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Navigating Share Repurchases in Volatile Markets

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The global outbreak of the 2019 Novel Coronavirus (“COVID-19”), together with the oil price war, have fueled the volatility and historical losses in the stock market. Despite this turmoil, a down market also could present opportunities for companies considering buying back their shares. Share repurchase strategies range from traditional open-market share repurchase programs to issuer puts on its own stock to accelerated stock repurchase programs (“ASRs”), which may include embedded floors or caps.

The following outlines some of the issues and questions to navigate as companies consider repurchasing their shares, especially in this volatile market.

1. Authorizations

A company contemplating buying back its shares should ensure that it has the authority and requisite approvals for such repurchase. In approving such a transaction, management should make sure that the contemplated repurchase is permissible under applicable corporate and other solvency laws and that the company has on hand adequate cash resources or ready access to liquidity (e.g., by drawing down on a revolver) to fund the purchase price for the company’s shares and ongoing cash requirements.

2. Compliance

The issuer also should make sure that the contemplated stock repurchase is not subject to any limitations or restrictions by assessing: (i) its organizational documents, (ii) any applicable state law or stock exchange rules, and (iii) its agreements and contracts, such as credit agreements, indentures, shareholder agreements, or derivatives transactions, which may include equity ratio requirements, restricted payment covenants, or other prohibitions relating to share repurchases.

3. Timing

The issuer should review its “insider trading policy” blackout procedures that govern trading in company shares during a blackout period. A company would be well-advised to enter into a share repurchase transaction when it is in an “open trading window” (i.e., not in a blackout period), and at a time when it has publicly disclosed any information that otherwise would be deemed material nonpublic information (“MNPI”).¹ Issuers with closed trading windows may release preliminary results and other updates should the issuer desire to trade during a blackout period. It also is prudent to

consider how the share repurchase may affect earnings per share (“EPS”) and executive compensation where EPS is a performance metric. Excessive executive compensation created by a share repurchase that boosted EPS may attract unwanted attention. While Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) provides a safe harbor for issuer repurchases, it “confers no immunity from possible Rule 10b-5 liability.”²

4. Rule 10b5-1 and 10b-18 Compliant Plans

The issuer should consider whether it is in its best interest to structure the share repurchases as a Rule 10b5-1 compliant plan that would provide an affirmative defense to insider trading claims under Section 10(b) of the Exchange Act as well as whether it should rely on the “safe harbor” from manipulation liability provided by Rule 10b-18 in carrying out the share repurchases. It should weigh the length and amount of involvement it would like to have in its broker’s purchasing activities against the likelihood that it might come into MNPI during such time and/or run up against the next blackout period and the benefits and constraints of adherence to Rule 10b-18’s manner, timing, price, and volume conditions.

5. Picking the Right Strategy

By taking into consideration the issuer’s liquidity situation, its existing contractual limitations and the length of its open trading window, among other factors, the issuer could make a well-informed decision on whether to conduct its share repurchase using a traditional open-market repurchase program, by selling put options on its shares, or by entering into an ASR. Generally speaking, open-market repurchase programs provide the issuer with the most control over the timing and execution pricing of the repurchases, whereas an ASR would provide the benefit of being able to retire a sizable number of its shares at the outset, yielding an upfront EPS boost. Typically, under an ASR, the issuer and dealer will enter into a forward agreement at inception with the company purchasing a block of shares for immediate retirement and settlement occurring at maturity in either cash or shares at the company’s election for any “true up.” Companies also may consider embedding optionality, such as collars and caps, for delivery obligations at maturity and a variable maturity.

6. Pay Attention to Certain Contractual Provisions

As always, but particularly in trying times, the issuer should pay particular attention to covenants and adjustment and termination triggers in its share repurchase contract. Companies need to understand the various market disruption events included in their share repurchase contracts that may be triggered in a volatile market, such as trading disruption, exchange disruption, and early closure of the relevant stock exchanges, which may affect the timing and price of the share repurchase and result in changes to settlement terms of the transaction.

7. Disclosure Requirements

In connection with adopting Rule 10b5-1 plans, pursuing share repurchases in the open market, or entry into ASRs or other private transactions, management must assess the issuer’s publicly available information and anticipated impact of the repurchases, and if material and not otherwise adequately disclosed, a public announcement of the repurchase plans may be necessary under the circumstances to satisfy ongoing disclosure obligations under the Exchange Act.

8. Other Considerations

Additionally, the following are other issues that should be reviewed and evaluated:

- Regulation M considerations prohibiting the purchase of securities by an issuer/affiliate while the issuer/affiliate is engaged in a “distribution” of the issuer’s securities and during the period of time immediately prior to the distribution;
- Characterization of any repurchase activity as a “tender offer” and implications under the Exchange Act;
- Rules and conditions related to “going private” transactions and consequences under the Exchange Act;
- For ASRs, Securities Act of 1933 registration concerns arising in connection with dealer’s hedging activity; and
- Understanding the accounting treatment and tax ramifications of share repurchases.

The current stock market turmoil presents many issuers with opportunities to take advantage of what may be perceived as an artificially low share price. But, as outlined here, companies will need to carefully navigate, understand, and assess myriads of business and legal issues in consultation with their financial and legal advisors as they determine when and how to execute any share repurchases.

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¹ When evaluating MNPI, a company should consider whether its response to COVID-19 (or effects from COVID-19) might be considered MNPI.

² U.S. Securities and Exchange Commission, “Division of Trading and Markets: Answers to Frequently Asked Questions Concerning Rule 10b-18 (‘Safe Harbor’ for Issuer Repurchases)” (Dec. 2, 2016), <https://www.sec.gov/divisions/marketreg/r10b18faq0504.htm>.

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