WINSTON & STRAWN LLP

BLOG

Fifth Circuit Directs SEC to Correct Defects in Share Repurchase Disclosure Rules

NOVEMBER 8, 2023

OVERVIEW

On October 31, 2023, the Fifth Circuit Court of Appeals held that the Securities and Exchange Commission (SEC) acted arbitrarily and capriciously, in violation of the Administrative Procedures Act (APA), when it failed to respond to petitioners' comments and failed to conduct a proper cost-benefit analysis in connection with the adoption of rules requiring issuers to disclose share repurchase activity and the reasoning as to why the issuer repurchased its own shares.

So far, the court has not vacated the rule entirely; rather, it remanded the matter, directing the SEC to correct the defects in the rule within 30 days of the remand. The court retains jurisdiction to review the SEC's actions on remand.

BACKGROUND

In May 2023, the SEC adopted final rules amending the disclosure requirements with respect to repurchases of equity securities to require issuers to disclose daily repurchase activity on a quarterly basis for domestic U.S. issuers and foreign private issuers and on a semi-annual basis for registered closed-end management investment companies that are exchange traded (Listed Closed-End Funds). The rules also require issuers to disclose the reasoning as to why the issuer repurchased its own shares (for a discussion of the amended disclosure rules, please see our Winston blog **here**).

Subsequently, the U.S. Chamber of Commerce, the Texas Association of Business and the Longview Chamber of Commerce (Petitioners) filed a lawsuit in the Fifth Circuit challenging the SEC's share repurchase disclosure rules on the grounds that: (1) the rationale-disclosure requirement violated the First Amendment by impermissibly compelling their speech; (2) the SEC acted arbitrarily and capriciously in adopting the final rules by not considering Petitioners' comments or conducting a proper cost-benefit analysis; and (3) the SEC did not provide the public with a meaningful opportunity to comment.

THE COURT'S DECISION

The court agreed with the Petitioners' claim that the SEC acted arbitrarily and capriciously in adopting the final rules by not considering their comments or conducting a proper cost-benefit analysis. The court rejected the Petitioners' First Amendment claim with respect to the rationale-disclosure requirement and their claim that there was no meaningful public opportunity to comment on the new rules.

In adopting the new rules, the SEC stated that many of the economic effects of the rules cannot be easily quantified and encouraged commenters to provide data and information that would assist in quantifying the benefits, costs, and potential impacts of the proposed amendments on efficiency, competition, and capital formation. In their comments, the Petitioners provided three suggestions for obtaining relevant data that the SEC could use to quantify the effects of share repurchases, which the SEC admitted it had not considered.

The court found that each of the Petitioners' suggestions would have facilitated the quantification of the rules' expected costs and benefits, which the SEC initially claimed were unquantifiable. Accordingly, the SEC, by continuing to insist that the rules' economic effects were unquantifiable in spite of the Petitioners' contrary suggestions, failed to demonstrate that its conclusion that the share repurchase disclosure rules promote efficiency, competition, and capital formation is the product of reasoned decision-making.

The court held that the SEC did in fact act arbitrarily and capriciously, in violation of the APA, when it failed to respond to Petitioners' comments and failed to conduct a proper cost-benefit analysis.

IMPLICATIONS

Notably, the court did not vacate the SEC's share repurchase disclosure rules and has given the SEC 30 days to revise the defects in its rules and substantiate its decision to adopt them. It is likely that the SEC will ask for an extension of the deadline to comply. Given that the court's decision focused on the lack of a cost-benefit analysis and rejected the First Amendment argument, there is a strong possibility that the SEC will be able to correct the defects to the court's satisfaction and the rules will go into effect substantially in their current form. However, if the SEC is unable to satisfy the court that the defects have been corrected, the court may vacate the rules in their entirety. It is expected that the SEC would appeal any decision to vacate the rules in their entirety.

Under the current timetable set forth in the SEC's rules, the earliest group that would be required to comply with the new rules would be U.S. domestic filers, which would be required to comply beginning with the first Form 10-Q or 10-K (for the fourth fiscal quarter) that covers the first full fiscal quarter that begins on or after October 1, 2023 (for calendar fiscal year companies, this would be the Form 10-K for the year ending December 31, 2023 (covering the fourth quarter of 2023)).

Accordingly, given the uncertainty of the outcome of the SEC's efforts to correct the defects noted by the court, all issuers should continue to take steps to prepare for compliance with the share repurchase disclosure rules.

Winston & Strawn's Capital Markets & Securities Law Watch and lawyers advising our public company clients will continue to monitor developments with the case and will provide updates to our readers as they become available.

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