Repurchase and Trading Issues Arising Out of COVID-19 Market Disruptions

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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The current market environment and unprecedented volatility during the COVID-19 pandemic has created novel issues, and in some cases opportunities, for public companies and individuals regarding securities trading. The below Q&A addresses some federal securities laws questions that may be arising for our clients, though companies also should be mindful of applicable state law requirements regarding capital impairment or surplus. As always, please reach out to your Skadden contact or any of the individuals listed below to discuss any of these issues that may be impacting your company.

1. Can a public company repurchase its securities in the current environment?

A repurchase program that already is underway through a plan in accordance with Rule 10b5-1[1] under the Exchange Act likely will continue to be able to operate under the current environment. If a company does not have a Rule 10b5-1 repurchase plan in place but would like to implement repurchases that are authorized by its board of directors, it may do so, provided the company is not in possession of material nonpublic information.

In the current environment, ensuring the company is not in possession of material nonpublic information may be more difficult than when the market is less volatile, and may not directly track the company's normal open trading window periods (see Question No. 2). As noted in recent SEC staff guidance, before entering the market a company may need to revisit, refresh or update previous disclosures that have become materially inaccurate, while also taking the necessary steps to avoid selective disclosures by disseminating material information broadly to the public. For example, if the company has not yet withdrawn or updated guidance no longer believed to be reliable, an update may be necessary.

Decisions to implement Rule 10b5-1 plans during closed windows should be handled with caution, but the fact that a company's prophylactic closed window is in effect for insiders does not necessarily mean that the company cannot reasonably conclude that it has no material nonpublic information. If the company determines that it does not have material nonpublic information, it could enter into a Rule 10b5-1 plan in order to effect the repurchases.

Most companies (together with their affiliated purchasers) will want to abide by the conditions for the safe harbor against manipulation claims established by Rule 10b-18[2] under the Exchange Act (*e.g.*, volume, manner of sale, price). Companies that are interested in repurchases through mechanisms not contemplated by Rule 10b-18 (*e.g.*, through accelerated share purchases) should consult with counsel about their plans.

[1] For a summary of Rule 10b5-1 requirements and considerations, see Skadden's one-page checklist.
[2] For a summary of Rule 10b-18 requirements and considerations, see Skadden's one-page checklist.

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Companies that may be participating in a distribution, including issuing stock as merger consideration, should be mindful of the impact of Regulation M.

2. How should companies revisit their regular trading windows in light of the current environment?

Given the current situation, a company — depending on its industry, prior disclosure, and specific facts and circumstances — may want to consider its practices and policies concerning closed trading windows or blackouts. For example, for some companies it may be appropriate to delay the schedule on which regular closed windows expire, implement a special blackout period or revisit the list of insiders who are subject to blackout/trading window restrictions.

Co-directors of the SEC's Division of Enforcement, Stephanie Avakian and Steven Peikin, recently issued a joint statement noting that in these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances, especially if earnings announcements or required SEC filings are delayed due to the pandemic. The statement explains that in these circumstances, a greater number of people may have access to material nonpublic information than usual. Accordingly, companies should consider whether their trading window restrictions apply to the appropriate group of insiders who have such access, including directors, officers and other employees who may be at risk of trading in the company's securities while in possession of material nonpublic information.

Companies that modify their trading windows or policies for employees and directors in order to ensure tighter controls in light of the changing circumstances should be especially careful with repurchases predicated on a claim that the company itself does not have material nonpublic information, despite having imposed such additional controls.

3. A public company has a Rule 10b5-1 plan in place for repurchases of its securities and would like to increase the volume of repurchases. Can the company repurchase securities outside of the plan? Can the company amend its Rule 10b5-1 plan to increase the volume of purchases under the plan?

In the first instance, the company should evaluate whether:

- the volume of repurchases to be made under its Rule 10b5-1 plan is less than the total amount of board-authorized repurchases;
- the volume of purchases permitted under its Rule 10b5-1 plan is less than the Rule 10b-18 volume limitations, or its Rule 10b5-1 plan is periodically dormant (*e.g.*, to allow for block purchases); and
- its Rule 10b5-1 plan allows purchases outside of the plan.

If the answer to all of these questions is "yes," then the company may be able to repurchase additional shares up to the Rule 10b-18 volume limitations, provided that (i) the company does not possess material nonpublic information (being mindful of the admonitions described in Question No. 2 above) and (ii) the repurchases made by the company outside the plan will not impact whether, when or how many shares are purchased under the existing Rule 10b5-1 plan. It is important that the company's actions outside of its Rule 10b5-1 plan do not cause the broker to adjust purchases made under the plan. It is advisable to consult with outside counsel on the terms of a company's existing plan and how to possibly implement opportunistic purchases to ensure there is no inadvertent impact on the Rule 10b5-1 plan.

If the company does not possess material nonpublic information, the company may amend its Rule 10b5-1 plan to increase the volume. The company should ensure that the plan volume stays within the board-approved limits and the volume limitations established by Rule 10b-18. Companies should be aware that following market-wide trading suspensions of more than 30 minutes, the volume limits under Rule 10b-18 are increased temporarily, together with other changes to the requirements under that Rule. The company should consider how it wants its Rule 10b5-1 plan to handle such alternative conditions.

4. A company has been making periodic repurchases of securities under an effective Rule 10b5-1 plan. Can the company terminate the Rule 10b5-1 plan in light of the current circumstances to preserve liquidity? What if the company has material nonpublic information?

Although the Rule 10b5-1 plan may specifically prohibit a termination while in possession of material nonpublic information, the rule itself does not impose that limitation. Early termination of a Rule 10b5-1 plan, however, can be used as evidence of lack of good faith in establishing the plan, and good faith is required in order for an insider to rely on Rule 10b5-1 as an affirmative defense. However, given the unanticipated and unprecedented market conditions, a company reacting to those conditions could argue that early termination for reasons such as preservation of the liquidity should not be used as evidence of a lack of good faith in establishing the plan.

5. Can an employee or director exercise stock options during a closed trading window?

Unless the company's insider trading policy or option award agreement provides otherwise, an employee or director may exercise options in exchange for payment of the exercise price, with no sales on the open market to fund the exercise. However, officers and directors also should consider any applicable fiduciary duties, which may raise so-called *Brophy claims*[3] in

[3] *See Brophy v. Cities Service Co., 70 A.2d 5 (Del. Ch. 1949).*

instances where they appear to benefit from the use of company information, such as by altering a standing or default net-settlement election to instead elect cash settlement, or vice versa. If a cashless exercise is required, then any sale on the open market to fund the exercise price may be done only during an open window and when the individual does not have any material nonpublic information. If permitted under the award agreement, the employee or director may surrender certain of the options to the company in exchange for the funds required for exercise, even if the company has material nonpublic information.

6. What should an employee or director do if he or she has pledged a company's stock as collateral for a loan under which, given the change in market price of the stock, the lender will be exercising its right to sell the stock?

If the company is in an open trading window and the borrower does not otherwise have material nonpublic information, a sale of the pledged stock should not present any issues from a Rule 10b5-1 perspective. However, the company should consider whether the individual is in compliance with the its policies regarding the sale of securities and any minimum stock ownership requirements. If, however, the company is not in an open trading window or the borrower otherwise has material nonpublic information, the borrower should seek to prevent the market sale of the collateralized stock by funding the amount called by the lender. Otherwise, the borrower may be at risk for trading while in possession of material nonpublic information. Borrowers who are subject to Section 16 also should consider that a foreclosure or lender sale for the borrower's account will typically be treated as a sale by the borrower. Companies should consider whether an impending foreclosure would be material and should be publicly disclosed in advance.

7. Can an employee or director enter into an agreement pledging a company's securities?

Many companies have insider trading policies that restrict their employees and directors from pledging their securities. If a company does not restrict pledging, consider the terms of the loan and the likelihood of a potential call on the securities. As we are seeing in the current environment, an unanticipated event can cause dramatic changes to a company's share price and result in a call on the shares that may be sold when the borrower is in possession of material nonpublic information. This eventuality should be avoided. In addition, borrowers subject to Section 16 should consider that establishing a non-recourse borrowing arrangement is likely subject to Section 16 and reportable on a Form 4. In addition, an employee or director should enter into such a pledge arrangement only when he or she is not otherwise in possession of material nonpublic information.

8. Is a company required to disclose its repurchases?

Yes, generally a company should disclose its repurchase authorization before implementing the repurchases (unless the amount of the reauthorization is immaterial), which is typically disclosed in a press release and/or a current report on Form 8-K or 6-K. In addition, a company is required to disclose its repurchases in its quarterly reports on Form 10-Q and annual reports on 10-K pursuant to Regulation S-K Item 703, or for a foreign private issuer, in Item 6E of its annual report on Form 20-F. A company that enters into a repurchase agreement also should consider whether entry into such agreement is subject to disclosure on Form 8-K.

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