KIRKLAND **M&A UPDATE**

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Avoiding Blowback from Your Stock Buyback

Companies should ensure that their clearance systems are properly designed to identify any MNPI that would preclude share repurchases.

Most stock buyback programs garner attention when the board authorization of a program is announced and when the company provides a quarterly update on its buyback progress during its earnings call or 10-Q filing. However, a recent SEC settled enforcement proceeding highlights that neither of those dates is relevant to the analysis of insider trading risk associated with stock repurchases. Instead, the question of whether the company possesses material non-public information (MNPI), and therefore should not be trading in its own securities, needs to be analyzed at the date of each purchase or, if relevant, the initiation of a 10b5-1 plan to facilitate automated repurchases.

In this case, the SEC alleged that the legal department authorized entering into a 10b5-1 plan for future repurchases at a time when the company's CEO had just recently reinitiated discussions relating to a potential material M&A transaction. In settling the action, the company paid a $20 million penalty.

This proceeding offers a few lessons for public companies:

- **Robust Compliance Program** — While the SEC noted that the company had an insider trading policy and the board's authorization required compliance with those guidelines, the SEC viewed the company's internal controls and process to determine whether there was any MNPI before a repurchase was made as insufficient. In particular, the process did not contemplate the possibility that the relevant finance and legal personnel may not be privy to material information known to the CEO or board, such as early-stage confidential M&A discussions. An issuer's approval process should include checks with any officers or directors who possibly possess MNPI. And these checks must be done on a rolling basis for an actively-managed repurchase program. By crafting this action as an alleged violation of the rules requiring effective internal accounting controls, the SEC did not need to allege or prove the more complex elements of an insider trading or fraud claim.
- **Materiality of M&A Discussions** — The SEC's findings suggest it views M&A discussions as particularly material. While the discussions for the sale of the company were at an early stage at the time the 10b5-1 plan was enacted, the SEC's order notes that it is "well established than an acquisition need not be more-likely-than-not to occur for it to be material". With materiality of information is typically adjudged as a matrix of significance and likelihood, the SEC's view of M&A, especially a sale of the company, is of high significance meaning the requisite likelihood to find materiality is comparably lower. It bears noting that M&A discussions may constitute MNPI precluding trading even if not yet requiring disclosure in a 10-Q or 10-K filing.

With many companies reactivating share repurchase programs as the economic environment stabilizes, the recent SEC action is a timely reminder that companies should ensure that the clearance systems they have in place are properly designed to identify any MNPI that would preclude trading by a company (or, for that matter, a corporate insider) in its shares. With political pressure in Washington around share repurchases, we expect that the SEC will remain focused on, and creative in enforcing, legal compliance by companies around buybacks.

If you have any questions about the matters addressed in this Kirkland M&A Update, please contact the following Kirkland attorneys or your regular Kirkland contact.

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