2024

The SEC's (Ill-Fated) Stock Repurchase Transparency Reform: For Investor Protection

Lin (Lynn) Bai
University of Cincinnati College of Law, lin.bai@uc.edu

THE SEC'S (ILL-FATED) STOCK REPURCHASE TRANSPARENCY REFORM: A MISSED OPPORTUNITY FOR INVESTOR PROTECTION (forthcoming Virginia Law & Business Review, Spring 2025)

Lynn Bai*

ABSTRACT

In May 2023, the SEC adopted new transparency measures designed to improve oversight of corporate stock buybacks. However, the new regulation faced immediate and successful challenges in court, prompting the agency to suspend its implementation in November 2023 for further cost-benefit analysis. Critics contended that the new regulation would offer minimal additional benefit to investors given the current regulatory framework. Despite this legal setback, advocates for the re-proposal of the regulation persist. This article shows that the new regulation would open new avenues of legal recourse for investors, fortify their claims that might otherwise be dismissed, and unlock corporate records for inspection that were previously inaccessible. The new regulation would enhance investor protection and market integrity.

Table of Contents

* Professor of Law, University of Cincinnati College of Law. The author gratefully acknowledges the meticulous research assistance provided by Deborah Myers and Daniel Zhou. Additionally, the author would like to thank the participants at the Business Law Workshop at the University of California Los Angeles School of Law for their valuable input. The author is responsible for any errors in this paper.

I. INTRODUCTION

Companies employ various strategies to repurchase their own shares, also known as stock buybacks. These methods include tender offers, negotiated repurchases, and open-market repurchases if the shares are traded on an exchange.

In a tender offer, the company announces its intention to buy back a specific number or aggregate dollar amount of shares at a predetermined price, typically at a premium to the current market price. Shareholders are given a deadline to decide whether to sell or retain their shares.

Negotiated share repurchases involve the company directly engaging with specific shareholders to buy back their shares. This method allows for customized pricing and avoids certain regulations applicable to tender offers.

In open-market repurchases, public companies simply instruct brokers to purchase their own shares on the stock exchange, much like any other investor. Purchases occur at prevailing market prices throughout the duration of the repurchase program, which can span months or even years. This extended timeframe allows companies to acquire shares strategically over time, adapting to market conditions and corporate needs.

Open market repurchases offer companies flexibility and cost-effectiveness, making them the most prevalent method for share repurchases. In the first quarter of 2024 alone, over 60 public companies announced stock buybacks in the open market, with aggregate values ranging from $50 million to $110 billion.[1]

Companies engage in share repurchases for various reasons. For instance, those with substantial cash surpluses may use buybacks to return value to shareholders. Companies might also repurchase shares in anticipation of future events, such as bond conversions or the exercise of stock options, which could result in a significant issuance of new shares and potentially dilute existing shareholders' holdings. Share repurchases can mitigate this dilution. Moreover, buybacks serve as an effective tool for fine-tuning a company's capital structure.

However, share buybacks can sometimes be driven by management's personal interests, rather than benefiting the company and shareholders. For example, when a company repurchases shares, it reduces the number of outstanding shares, boosting earnings per share (EPS). This artificially inflated EPS can distort the company's true performance for unsuspecting investors. Additionally, there are concerns that buybacks may be employed to inflate stock prices, potentially benefiting management whose compensations are tied to stock performance and those planning to sell their shares.

[1] For a list of the companies that announced open-market repurchases, *see* 2024 Stock Buyback List - MarketBeat (last visited September 9, 2024).

In May 2023, the Securities and Exchange Commission (SEC) adopted new regulations to address concerns about undisclosed motives behind stock buybacks. These regulations aim to increase transparency by requiring companies to disclose more detailed repurchase information and shifting reporting from monthly aggregate data to daily breakdowns.[2] This enhanced transparency allows investors to compare repurchase activities to events like executive compensation decisions, earnings announcements, and insider share sales to identify potentially illicit motives and schemes.

However, within days of the SEC's adoption of the new disclosure rules, the US Chamber of Commerce filed a lawsuit against the agency with the Fifth Circuit Court of Appeals. The Chamber challenged the SEC's new rules as arbitrary and capricious, arguing that the agency failed to conduct a comprehensive cost-benefit analysis before adopting them.[3]

Influential institutions such as the American Securities Association, the Association for Investor Relations, and the Center on Executive Compensation echoed the Chamber's position.[4] However, numerous commenters supported the new rules.[5]

On October 31, 2023, the Fifth Circuit ruled in favor of the Chamber, requiring the SEC to rectify the deficiency in this rulemaking process. In response, the SEC announced on November 22, 2023, that it would postpone the implementation of the new rules while conducting a more thorough cost-benefit analysis.[6]

Despite the setback in court, the push for enhanced transparency persists. In February 2024, a coalition of labor and industry trade organizations urged the SEC to "stand behind the need for investors to have basic transparency about share repurchases" by re-proposing the rules. They contended that "the status quo is untenable for investor protection, fair, orderly, and efficient markets, and capital formation."[7] Senators Marco Rubio and Tammy Baldwin followed suit, urging a swift re-proposal to allow investors to make better-informed decisions.[8]

Enhanced transparency potentially provides dual benefits: aiding informed investment decisions and holding companies accountable. Initially, the SEC proposed daily reporting of buyback activities, but this requirement faced strong opposition from an overwhelming majority of commenters who found it onerous, impracticable, and potentially deterrent to legitimate stock

---

[2] SEC Release Nos. 34-97424, 17 C.F.R. Parts 229, 232, 240, and 274 (May 3, 2023) [hereinafter SEC's Adopting Release], https://www.sec.gov/files/rules/final/2023/34-97424.pdf.

[3] *Chamber of Com. of the USA v. SEC*, No. 23-60255 (5th Cir. 2023)

[4] *See* Letter from Multiple Entities to Vanessa Countryman, Sec'y, SEC (Apr. 1, 2022), https://www.sec.gov/comments/s7-20-21/s72021-20122313-278364.pdf.

[5] *See, e.g.*, Letter from Dr. Edwin Hu et al. to Vanessa A. Countryman, Sec'y, SEC (June 27, 2022), https://www.sec.gov/comments/s7-21-21/s72121-20133158-303422.pdf; Letter from Melanie Senter Lubin, President, N. Am. Sec. Adm'rs Ass'n, to Vanessa A. Countryman, Sec'y, SEC (Apr. 1, 2022), https://www.sec.gov/comments/s7-21-21/s72121-20122140-275533.pdf.

[6] *See Repurchase Disclosure Modernization, U.S. SEC. & EXCH. COMM'N (Nov. 22, 2023), https://www.sec.gov/corpfin/announcement/announcement-repurchase-disclosure-modernization-112223.*

[7] *See* Letter from Americans for Financial Reform et al. to Gary Gensler, Chair, SEC (Feb. 13, 2024), https://ourfinancialsecurity.org/wp-content/uploads/2024/02/Repropose-stock-buybacks-rule.pdf.

[8] Andrew Ramonas, *SEC Faces Bipartisan Plea to Revamp Tossed Stock Buyback Rule*, BLOOMBERG L. (May 8, https://news.bloomberglaw.com/securities-law/sec-faces-bipartisan-plea-to-revamp-tossed-stock-buyback-___.

buybacks. In response, the SEC revised the proposal to mandate *quarterly* reporting of daily buyback data.

With its considerable lag behind corporate actions, the quarterly reporting offers scant benefit in guiding short-term investment decisions. Thus, the potential benefits of the new rules lie in their ability to empower investors to hold management accountable for ill-motivated buybacks. The question remains whether the additional disclosures can help investors overcome evidentiary challenges in lawsuits against management accused of leveraging buybacks for personal gain. A comprehensive analysis of this issue is crucial to the SEC's cost-benefit evaluation, and this article aims to contribute to that analysis.

This article proceeds in the following order: Part II discusses the existing disclosure rules regulating companies' stock buybacks and the SEC's ill-fated transparency push. Part III discusses whether and how the new rules can empower investors to hold companies accountable in court. Part IV concludes.

II. THE EXISTING DISCLOSURES AND THE SEC'S TRANSPARENCY PUSH

1. Existing Disclosures

(1) *Quarterly Reporting of Monthly Data Pursuant to Item 703 of Regulation S-K*

Item 703 of Regulation S-K[9] prescribes the information required and the reporting format for open-market stock repurchase activities by issuers and their affiliates. Currently, US companies with securities traded on a national exchange are obligated to report, on a quarterly basis, monthly aggregate buyback data in their Form 10-Qs[10] and Form 10-Ks[11] (for the issuer's fourth fiscal quarter). This report includes basic information such as the total number of shares repurchased, the average price paid, whether repurchases were part of a repurchase plan, and whether shares remain to be repurchased under such a plan.[12]

Additionally, companies must provide more detailed information in footnotes about their repurchase programs, including the announcement date, the approved dollar (or share or unit) amount, the expiration date (if any); expired plans or programs, and any plans or programs that the issuer has decided to terminate or under which no further buybacks are intended.[13]

(2) *Disclosures under Section 16 of the Securities Exchange Act*

Given that one major concern driving the SEC to adopt the new transparency rules is the potential use of buybacks by insiders to influence the market for their own trades, it is pertinent to consider existing insider trading reports under Section 16 of the Securities Exchange Act.[14] This section requires a public company's directors, officers, and shareholders who own more than 10%

[9] 17 CFR § 229.703 (2024).
[10] 17 CFR § 249.308a (2024).
[11] 17 CFR § 249.310 (2024).
[12] 17 C.F.R. § 249.308a (Form 10-Q) Item 2(c); 17 C.F.R. § 249.310 (Form 10-K) Item 5(c) (2024).
[13] 17 C.F.R. § 229.703 Instructions to paragraphs (b)(3) and (b)(4) (2024).
[14] 15 U.S.C. § 78p(b) (2024).

of a class of the company's equity securities to report their trades to the SEC within the required time limit on Forms 3, 4, or 5 as appropriate.

Form 3: This form is filed by insiders when they first become subject to reporting requirements, such as upon becoming a director, officer, or 10% shareholder. It details their initial holdings of the company's securities within 10 days of acquiring insider status.[15]

Form 4: Unless exempted from reporting, insiders must file this form within two business days of executing a transaction in the company's stock (including common stock and derivatives like options and warrants). This form discloses the amount bought or sold and the price per share.[16]

Form 5: If an insider has executed at least one trade in the company's securities but has not reported the transaction during a fiscal year, either due to an exemption or for any other reason, the insider is required to file Form 5 with the SEC no later than 45 days after the company's fiscal year ends. For example, a transaction by an insider of less than $10,000 in a six-month period does not have to be reported on Form 4 when it occurred but must be reported on Form 5.[17]

Form 4 and Form 5 were amended in December 2022 to require insiders to identify trades consummated according to the company's Rule 10b5-1 (c) plan (see discussions below).

(3) *Reporting on Rule 10b5-1(c)Plans*

Rule 10b5-1(C)[18] provides an affirmative defense to unlawful insider trading charges for companies and their insiders who buy or sell the company's stock. The rule allows insiders to establish a plan outlining the number of shares, price range, and timing of their stock trades in advance when they do not possess unpublished information. For example, a company's CEO may set up a plan with the help of the company's compliance team to specify that during the next twelve months, 10,000 shares of the CEO's holding in the company's stock will be sold on the third Monday of each month. After establishing the plan and following any mandatory cooling-off period (90 days for officers and directors, and 30 days for non-officer employees), trades can be executed automatically according to the predetermined parameters. This helps to ensure the CEO isn't making subjective decisions about when to sell based on potentially undisclosed information.

On December 14, 2022, the SEC adopted new rules requiring, among other things, directors and officers of public companies to disclose the establishment, modification, or termination of Rule 10b5-1 trading plans.[19] The new rules also require public companies to disclose option grant practices and insider trading policies and procedures. In addition, Forms 4 and 5 were amended to require reporting persons to identify transactions made pursuant to a Rule 10b5-1 trading plan and disclose all gifts of equity securities on Form 4.

2. The SEC's Transparency Push

The SEC sought to enhance transparency by adopting new disclosure rules in May 2023 following a lengthy public consultation period. However, as discussed earlier, the new rules faced

[15] 17 CFR § 249.103 (2024).
[16] 17 CFR § 240.16a-3 (2024).
[17] 17 CFR § 240.16a-3(f) (2024). *See also* https://www.sec.gov/files/forms-3-4-5.pdf.
[18] 17 CFR § 240.10b5-1(c) (2024).
[19] *See* Insider Trading Arrangements and Related Disclosures, Securities Act Release No. 33-11138, Exchange Act Release No. 34-96492, 88 Fed. Reg. 80,362 (Dec. 29, 2022) (to be codified at 17 C.F.R. pts. 229, 232, 240, 249).

immediate challenges in court and were subsequently suspended pending a comprehensive cost-benefit analysis. The SEC introduced the following changes in the ill-fated new rules.

(1) *Reporting Daily Repurchase Activities in Quarterly Reports*

The new rules would have required issuers to report daily repurchase activities in Forms 10-K and 10-Q, replacing the current quarterly reporting of monthly aggregate data. Daily data would be presented in XBRL format for customizable investor analysis. [20] While the SEC initially proposed daily reporting, it ultimately adopted a more balanced approach due to implementation challenges and costs raised by the financial industry. [21]

(2) *Supplemental Disclosures of Repurchase Rationales and Trades Under or Outside Pre-Arranged Plans*

The SEC mandated additional disclosures in Regulation S-K to help investors understand management's motives for stock repurchases and identify suspicious trades outside pre-authorized plans. These disclosures include:

1) The objectives and rationales for each repurchase plan or program, and the process or criteria used in determining buyback quantities.[22]
2) Any corporate policies or procedures governing the director or officer trading the company's stocks during the repurchase program.[23]
3) The number of shares repurchased under Rule 10b-18[24] or Rule 10b5-1(c) plans, providing insight into the company's effort to minimize market impact and mitigate unlawful insider trading.[25]
4) Whether directors and officers traded the company's securities within four business days of the company's repurchase announcement.[26]
5) Whether any director or officer was required to report insider trading on Forms 3, 4, or 5 under Section 16 of the Exchange Act.[27]
6) The number and nature of shares repurchased outside publicly announced buyback programs.[28]

3. Criticisms of the Proposed Changes

The SEC's overhaul of stock repurchase disclosures has received both praise and criticism. Key criticisms include:

---

[20] *See* SEC's Adopting Release, supra note 2, at 56.
[21] *Id*. at 30
[22] *Id*. at 75
[23] *Id.* at 76
[24] 17 C.F.R. § 240.10b-18 (2024). Rule 10b-18 provides a safe harbor for companies repurchasing their own stock in the open market. To qualify, companies must adhere to specific manner, volume, timing, and price conditions to avoid manipulation. While complying with this rule doesn't guarantee complete immunity, it offers protection against anti-fraud and anti-manipulation claims under Section 10b of the Securities Exchange Act.
[25] See the SEC's Adopting Release, supra note 2, at 63.
[26] *Id*. at 85
[27] *Id*. at 76
[28] *Id*.

1) *Limited value of daily data*: Critics argue that daily data doesn't provide more insights than existing monthly aggregates. [29] The SEC counters that daily data helps detect unusual repurchase activity and analyze links between repurchases, insider trades, and executive compensation events.[30] This level of detail enables investors to evaluate better whether the repurchases are driven by factors other than enhancing shareholder value.[31]
2) *Immaterial disclosures about plan information*: Some argue that disclosing whether repurchases are conducted under an existing plan (Rule 10b5-(c)(1) or Rule 10b-18) is immaterial information.[32]
3) *Duplication of insider trading reports*: Critics believe that the checkbox requirement for insider trading disclosures in buyback reports duplicates Forms 3, 4, and 5. The SEC counters that the checkbox simplifies the process for investors by highlighting suspicious behaviors without requiring separate searches for information in insider trading reports.[33]
4) *Limited value of rationale disclosures*: Some argue that disclosing the rationale for buybacks provides little useful information and reveals sensitive company data.[34] The SEC clarifies that the new disclosures require reasonable detail without exposing overly sensitive information.[35]
5) *Ineffectiveness in deterring manipulation*: Critics question whether the disclosures will deter market manipulation through stock buybacks.[36]
6) *Unintended effect of banning insider trading*: Some argue that requiring companies to disclose insider trading policies could inadvertently ban such practices if the company lacks such policies, as it may signal that these policies are mandatory. The SEC clarifies that the disclosures are intended to provide information, not mandate specific policies.[37]

III. Can Enhanced Transparency Empower Investors to Hold Management Accountable?

While the SEC extols the virtue of more granular repurchase disclosures in helping investors discern potentially deceptive motives, the Commission has yet to elucidate how this information empowers investors in legal actions against management. Investors suspecting management of illicit motives behind repurchases - such as price distortion through open-market trading - can explore two legal venues: (1) A state law claim for breach of fiduciary duty, claiming that repurchases constituted corporate waste because capital was deployed to serve management's personal interests at the expense of corporate growth opportunities. (2) Federal securities law

[29] Letter from Davis Polk & Wardwell LLP to Vanessa A. Countryman, Sec'y, SEC (Mar. 28, 2022), https://www.sec.gov/comments/s7-21-21/s72121-20121498-273485.pdf.
[30] *See* SEC's Adopting Release, supra note 2, at 82.
[31] *Id*. at 52.
[32] *See* Letter from Comm. on Sec. L. of the Bus. L. Section of the Md. State Bar Ass'n to Vanessa A. Countryman, Sec'y, SEC (Apr. 5, 2022), https://www.sec.gov/comments/s7-21-21/s72121-20122520-278557.pdf.
[33] *Supra* note 30
[34] *See supra* note 4; *see also* SEC's Adopting Release, *supra* note 2, at 79.
[35] *Supra* note 2, at 79.
[36] *See* Letter from Jennifer J. Schulp, Dir. of Fin. Regul. Stud., Cato Inst., to Vanessa A. Countryman, Sec'y, SEC (Apr. 1, 2022), https://www.sec.gov/comments/s7-21-21/s72121-20122356-278388.pdf.
[37] *Supra* note 2, at 81.

claims under Section 10b-5 of the Securities Exchange Act of 1934 and the corresponding SEC rule, Rule 10b-5.[38]

1. Fiduciary Breach Claims under State Law

(1) *Utility for Pleading Demand Futility*

Directors and officers owe a fiduciary duty to the corporation, not directly to individual shareholders. Therefore, claims for breach of fiduciary duty are derivative, meaning shareholders sue on behalf of the corporation to remedy wrongs done to it. While directors should typically bring such lawsuits, shareholders can bypass the board and sue directly if they can prove it is futile to demand the board act.

The futility exception applies when a conflict of interest exists, or the board's decisions likely wouldn't survive the court's "business judgment rule" scrutiny. Shareholders must plead *specific facts* showing that the majority of directors (i) personally benefitted materially from the alleged misconduct, (ii) face a high likelihood of liability from the shareholders' claims, or (iii) lack independence from someone who benefitted or faces liability. [39] "A prolix complaint larded with conclusory languages does not comply with these fundamental pleading mandates"[40]

The SEC's new disclosures reveal daily buyback volumes and average prices, allowing shareholders to pinpoint substantial buybacks and compare them to reported insider trading activities. This facilitates the identification of management members who traded shortly after large buybacks and determines if they form a majority of the board. By knowing the exact dates, volumes, and prices of buybacks, shareholders can assess the price effects and quantify the benefits insiders gain from selling their holdings. Similarly, the new rules allow shareholders to establish the temporal proximity of buyback activities to the setting of executive compensations, if those dates are known to shareholders, and build a case of personal gains.

The new rules also require companies to disclose whether repurchases complied with Rule 10b-18's safe harbor against market manipulation. This aids shareholders in identifying and focusing on trades outside the safe harbor when analyzing price effects.

Without such granular disclosures, shareholders would be limited to monthly aggregate buyback data, hindering their ability to isolate specific trades or establish a plausible story of board members' self-interest and potential liability.

(2) *Evidentiary Hurdles for Pleading a Substantive Claim of Corporate Waste*

To plead a case of corporate waste under the law of Delaware, where most U.S. public companies are incorporated, the complaint must allege particularized facts that overcome the general presumption of good faith. That requires sufficient facts demonstrating the board's decision was so egregious or irrational that it could not have been based on a valid assessment of

[38] 17 C.F.R. § 240.10b-5.
[39] United Food & Com. Workers Union & Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg, 262 A.3d 1034, 1059 (Del. 2021).
[40] *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 121 (Del. Ch. 2009).

the corporation's best interests. [41] As the court has noted, "[the test to show corporate waste is difficult for any plaintiff to meet." [42]

A search for case law on the pleading requirements for a corporate waste claim arising from management's authorization of stock buybacks for illicit motives yielded no results. Such a claim would likely require showing that the corporation could not have benefitted from the buybacks and that no one of sound mind could have authorized them, except for self-interest. This is a tall order, as it requires shareholders to know the board's deliberations, alternative investment opportunities, and the board's reasons for preferring buybacks. In most cases, shareholders, excluded from managerial roles, must access corporate records to obtain this information.

And yet corporate records may be inaccessible. Delaware requires shareholders to demonstrate a credible basis for suspecting managerial wrongdoing before accessing corporate records for investigative purposes. Mere curiosity, suspicion, under-performance relative to peers, disagreements with management, or a generic statement about investigating possible mismanagement, without more, fails the credible basis standard.

In *Seinfeld v. Verizon Communications, Inc.*,[43] the plaintiff sought to inspect the company's records related to executive compensation from 2000-2002, alleging that the board of directors committed waste by paying excessive amounts - $205 million to the top three executives - while the company's performance was poor. The plaintiff acknowledged that he had no direct evidence of mismanagement or overpayment. The Delaware Supreme Court affirmed the lower court's ruling that the plaintiff failed to establish a credible basis for inspection, as his claims were based only on suspicion and lacked corroborating evidence.

The SEC's new buyback disclosures, while more informative than the current rules, may only equip investors with a suspicion that management timed repurchases around upcoming earnings announcements, executive compensations, or insider trading. This, unfortunately, falls short of the "credible basis" standard needed for record inspection under Delaware law. Unless Delaware lowers this standard to rational belief, as some research has urged,[44] the SEC's new disclosures are unlikely to significantly advance shareholders' ability to pursue claims of corporate waste alone. However, as shown later in this article, the new rules could help the plaintiff survive a motion to dismiss in federal securities law claims arising from share buybacks, opening the door to record inspections indirectly.

2. Federal Securities Law Claims

Section 10(b) of the Securities Exchange Act and corresponding Rule 10b-5 make it unlawful to employ any scheme, device, or artifice to defraud, make any material misrepresentation or misleading omission, or engage in any act that defrauds or deceives any person in connection with the purchase or sale of securities. [45] When open-market stock buybacks are used to serve management's undisclosed personal interests, causes of action potentially arise for (1)

[41] White v. Panic, 783 A.2d 543, 554 (Del. 2001)
[42] *Supra* note 40 at 136.
[43] Seinfeld v. Verizon Commc'ns, Inc., 909 A.2d 117 (Del. 2006).
[44] *See* Lynn Bai, *Shareholder Inspection Rights: From Credible Basis to Rational Belief*, 10 Emory Corp. Governance & Accountability Rev. 193 (2023).
[45] 15 U.S.C. § 78j(b) (2018), and 17 C.F.R. § 240.10b-5 (2023).

misrepresentations about management's true motives and/or the stock's true value by falsely stating it is undervalued, (3) illegal insider trading, and (4) open-market manipulation.

(1) *Misrepresentation of True Purposes and/or Stock Value*

A New Avenue of Claim

The SEC's new disclosure rules mandate that companies disclose the rationales behind buyback decisions, providing investors a fresh avenue for making a Rule 10b-5(b) claim. This rule prohibits making false statements or omissions of material facts in connection with the purchase or sale of securities.[46] Currently, companies are not liable for omitting true motives in public announcements about stock buybacks.

In *IBEW Local 595 Pension and Money Purchase Pension Plans v. ADT Corporation*,[47] shareholders alleged that the company violated Rule 10b-5 by concealing its true motives for a stock repurchase program. The company's press release made a generic statement about its motives, such as returning value to shareholders and using the shares for future acquisitions. However, it omitted the fact that the controlling shareholder threatened to replace the board unless they approved the debt-financed buybacks. The repurchase caused the company's credit rating to deteriorate and its stock price plummet. The Eighth Circuit Court of Appeals upheld the lower court's dismissal of the claim, citing the company's truthful disclosure of transaction details – scope, time, mechanics, etc. – and the lack of obligation to reveal underlying motives.[48]

Similarly, in *Alabama Farm Bureau Mut. Cas. Co., Inc. v. American Fidelity Life Ins. Co.*,[49] a shareholder accused management of violating Rule 10b-5 by concealing the true purpose of an open-market buyback program: inflating the stock price to thwart potential acquisitions and maintain control. The company's proxy materials presented the repurchase as a standard financial strategy. The Fifth Circuit held that Rule 10b-5 was not intended "to require, under normal circumstances, the disclosure of an individual's motives or subjective beliefs, or his deductions reached from public available information."[50]

The SEC's new rules would have established a duty for companies to disclose the true motives for stock repurchases, creating a new cause of action under Rule 10b-5. However, as discussed immediately below, challenges remain in pleading such a cause.

A Challenging Pleading Standard

Securities fraud cases are subject to heightened pleading standards as specified by Rule 9(b) of the Federal Rules of Civil Procedure[51] and the Private Securities Litigation Reform Act (PSLRA).[52] Rule 9(b) provides that "[i]n alleging fraud ... a party must state with particularity the circumstances constituting fraud." The PSLRA requires that securities fraud complaints alleging

[46] 17 C.F.R. § 240.10b-5(b) (2023).
[47] 660 F. App'x 850 (8th Cir. 2016).
[48] *Id*. at 856.
[49] 606 F.2d 602 (5th Cir. 1979).
[50] *Id*. at 610.
[51] Fed. R. Civ. P. 9(b).
[52] Pub. L. No. 104-67, 109 Stat. 737 (1995).

misrepresentations "specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed."[53] Furthermore, PSLRA requires that the complaints state with particularity facts giving rise to a strong inference of scienter.[54] The Supreme Court has interpreted "strong inference of scienter" to mean "more than merely plausible or reasonable--it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent."[55]

However, investors pleading a Rule 10b-5 claim against management for misrepresenting stock repurchase motives often lack direct or strong circumstantial evidence. After all, share repurchases can be motivated by sound financial strategies. Share buybacks can be particularly attractive due to their potential tax advantages compared to traditional dividend distributions. Additionally, management teams with a sincere conviction that their stock price is undervalued may initiate buybacks to signal confidence and close the perceived gap between market valuation and intrinsic worth.

Public pronouncements regarding share repurchase programs often lack specificity, resorting to generic statements that offer minimal insight into the true rationale behind the management's decision. For example, in the press release of Nextdoor dated June 1, 2022,[56] the company stated:

> "We are committed to strategically deploying capital to drive long-term value for stockholders. We believe that the current macroeconomic environment, combined with the strength of our balance sheet, presents an attractive buying opportunity for our stock. This plan is a reflection of the confidence we have in our market opportunity and our strategy to invest for long-term growth, which we believe is not reflected in the current market valuation, while creating sustainable value for our stockholders, employees and neighbors."

This boilerplate statement does not allow investors to discern the true motives for the buybacks or understand why management believes the company's growth potential is "not reflected in the current market valuation." By mandating disclosures of daily repurchase activities, the SEC intended for investors to cross-reference the dates of buybacks to insider trading disclosures, earnings announcements, and dates for setting executive compensations (if the information is available), thereby identifying suspicious patterns. However, the temporal proximity merely hints at a motive to commit fraud. Courts have consistently held that a mere allegation of motive and opportunity to commit fraud, insider trading, or the privity to the true information due to managerial positions cannot satisfy the PSLRA's heightened pleading standard for scienter.[57]

---

[53] 15 U.S.C. § 78u-4(b)(1) (2018).
[54] 15 U.S.C. § 78u-4(b)(2) (2018).
[55] Tellabs Inc. v. Makor Issues & Rights Ltd., 551 U.S. 308, 314 (2007).
[56] Nextdoor Holdings, Inc., *Nextdoor Announces Share Repurchase Program* (June 1, 2022), https://about.nextdoor.com/press-releases/nextdoor-announces-share-repurchase-program/.
[57] *In re* Biogen Inc. Sec. Litig., 193 F. Supp. 3d 5 (D. Mass. 2016), Mississippi Pub. Emps. Ret. Sys. II, 649 F.3d 5, 29 (1st Cir. 2011), In re Cabletron Sys., 311 F.3d 11, 39 (1st Cir. 2002), and Orton v. Parametric Technology Corp., 344 F. Supp. 2d 290 (D. Mass. 2004). *See also In re* Boston Tech., Inc. Sec. Litig., 8 F. Supp. 2d 43, 59 (D. Mass.

Public reports filed by companies offer little insight. For example, a claim that management used buybacks to inflate stock prices to influence executive compensations requires demonstrating how compensation is affected by stock price fluctuations. This necessitates a thorough understanding of how stock price is factored into the compensation algorithm. While companies are obligated to disclose the general principles governing executive compensation in their proxy statements, they are not required to divulge intricate details of the mechanism.

Apple Inc.'s disclosure about its CEO Timothy Cook's compensation sheds light on this point. In the company's 2024 Proxy Statement, the Compensation Committee touted Mr. Cook's numerous achievements as factors considered in the compensation decision. Those achievements included, among others, "over the past three years, Apple's total shareholder return is more than 55% — nearly 20% above the S&P 500."[58] In discussing "Guiding Compensation Principles," the document states, "[t]he vast majority of our executive pay is tied to performance to ensure alignment with the long-term interests of shareholders. We establish clear, quantitative financial goals and values-driven performance expectations for our named executive officers each year that focus on Apple's overall success…"[59]

These statements imply that Apple's stock performance significantly impacts Timothy Cook's compensation**.** However, the precise mechanism by which stock market performance influences his paycheck remains conspicuously absent from the extensive discussions. Furthermore, the specific dates when the Compensation Committee determines his compensation are not disclosed to the public, although such information is likely known to Timothy Cook, a corporate insider familiar with the Committee's historical practices.

Courts have stated that compelling evidence of scienter most often includes "clear allegations of admissions, internal records or witnessed discussions that suggest that defendants were aware that they were withholding vital information or at least were warned by others that this was so when they made the misleading statements."[60] However, eyewitnesses who were privity to the inner circle of decision and are willing to testify are hard to come by. Moreover, as discussed earlier in this article, corporate records are inaccessible to investors with mere suspicions.

PSLRA's Exemption for Forward-Looking Statements

If the complaint is premised on management's misrepresentation of the stock's undervaluation relative to the company's intrinsic worth and potential, the plaintiff faces an additional pleading hurdle due to PSLRA's exemption for forward-looking statements. The exemption exonerates expressions of optimism from Rule 10b-5 liabilities if (1) they are identified as a forward-looking statement and are accompanied by cautionary statements identifying important factors that could cause actual results to differ from those expressed in the forward-looking statement, or (2) the plaintiff fails to prove that the defendants made the forward-looking statement knowing they were

1998) (rejecting the plaintiff's claim that the defendant's sale of over 300,000 shares during the class period was sufficient for pleading scienter).

[58] Apple Inc., Proxy Statement 45 (Jan. 8, 2024), https://www.sec.gov/ix?doc=/Archives/edgar/data/320193/000130817924000010/laapl2024_def14a.htm.

[59] *Id*. at 48.

[60] *In re* Biogen Inc. Sec. Litig., 193 F. Supp. 3d 5, 44 (D. Mass. 2016).

deceptive.[61] Most courts believe the second prong scienter is irrelevant if the first prong is satisfied by adequate cautionary language.[62]

If drafted by well-trained legal counsels, stock buyback announcements are almost always accompanied by disclaimers seeking to benefit from PSLRA's exemption, as is demonstrated by Nextdoor's press release about its June 2022 stock buyback program:[63]

> "This press release contains forward-looking statements, including but not limited to, statements regarding Nextdoor's share repurchase program. … Forward-looking statements give our current expectations and projections relating to our share repurchase program; financial condition; plans; objectives; growth opportunities; assumptions; risks; future performance; business; and results of operations. Neither we nor any other person assumes responsibility for the accuracy and completeness of any of these forward-looking statements…."

In sum, while the SEC's new disclosures would have bolstered investors' ability to discern suspicious trades and opened a new avenue for investors to pursue Rule 10b-5(b) claims against management for misrepresenting their true motives, the additional information alone is still inadequate to meet the stringent pleading standards for securities misrepresentation claims. Nonetheless, as detailed below, the new regulation would greatly enhance investors' survival of a motion to dismiss in other federal securities law claims, such as insider trading and open-market manipulation. This leads to the discovery phase of litigation, where further evidence could emerge to support a securities misrepresentation case that might otherwise struggle to stand on its own.

(2) *Unlawful Insider Trading*

Corporate insiders who sell their own holdings while knowing material nonpublic information about the company, such as an artificially inflated price due to the company's buyback activities, are liable for insider trading violations against Rule 10b-5. Again, insider trading liability requires scienter, which refers to the trader's knowledge and intent when trading based on material non-public information.[64]

In *In re Countrywide Fin. Corp. Derivative Litig*, shareholders brought a derivative lawsuit against the company's former executives for insider trading violations. They claimed the executives authorized stock repurchase programs to mislead investors into believing the company's stock was undervalued while simultaneously selling their own holdings, knowing the prices were inflated.[65]

Since the company was required to report only monthly aggregate buyback data, the plaintiff had difficulty linking insider trades to the timing of specific repurchases. The court noted that the

---

[61] 15 U.S.C. §§ 78u-5(c)(1), 77z-2(c)(1) (2018).
[62] Ann Morales Olazábal, *False Forward-Looking Statements and the PSLRA's Safe Harbor*, 86 IND. L.J. 595, 602–03 (2011).
[63] *Supra* note 56.
[64] SEC v. Johnson, 174 F. App'x 111, 115 (3d Cir. 2006).
[65] 554 F. Supp. 2d 1044, 1055 (C.D. Cal. 2008).

plaintiff failed to pinpoint which repurchases could have distorted the price, allowing insiders to capitalize on subsequent selling. [66]

While the court eventually allowed the complaint to survive a motion to dismiss, it highlighted the utility of more granular repurchase data in linking repurchases and insider trades. The SEC's new rules mandating the disclosure of daily repurchase activities and average prices paid would have achieved precisely this.

Furthermore, the SEC's new rules would require companies to disclose policies on insider trading during stock buybacks. In conjunction with daily data, this information would empower investors to monitor executive compliance with the company's policies. For instance, if the company's policies prohibit insiders from trading during and within a specified period after buybacks, identifying the dates of repurchases and insider trading would reveal whether insiders adhered to those guidelines.

(3) *Open-Market Manipulation*

Rule 10b-5(a) and (c) make it illegal for anyone to engage in manipulative or deceptive conduct in connection with buying or selling securities. Liabilities under these rules are often referred to as scheme liability. The scheme can be implemented by disseminating material misrepresentations or through large quantities of trading alone, both with the sole intent to inflate stock prices. The trade-based violation can be established even if the defendant did not make any misrepresentation or use deceptive schemes such as wash trades. [67]

To survive a motion to dismiss for trade-based violations, courts require the plaintiff to show that the defendant's trading was solely motivated by manipulation, that it had dominant market power, and that manipulation was successful at moving the prices. A sustained market dominance makes a manipulation case stronger. [68]

Courts have allowed cases to survive dismissal or even summary judgment when the plaintiff demonstrates manipulative intent through a combination of motive, timing, trade volume, prices, and irregularities of the trades.

In *SEC v. Masri*,[69] the SEC accused the defendant of manipulating a stock's closing price by placing consecutive buy orders in large quantities. The quantities of the defendant's trades exceeded by a substantial degree the average daily volume of shares traded over the preceding thirty trading days.[70] The SEC alleged that the defendant had the motive to push the stock price above $5 to avoid triggering his payment obligations under a put option. The defendant offered economic reasons for his activities and claimed financial capability to meet his obligations.

Interestingly, despite finding the SEC's evidence of manipulative intent weak, the court believed that the SEC had sufficiently raised an issue of material fact by identifying the timing, size, incremental execution of the transactions, and the unconventional nature of the orders. The

[66] *Id*. at 1067–68.
[67] Markowski v. SEC, 274 F.3d 525 (D.C. Cir. 2001).
[68] Nanopierce Techs., Inc. v. Southridge Cap. Mgmt. LLC, No. 02 Civ. 0767(LBS), 2002 WL 31819207 (S.D.N.Y. Oct. 10, 2002), United States v. Mulheren, 938 F.2d 364 (2d Cir. 1991).
[69] SEC v. Masri, 523 F. Supp. 2d 361 (S.D.N.Y. 2007).
[70] *Id*. at 365.

court held that whether these factors establish the requisite intent for Rule 10b-5(a) violation is a factual question for the jury to decide.[71]

Similarly, in *Alabama*,[72] while the court dismissed the misrepresentation claim about the company's stock buyback motives, it allowed the manipulation claim to proceed. The court cited the timing of the buybacks, the steady buying irrespective of prices, and the company's financial tolls as raising a genuine issue of the defendants' manipulative intent.[73]

The above precedents demonstrate the utility of enhanced transparency surrounding stock repurchases. The daily repurchase volumes allow investors to assess market impact relative to the independent order flow. Analyzing the temporal proximity to earnings announcements, insider trades, and price-sensitive transactions can suggest manipulative motives. While critics dismissed the value of disclosing information about Rule 10b-18 and 10b5-1 plans, these disclosures could identify repurchase irregularities and strengthen claims of open-market manipulation. These disclosures also enable investors to focus attention on trades that fall outside regulatory safe harbors.

While the SEC's new disclosures may not definitively establish manipulative intent at trial for market manipulation claims, they appear sufficient to overcome at least a motion to dismiss, paving the way for discovery. Discovery offers investors an opportunity to unearth further evidence of managerial misconduct, potentially bolstering claims of securities fraud under Rule 10b-5(b) and breaches of fiduciary duty under state law.

IV. CONCLUSION

Contrary to critics' arguments, the SEC's new transparency rules regarding open-market stock repurchases can indeed yield tangible benefits for investors. These regulations would create a new avenue for legal recourse by requiring disclosures of buyback motives. The mandated disclosures of daily repurchase activity, insider trade information, and safe harbor plan details would enhance the ability to detect potentially suspicious transactions. They also enable investors to meet the pleading requirements for insider trading and market manipulation claims, thus paving the way to discovery. Discovery would, in turn, grant investors access to otherwise inaccessible corporate records, providing the necessary information to support claims of misrepresentation and fiduciary breach. Furthermore, these disclosures would enable investors to monitor compliance with companies' insider trading policies.

These factors warrant careful consideration in the SEC's cost-benefit analysis when deciding whether to re-propose the regulation, given its potential to profoundly impact investor protection and market integrity.

[71] *Id*. at 375.
[72] *Supra* note 49.
[73] *Id*. at 616.