

FIFTH CIRCUIT SENDS SEC BACK TO COST-BENEFIT DRAWING BOARD TO SUBSTANTIATE ITS NEW STOCK REPURCHASE DISCLOSURE RULES WITHIN 30 DAYS

Nov 02, 2023

WHAT HAPPENED

On October 31, 2023, the Fifth Circuit ruled in *Chamber of Commerce v. SEC* that the SEC acted arbitrarily and capricious, in violation of the Administrative Procedure Act, when it adopted the new share repurchase disclosure rules in May. The court concluded the SEC:

- Failed to respond to the Chamber's suggestions for quantifying costs and benefits.
- Failed to substantiate its view that improperly motivated buybacks are a genuine problem or that disclosure of recent repurchases and prices would result in “relatively modest [costs] for most issuers.”

The court remanded the matter to the SEC with direction to correct the deficiencies within 30 days. Accordingly, it remains uncertain whether the SEC will satisfy the court or either party will decide to appeal the final decision.

TAKEAWAYS

Subject to the outcome of the lawsuit, the compliance date for the new rules is around the corner:

- Companies – other than foreign private issuers (FPIs) and closed end funds – are required to comply in Forms 10-Q and 10-K beginning with the first filing that covers the first full fiscal quarter that begins on or after October 1, 2023.
- FPIs that file on FPI forms must comply in new Form F-SR beginning with the Form F-SR that covers the first full fiscal quarter that begins on or after April 1, 2024. The related Form 20-F narrative disclosure is required starting in the first Form 20-F filed after the FPI’s first Form F-SR has been filed.

Although the final resolution is uncertain, companies would be well served by continuing to prepare for the new disclosures to allow for adequate lead time, as discussed in our [May 4, 2023 post](#), in case the rule is upheld.

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The court considered three arguments from the Chamber of Commerce:

- That requiring companies to disclose the rationale for repurchases (the rationale-disclosure requirement) violates the First Amendment by impermissibly compelling their speech.
- That the SEC acted arbitrarily and capriciously in adopting the rule by not considering their comments or conducting a proper cost benefit analysis.
- That the SEC did not provide the public with a meaningful opportunity to comment.

No violation of First Amendment. The court rejected the first argument because:

- The rationale-disclosure requirement only applies to “purely factual and uncontroversial information,” which is considered commercial speech and therefore subject to a lower level of scrutiny.
- The rationale-disclosure requirement satisfies the First Amendment because (1) the rule is justified, (2) is reasonably related to a legitimate state interest, and (3) does not burden protected speech:

“The SEC adopted the requirement because of a supposed asymmetry in information surrounding the reasons issuers repurchase their shares. The SEC cited empirical evidence demonstrating that issuers could have many different reasons for repurchasing shares. Some, such as increasing the value of the shares, are beneficial to investors. Others, such as a desire to achieve accounting metrics or impact executive compensation, could make purchasers less inclined to invest. The stated purpose of the rationale-disclosure requirement is to allow investors to separate out and assess the different motivations behind, and impacts of, share repurchases. In the SEC’s view, when investors know why a company is repurchasing its shares, they can better evaluate whether a share repurchase was intended to increase the value of the issuer or, instead, represented an inefficient deployment of capital. . . . [T]he rationale-disclosure requirement neither burdens issuers’ protected speech nor drowns out their message. The issuer is free to speak (or not) however and whenever it wishes apart from a privately crafted explanation of its reasons for repurchasing shares.”

Meaningful opportunity to comment. The court rejected the third argument because:

- The APA generally requires only a minimum 30-day comment period.

- The public need only have an opportunity to participate meaningfully in the rulemaking process, not “to comment on every bit of information influencing an agency’s decision.”
- The initial 30-day comment period was not so short as to deprive the public of a meaningful opportunity to comment.

Arbitrary and capricious decision. The court agreed that the SEC’s approval violated the APA because:

- The SEC failed to address the Chamber’s comments about the rules’ economic implications.
- The SEC conducted a qualitative assessment because it believed many economic effects could not be quantified, but invited commenters to provide data that could help with quantification.
- The petitioners submitted three suggestions explaining how the SEC could quantify expected costs and benefits, including by pointing to academic data sets and studies. The SEC admitted it never considered the suggestions.
- The SEC never substantiated the proposition that improperly motivated buybacks are a genuine problem, taking into account factors such as likelihood and severity. In addition, the SEC took the illogical position that requiring valuable information about recent repurchases and prices would result in “relatively modest [costs] for most issuers” –while at the same maintaining that issuers currently fail to disclose that information because of “the potential costs of leaking valuable private information to competitors.” Further, it otherwise failed to demonstrate that it considered relevant factors supporting its view that such costs would be “relatively modest.”

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