased; (2) the repurchase methods that may be used; (3) the duration of the program; (4) any existing repurchase arrangements; and (5) any previously undisclosed material developments.

If the issuer enters into a Rule 10b5-1 plan in connection with the repurchase program, the issuer is not required to disclose the existence or terms of the Rule 10b5-1 plan. However, announcing the plan's adoption may be desirable from a public relations perspective in that it indicates a greater commitment to buying back shares than the mere announcement of an open

market plan. This disclosure can be made in a press release, which the company may consider filing on Form 8-K. However, once the issuer publicly announces the adoption of the 10b5-1 plan, material modifications to the plan also should be announced. It is not common practice to disclose the terms of a Rule 10b5-1 plan.

Disclosure of Repurchases

Regardless of the method used to repurchase the shares or whether the buyback was publicly announced, an issuer will be required to disclose its repurchases in its SEC filings on a quarterly basis in accordance with Item 703 of Regulation S-K.[20] The impact of the repurchase program on the issuer's current assets also should be discussed, if material, in the liquidity and capital resources section of its annual and quarterly reports. Financial statement disclosure of the repurchase program and its impact also should be considered.

For open market repurchases and smaller privately negotiated repurchases, issuers tend to limit their disclosure to the quarterly reporting required under SEC rules. However, a significant privately negotiated repurchase may need to be disclosed on Form 8-K as an entry into a material definitive agreement, and issuers repurchasing their shares in a tender offer are required to provide significant disclosure under tender offer rules. If a repurchase program or tender offer triggers Rule 13e-3 under the Exchange Act, substantial additional disclosure will be required (discussed below).

Additional Topics

Accelerated Share Repurchase Programs

An accelerated share repurchase program (ASR) is another method an issuer can use to repurchase its shares. In an ASR, an issuer enters into an agreement with an investment bank pursuant to which the bank borrows shares of the issuer's stock from stockholders and delivers those shares to the issuer, which then will pay the bank the current market price for the shares plus a fee and retire the shares. The bank then will buy the issuer's shares in the open market and return the borrowed shares to the lenders, with the issuer generally insuring the bank against trading losses resulting from the purchases.

The main benefits of using an ASR are its speed relative to a Rule 10b-18 compliant open market repurchase program (due to volume limitations) and the avoidance of the substantial premium above market price generally paid in a tender offer. The disadvantages of an ASR are the inapplicability of Rule 10b-18 safe harbor protection and the loss of flexibility to make the repurchases over an extended period of time, if at all, as under an open market repurchase program.[21]

Applicability of Rule 13e-3

The implementation of a buyback program may trigger additional filing and disclosure requirements under Rule 13e-3 as a "going private transaction." A purchase by an issuer or its affiliate, or the commencement of a tender offer for the purchase, of any equity security of such issuer, that has a reasonable likelihood or a purpose of either (1) causing the issuer to fall below the applicable number of the holders of record allowing it to deregister under Section 12 of the Exchange Act,[22] or (2) causing securities of the issuer listed on a national securities exchange to be delisted, will fall under Rule 13e-3. Rule 13e-3 also applies to a series of transactions that, taken together, satisfy the elements of the Rule 13e-3 test. If a repurchase or series of repurchases triggers Rule 13e-3, the issuer must file a Schedule 13E-3 with the SEC in addition to any other required filings. Schedule 13E-3s often draw SEC comments, which can delay the repurchase process and result in additional legal and administrative costs. Consequently, issuers should always consider the potential triggering of Rule 13e-3 prior to commencing a repurchase.

Restrict Transactions with and by Insiders

In order to avoid any appearance of insider trading or conflict of interest, an issuer may take the additional step of refusing to repurchase shares directly from any director, officer, or controlling stockholder, and attempt to avoid repurchasing shares while any director, officer or controlling stockholder is in the process of selling its shares of the issuer's stock. In practical terms, this would require the issuer to adopt a corporate policy for its directors, officers, and controlling stockholders (preferably while establishing the buyback program) restricting them from purchasing the issuer's stock without clearing the transaction with a designated officer of the issuer, much like an insider trading program.

Regulation M

Regulation M prohibits an issuer from manipulating the market price of its securities in the context of a public offering. Regulation M prohibits the issuer and the offering participants from, outside of the public offering, bidding for or purchasing the security being distributed. It is illegal for the issuer, its selling stockholders and affiliated purchasers "to bid for, purchase, or attempt to induce any person to bid for or purchase, a covered security during the applicable restricted period." Generally, this restricted period commences either one or five days before pricing (depending on the issuer's market capitalization at the time) and continues until completion of the distribution.

Notes

1. Press Release, S&P Indices, S&P 500 Quarterly Stock Buybacks Back to $100 Billion Level (Sept. 20, 2011). The amount of buybacks made in the second quarter remains well short of the heights seen in the third quarter of 2007, when S&P 500 companies spent a total of $172.0 billion on stock repurchases.

2. Information disclosed in Quarterly Reports on Form 10-Q for each company.

3. Andrew Frye, *Buffett Likens Buyback to Getting Dollar Bills for 90 Cents,* BloombergBusinessweek (Oct. 4, 2011).

4. One potential exception is if the buyback is deemed to be a defensive action, in which case an entire fairness standard may apply.

5. Most states provide for certain restrictions on the ability of an issuer to repurchase shares while it is insolvent or otherwise capital impaired. For example, Section 160 of the General Corporation Law of the State of Delaware provides that a Delaware corporation cannot purchase shares of its capital stock when the purchase "would cause any impairment of the capital of the corporation."

6. Stock exchanges rules regarding advance notice of material corporate developments may apply. Also, certain stock exchanges have additional rules regarding tender offers.

7. On January 26, 2010, the SEC proposed amendments to modernize Exchange Act Rule 10b-18 and solicited comments on such amendments and other matters related to Exchange Act Rule 10b-18. *See Purchases of Certain Equity Securities by the Issuer and Others*, Release No. 34-61414. To date the SEC has not published any Final Rules with respect to the proposed amendments.

8. The issuer may use a second broker for after-hours trading.

9. Under Exchange Act Rule 10b-18(a), "ADTV" means the average daily trading volume reported for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected. A "block" purchase made under Rule 10b-18 and foreign trading volume, if any, are not included when calculating ADTV.

10. Under Exchange Act Rule 10b-18(a), "principal market" means the single securities market with the largest reported trading volume for the security during the six full calendar months preceding the week in which the Rule 10b-18 purchase is to be effected.

11. Under Exchange Act Rule 10b-18(a)(5), a block does not include any amount a broker, acting as principal, has accumulated for the purpose of sale or resale to the issuer or to any affiliated purchaser of the issuer if the issuer or affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose, nor will it include any amount that a broker has sold short to the issuer or to any affiliated purchaser of the issuer if the issuer or affiliated purchaser knows or has reason to know that the sale was a short sale.

12. If the adopting party is subject to trading volume limitations (*e.g.,* volume limitation on sale of restricted securities by an affiliate under Rule 144), trades outside of a 10b5-1 plan may reduce the number of shares that can be traded under the plan, which may be deemed to be an impermissible modification of the plan and endanger the affirmative defense.

13. Exchange Act Section 13(e)(1). Issuers are required to register under Exchange Act Section 12 under two circumstances: (1) upon becoming listed on a national securities exchange, such as NYSE, Nasdaq, or NYSE Amex (*see* Exchange Act Section 12(b)); and (2) if the issuer as of the end of any completed fiscal year has more than 500 shareholders

of a class of an issuer's equity securities and has $10 million or more in assets (*see* Exchange Act Section 12(g)).

14. Exchange Act Rule 13e-4(h) sets forth a list of transactions exempted from Rule 13e-4.

15. Under instructions to Exchange Act Rule 13e-4(c), "public announcement" means any oral or written communication by the issuer, affiliate or any person authorized to act on their behalf that is reasonably designed to, or has the effect of, informing the public or security holders in general about the issuer tender offer.

16. In addition to the Offer to Purchase, an issuer typically mails a Letter of Transmittal which is the document used by the holder to indicate how many shares they are tendering, a Notice of Guaranteed Delivery, a Letter to Brokers, Dealers, Commercial Banks, Trust Companies, and Other Nominees through which the issuer's shares are owned and a Letter to Clients for Brokers, Dealers, Commercial Banks, Trust Companies and, Other Nominees to mail to the beneficial owners of the issuer's shares.

17. Regulation FD prohibits an issuer, or any person acting on its behalf, from disclosing any material nonpublic information about the issuer or its securities to certain individuals, unless the issuer, simultaneously in the case of an intentional disclosure, or promptly in the case of a non-intentional disclosure, makes public disclosure of such information.

18. Issuers are prohibited from publicly announcing that they intend to commence a tender offer if such issuer (1) is making the announcement of a potential tender offer without the intention to commence the offer within a reasonable time and complete the offer, (2) intends, directly or indirectly, for the announcement to manipulate the market price of the stock of the bidder or subject company, or (3) does not have the reasonable belief that the person will have the means to purchase securities to complete the offer.

19. Reliance on a misstatement or an omission is an element of a common law fraud claim and a Rule 10b-5 claim in a private action. An issuer may argue that certain representations serve as evidence of the absence of reliance necessary to support a claim. *See AES Corp. v. Dow Chemical Co.*, 325 F.3d 174 (3d Cir. 2003).

20. Item 703 of Regulation S-K requires tabular disclosure of the following: (1) the total number of shares repurchased during the past quarter, divided up by month; (2) the average price paid per share; (3) the number of shares purchased as part of a publicly announced repurchase plan; and (4) the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs. For publicly announced repurchase plans, the issuer is also required to disclose the following in footnotes to the table: (1) the date each repurchase plan was announced; (2) the share or dollar amount approved under each plan; (3) the expiration date (if any) of each plan; (4) each plan that has expired during the period covered by the table; and (5) each plan that the issuer has determined to terminate prior to expiration, or under which the issuer does not intend to make further purchases.

21. In early 2010 the SEC requested comments regarding what, if any, manipulative concerns are presented by ASRs and other "alternative" buyback methods, and what limitations should apply to these repurchases to address the concerns, so it is possible limitations on the use of ASRs may be coming. *See Purchases of Certain Equity Securities by the Issuer and Others*, Release No. 34-61414.

22. Exchange Act Rule 12g-4 provides that the threshold for deregistration is having fewer than 300 holders of record, except that if the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years the threshold is having fewer than 500 holders of record. Under Exchange Act Rule 12g5-1, holders of record include individuals who hold their shares in their own name ("of record") and brokers that hold shares on behalf of their clients, but not individuals who hold their shares in their broker's name ("in street name").