May 12, 2015

Division of Corporation Finance
Attn: Elizabeth Murphy, Associate Director
U. S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-0213

RE: SEC Disclosure Effectiveness Project – Comments on Adequacy of Disclosure of Potential Benefits and Drawbacks of "Stock Buybacks"

Dear Ms. Murphy:

We understand that your office is still receiving information and public comments on its "Disclosure Effectiveness Project." As you may recall, we previously submitted to your office three reports setting forth our findings, conclusions and recommendations regarding this project. The last of these three reports (titled "SEC Disclosure Effectiveness Project - Comments on Proxy Disclosure Requirements") was submitted under cover of a letter addressed to you and dated March 16, 2015.

Since then, we have become increasingly concerned with the adequacy of disclosure in SEC filings regarding the growing practice of stock buybacks by public companies. Accordingly, we decided to prepare and submit for your consideration a fourth report (titled "Comments on Adequacy of Disclosure of Potential Benefits and Drawbacks of 'Stock Buybacks' ") (copy enclosed) because we believe that this issue falls within the scope of your office's ongoing Disclosure Effectiveness Project.

We have now submitted a total of four reports regarding this matter. We would appreciate any feedback (written or otherwise) your staff may have regarding the findings, conclusions and recommendations set forth in our reports. If you have any questions, please contact Bill Klein [(303) 759-4413] or Tom Amy [(303) 722-0079].

Thank you for taking the time to review and consider our comments.

Respectfully submitted,

William J. Klein

William J. Klein, Esq.

Thomas J. Amy, Esq.

Encl: As stated

Comments on Adequacy of Disclosure of Potential Benefits and Drawbacks of "Stock Buybacks"

I. Background and Discussion

As is well known, it is not uncommon for an issuer of stock to repurchase (or "buyback") shares of its own stock from its shareholders. In fact, of late, this practice has blossomed to the benefit of shareholders. For example, according to one commentator, in the 1960's and 1970's about 40 cents of every dollar borrowed or retained in net earnings was reinvested in the company's business [e.g., in new facilities, research and development ("R&D"), and in new hires]. [1] However, since the 1980's, only about 10 cents (10%) of every dollar was reinvested in the company. It appears that money once reinvested in the company has instead gone into shareholders' pockets in the form of share repurchases.[2]

In fact, the dollars spent on stock buybacks have been staggering. For example, the companies in the S&P 500 Index ("S&P 500") bought back $550 billion worth of stock in 2014, up 16% from 2013.[3] Moreover, these repurchases appear to have an artificial effect on market prices. According to Levisohn, S&P 500 companies typically cease their repurchases of shares some five weeks before they issue earning reports; and don't resume these repurchases until several days after they issue their reports. This "sets the stage for major buyers to exit, and adds to weakness." For example, the S&P 500 fell 2.3% during the recent earnings season (e.g., the week of March 23, 2015).

Critics of share buybacks claim that this decline in reinvestment since the 1980's has reduced productivity growth and increased the amount of corporate borrowing (i.e., to finance stock buybacks).[4] The major shareholders in these companies appear to be the winners since they are enriched not only by regular dividends, but also by repurchases of their shares.

In our view, this recent shift in corporate priorities poses serious questions about the adequacy of disclosures made to investors about the use of cash flow to finance these repurchases. For example, investors primarily pursuing a growth

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[1] See, e.g., an article by Harold Meyerson (titled "YES: Firms Now Skimp on Vital Spending") in the March 2015 issue of the Washington Post.

[2] Ibid.

[3] See article by Ben Levisohn (titled "Benefitting from the Buyback Lull") in the March 30, 2015 issue of Barron's, at p.13.

[4] See article titled "The Repurchase Revolution" in the Economist magazine (dated September 13 – 19, 2014), at pp. 71 – 73.

objective should be wary of investing in companies whose policies stress rewarding shareholders in the short term (i.e., through dividends and buyback programs) at the expense of increased productivity and growth in the long term. Accordingly, companies with established buyback programs should make clear in their disclosure documents both the "Pros" and "Cons" of such programs from the standpoint of investors, as follows.

PROS

- **Reinvestment of surplus cash** is a higher priority for **manufacturing concerns** (that rely more on new facilities, R&D, new hires, etc., to remain competitive) than for the rising **digital, internet and services companies** which are "inherently less capital-hungry."[5] For example, the growing popularity of **online sales** means that retailers can create or increase surplus cash by (1) cutting back on spending for new stores; and (2) closing existing stores that are no longer needed.

- **Major investors** seem to fare the best since they receive both cash dividends and additional cash from sales of their shares back to the company.[6]

- **Company executives** also benefit because their compensation packages typically reward them for increasing earnings per share. Since the announcement of buyback programs often provide at least a temporary boost in market price (and earnings per share), executives stand to receive enhanced compensation from such price increases. In addition, an executive officer's compensation package sometimes provides for additional stock options if the market price of his or her company's stock rises to the "strike price" specified in their employment agreement.

- **Most well-managed companies** today strike a balance between rewarding shareholders, on the one hand, and sustained growth, on the other: first, they invest cash in any projects that promise positive returns; secondly, they continue to pay out a steadily growing dividend; and thirdly, they spend any remaining cash flow on buy backs of shares.[7]

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[5] See Economist, supra, at p. 73.

[6] In fact, buybacks have usurped dividends as the main way companies give money back to their shareholders, accounting for 60% of cash returns in 2013. See Economist magazine, supra, at p. 71.

- **Borrowing** funds (i.e., increasing net debt) to help finance share repurchases is reasonable because: (1) with interest rates currently at a record low, borrowing is cheap; and (2) since interest paid on debt is tax-deductible, a company can cut its tax bill.[8]

CONS

- **Critics** worry that the current boom in buybacks has become excessive (even reckless) and, if it goes on unabated, may damage the companies involved and the economy. Some critics even suggest that there could be a buyback "bubble."[9]

- **For mid to long-term investors**, the benefit of share buybacks may be illusory because surplus cash is not reinvested in the company, thereby diminishing opportunities for future productivity and growth (e.g., the primary investment objective for younger, long-term investors planning for retirement). In other words, skimping on reinvestment in new plant and equipment, R&D and new hires may reduce prospects for future productivity and growth. One recent study found that a doubling of buybacks leads to an 8% fall in spending on R&D.[10]

- **Fully 38%** of companies that repurchased shares in 2013 paid more to investors than their cash flow could afford. It seems likely that, for many of these companies, applying all their cash flow (plus borrowing additional funds) to finance share repurchases increases corporate indebtedness which, in turn, makes firms riskier.[11]

II. Conclusions and Recommendations

In their disclosure documents for investors, companies should give consideration to making enhanced disclosure of the above Pros and Cons of share

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[7] See Economist, supra, at p. 72

[8] See Economist, supra, at p. 72.

[9] See Economist, supra, at p. 71.

[10] See article titled "Tyranny of [the] Long Term" in the Economist magazine (dated November 22, 2014).

[11] See Economist, supra, at p. 72.

buyback programs, by addressing, among other things: (a) the time period specified for each program (e.g., up to three years); (b) the maximum number of shares authorized by the board to be repurchased over this time period; (c) the cash flow (and borrowing, if any) spent on buybacks/dividends compared to the cash flow (and borrowing, if any) spent on reinvestment during the reporting period; and (d) the impact of buyback programs on corporate indebtedness.

We also recommend that companies consider the use of "pie charts" and "bar charts" to enhance their disclosure of buyback programs. In this way, companies could disclose important and relevant information in a more "short hand" fashion. [12] For example, one filer included in its FY 2014 Form 10-K Annual Report a "pie chart" summarizing its "Capital Allocation Strategy" since 2012, as follows: $8.5 billion for "Share Repurchases;" $2.1 billion for "Dividends;" another $2.1 billion for "Internal Investments;" and $1.1 billion for "Acquisitions."[13] At a glance, the reader can readily ascertain that, between 2012 and 2014, ITW returned a total of $10.6 billion, the vast majority (76.8%) of its total capital outlays of $13.8 billion, to shareholders in the form of dividends and stock repurchases.

ITW also utilized a series of bar charts to reflect "Total Shareholder Returns" the company projected for the long term.[14] In this way, ITW was able to summarize its projected shareholder returns concisely without adding paragraphs and more pages to its 83-page Annual Report for 2014.

Finally, we recommend that companies consider using a similar pie chart to demonstrate the **sources of funds** to finance stock buybacks. For example, the pie chart could show: (1) the amount of retained earnings expended on repurchases during the reporting period; (2) the amount of surplus cash (if any) spent on such repurchases; (3) the amount borrowed (if any) to finance the repurchases; and (4) any other source (or sources of funds) used to finance stock repurchases. A reporting company also might want to combine the amounts in the above categories that were spent to finance both payment of dividends and stock repurchases to more accurately reflect the total return to shareholders during the reporting period.

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[12] Arguably, many disclosure documents filed with the Commission are too voluminous. We want to minimize the addition of more narrative by using charts or graphs to provide the necessary disclosure, to the extent possible.

[13] See Annual Report on Form 10-K filed by Illinois Tool Works ("ITW") for FY 2014, at p. 4.

[14] Ibid.