

April 21, 2021

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Petition for Rulemaking: Regulation S-K (17 C.F.R. § 229.402(d), instruction (7))

Dear Ms. Countryman:

I respectfully request that the U.S. Securities and Exchange Commission (the “Commission” or “the SEC”) amend Regulation S-K (17 C.F.R. § 229.402(d), Instruction 7, to better inform investors as to whether issuer repurchases trigger higher payments to senior executives under performance-based compensation schemes, such as by altering earnings per share calculations.

I respectfully suggest that the Commission not heed the advice of some critics who urge it to repeal Rule 10b-18, its safe harbor for stock buybacks. Repealing the SEC’s Issuer Repurchase Safe Harbor only will reintroduce legal uncertainty for issuers and will not address the critics’ concerns about pay disparities and other issues.

In accordance with the Commission’s instructions, I state that I am submitting these recommendations for the purpose of improving the law to enhance investor protection. I do not represent any client; these views are strictly my own. A version of the discussion below appeared in a publication of the American Bar Association.¹

Summary

Critics of Rule 10b-18 (17 CFR § 240.10b-18) believe it is bad for the country because they claim that:

- it furthers the income disparity between senior managers of public companies and the wages of average workers;
- senior executives may use buybacks to manipulate triggers for overly generous executive compensation payments; and

¹ Kaswell, [*Should Congress or the SEC ‘Do Something’ About Stock Buybacks?*](#) *Business Law Today*, American Bar Association, March 30, 2021, © Stuart J. Kaswell, Esq., used by permission. See footnote 1 of that article and acknowledgements therein.

- curtailing stock buybacks would cause public companies to spend more of their resources on better pay for workers or for investments in research and development.

Repealing Rule 10b-18 would not be wise policy for several reasons:

- Repealing Rule 10b-18 would reintroduce legal ambiguity that could harm issuers seeking to alter their capital structures for any reason.
- Discouraging repurchases would not cause issuers to redirect resources to higher compensation for workers or for research and development. Achieving those goals would require the federal government to dictate the specifics of corporate management to issuers.
- Eliminating the rule only would cause issuers to use different approaches that achieve some of the same goals, but at investors' expense. Instead of repurchases, issuers could return capital to their investors by declaring dividends, triggering ordinary income for investors.

The federal securities laws are not an effective means for achieving public policy goals beyond investor protection and fostering vibrant capital markets. Government requirements for salaries, capital structure, and investment are not consistent with a free-market economy. Such restrictions discourage companies from going public and encourage businesses to seek financing from private markets. Investors need information to inform their investment decisions, as articulated in *Basic v. Levenson*.² Disclosure provisions based on other factors neither help investors nor achieve other public policy objectives.

Instead, the SEC should augment its disclosure requirements to better inform investors as to whether issuer repurchases trigger higher payments to senior executives under performance-based compensation schemes, such as by altering earnings per share calculations

Introduction

Stock buybacks or issuer repurchases are now a political issue and may become the subject of intense political debate. In March 2020, former Vice President Joe Biden tweeted: “I am calling on every CEO in America to publicly commit now to not buying back their company's stock over the course of the next year. As workers face the physical and economic consequences of the coronavirus, our corporate leaders cannot cede responsibility for their employees.”³

The SEC adopted Rule 10b-18 in 1982 as a safe harbor to protect an issuer from the charge that it was manipulating the price of its stock if it repurchased its shares. The SEC has amended and interpreted Rule 10b-18 from time to time. What began as a technical rule that the SEC intended to address a legitimate problem, has attracted high level criticism and complaints. Why has such a technical rule engendered such controversy?

² *Basic Inc. et al v. Levinson et al*, 485 U.S. 224 (1988).

³ Biden [@JoeBiden]. Mar. 20, 2020. [[Tweet](#)]. Twitter.

History of the SEC's Safe Harbor

In 1982, the SEC adopted a non-exclusive “safe harbor” for issuers to repurchase their shares.⁴ The Commission said that it was creating the safe harbor:

from liability for manipulation in connection with purchases by an issuer and certain related persons of the issuer's common stock. The issuer or other person will not incur liability under the anti-manipulative provisions of Sections 9(a)(2) or 10(b) (and Rule 10b-5 thereunder) if purchases are effected in compliance with the limitations contained in the safe harbor.⁵

The question of whether, and under what circumstances, an issuer should buy its own shares has been around for decades. When it adopted Rule 10b-18, the SEC stated:

The Commission has considered on several occasions since 1967 the issue of whether to regulate an issuer's repurchases of its own securities. The predicates for this effort have been two fold: first, investors and particularly the issuer's shareholders should be able to rely on a market that is set by independent market forces and not influenced in any manipulative manner by the issuer or persons closely related to the issuer. Second, since the general language of the anti-manipulative provisions of the federal securities laws offers little guidance with respect to the scope of permissible issuer market behavior, certainty with respect to the potential liabilities for issuers engaged in repurchase programs has seemed desirable.

The SEC wanted to allow issuers to repurchase their shares for legitimate business reasons, without running the risk of facing allegations of market manipulation.

Twenty-one years later, the SEC adopted amendments to Rule 10b-18 which fine-tuned the rule, but did not revisit its original purpose. In its proposing release, the Commission explained:

Issuers repurchase their securities for many legitimate business reasons. For example, issuers may repurchase their stock in order to have shares available for dividend reinvestment, stock option and employee stock ownership plans, or to reduce the outstanding capital stock following the cash sale of operating divisions or subsidiaries. Issuers may believe that a repurchase program is preferable to paying dividends as a way of returning capital to shareholders. Issuer repurchases also provide liquidity in the marketplace, which benefits all shareholders.

⁴ Release No. 33-6434 (Nov. 17, 1982); 47 FR 53333 (Nov. 26, 1982) (footnote omitted). I refer to Section 9(a)(2) and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder as the “anti-manipulation” provisions, rather than repeating these citations below. Rule 10b-18 does not provide a safe harbor for other types of securities frauds, such as insider trading.

⁵ *Id.*

At the same time, an issuer has a strong interest in the market performance of its securities. Among other things, its securities may be the consideration in an acquisition, or serve as collateral for financing. The market price also determines the price of offerings of additional securities. Therefore, at various times, the issuer may have an incentive to manipulate the price of its securities. One way to positively affect the price is to purchase the securities in the open market. Because repurchases of its securities could affect the market price of an issuer's stock, this may expose the issuer to claims that the repurchases were made in a manipulative manner even when they were done in a manner not intended to move market prices.⁶

The 2003 Amendments modified the rule and added new disclosure provisions. Significantly, in its summary of comments, the Commission did not indicate that any commentator objected to the rule itself or asked the SEC to eliminate the rule. The commentators only raised technical issues, such as whether the revisions should eliminate a "block exception."⁷

Basic Outlines of the Rule

The SEC intended Rule 10b-18 to minimize the impact of the issuer's purchases on the market for the shares. Investors who buy or sell when the issuer is purchasing should not suffer or benefit from the fact that the issuer is in the market at the same time. Of course, every purchase or sale has some effect on a security's price; nonetheless, the SEC's goal was to reduce the impact of the issuer's purchases as much as possible so as not to upset ordinary market dynamics.

To achieve that goal and to qualify for the non-exclusive safe harbor, Rule 10b-18(b) provides that the issuer must meet four conditions:

1. The issuer must execute its trades through one broker-dealer;
2. The broker-dealer must not execute its trades at the opening or before the close of trading for that day;
3. The broker-dealer must execute trades at prices that do not exceed the highest independent bid or the last independent transaction price, whichever is higher; and
4. The total volume of purchases effected by or for the issuer and any affiliated purchasers effected on any single day must not exceed 25% of the average daily trading volume for that security.

Preliminary Note ¶2 of Rule 10b-18 states that "the safe harbor, moreover, is not available for repurchases that, although made in technical compliance with the section, are part of a plan or scheme to evade the federal securities laws." By the same token, subsection (d) also provides that:

No presumption shall arise that an issuer or an affiliated purchaser has violated the anti-manipulation provisions of sections 9(a)(2) or 10(b) of the [Exchange] Act or §240.10b-5 under the [Exchange] Act, if the Rule 10b-18 purchases of such issuer

⁶ Release 33-8160 (Dec. 10, 2002); 67 FR 77594 (Dec. 18, 2002) (footnote omitted).

⁷ Release 33-8335 (Nov. 10, 2003); 68 FR 64952 (Nov. 1, 2003) (2003 Adopting Release).

or affiliated purchaser do not meet the conditions specified in paragraph (b) or (c) of this section.⁸

As noted, the 2003 Amendments added new provisions requiring issuers to disclose specific time and volume information about their buy-back activities. The Commission added Item 703 to Regulation S-K requiring issuers to disclose for each month in which the issuer buys back its securities:

- Total number of shares (or units) purchased;
- Average price paid per share (or unit);
- Total number of shares (or units) purchased as part of publicly announced plans or programs; and
- Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs.

The SEC explained that issuers would need to make these disclosures for repurchases of Section 12 registered equity securities, whether the issuer purchased them in open market or private transactions. Item 703 requires the issuer to make these disclosures on:

- Form 10-Q – for its last fiscal quarter;
- Form 10-K – for the fourth quarter of its fiscal year.
- Form N-CSR (Item 8)– for registered closed-end funds for the semi-annual period.

This disclosure requirement is independent of the Rule 10b-18 safe harbor.⁹

Again, commentators supported the changes, and only disagreed with a specific provision that would have required the issuer to identify the broker-dealer effecting the trades. The SEC agreed with that objection, but otherwise adopted a detailed [tabular disclosure](#) requirement.¹⁰

These changes were in addition to other executive compensation disclosure requirements. Subsections of Item 402 of Regulation S-K (17 C.F.R. §229) require issuers to disclose compensation that the issuer pays to certain senior officers, including:

- (a)(6)(iii) – Definition of “Incentive Plan;”¹¹
- (c) – Summary compensation table;

⁸ The rule has many qualifications and the Division of Trading and Markets has issued numerous [FAQs](#) regarding the rule.

⁹ 2003 Adopting Release at 64962 (citation omitted). I also have deleted references to forms that the SEC subsequently abolished.

¹⁰ *Id.* at 64961-2.

¹¹ 17 CFR § 229.402(a)(6)(iii) provides, in part, that “the term incentive plan means any plan providing compensation intended to serve as incentive for performance to occur over a specified period, whether such performance is measured by reference to financial performance of the registrant or an affiliate, the registrant’s stock price, or any other performance measure.”

- (d) – Grants of plan-based awards;
- (e) -- Narrative disclosure to summary compensation table and grants of plan-based awards table.
- (f) – Outstanding equity awards at fiscal year-end table;
- (g) – Options exercises and stock vested table;
- (h) – Pension benefits;
- (i) – Nonqualified deferred compensation and other nonqualified deferred compensation plans; and
- (j) – Potential payments upon termination or change-in-control.

In summary, the SEC designed Rule 10b-18 to minimize the market impact of an issuer's repurchases conducted within its safe harbor. In addition, Items 703 and 402 of Regulation S-K require the issuer to disclose information about the buyback program and any related compensation that the issuer pays to senior executives that relate to the issuer's stock price.

Are Buybacks Good for Investors?

As noted, in recent years, many issuers have repurchased their shares. In his famous Annual Letter to Shareholders, Warren Buffet explains the benefits to shareholders of Berkshire Hathaway's share repurchases:

Last year we demonstrated our enthusiasm for Berkshire's spread of properties by repurchasing the equivalent of 80,998 "A" shares, spending \$24.7 billion in the process. That action increased your ownership in all of Berkshire's businesses by 5.2% without requiring you to so much as touch your wallet.

Following criteria Charlie [Munger] and I have long recommended, we made those purchases because we believed they would both enhance the intrinsic value per share for continuing shareholders and would leave Berkshire with more than ample funds for any opportunities or problems it might encounter.

In no way do we think that Berkshire shares should be repurchased at simply any price. I emphasize that point because American CEOs have an embarrassing record of devoting more company funds to repurchases when prices have risen than when they have tanked. Our approach is exactly the reverse.

Mr. Buffet then discusses Berkshire Hathaway's investment in Apple, which itself repurchased its shares:

Berkshire's investment in Apple vividly illustrates the power of repurchases. We began buying Apple stock late in 2016 and by early July 2018, owned slightly more than one billion Apple shares (split-adjusted). *** When we finished our purchases in mid-2018, Berkshire's general account owned 5.2% of Apple.

Our cost for that stake was \$36 billion. Since then, we have both enjoyed regular dividends, averaging about \$775 million annually, and have also – in 2020 – pocketed an additional \$11 billion by selling a small portion of our position.

Despite that sale – voila! – Berkshire now owns 5.4% of Apple. That increase was costless to us, coming about because Apple has continuously repurchased its shares, thereby substantially shrinking the number it now has outstanding.

But that’s far from all of the good news. Because we also repurchased Berkshire shares during the 2½ years, you now indirectly own a full 10% more of Apple’s assets and future earnings than you did in July 2018.

This agreeable dynamic continues. Berkshire has repurchased more shares since yearend and is likely to further reduce its share count in the future. Apple has publicly stated an intention to repurchase its shares as well. As these reductions occur, Berkshire shareholders will not only own a greater interest in our insurance group and in BNSF and BHE, but will also find their indirect ownership of Apple increasing as well.

The math of repurchases grinds away slowly, but can be powerful over time. The process offers a simple way for investors to own an ever-expanding portion of exceptional businesses.

And as a sultry Mae West assured us: “Too much of a good thing can be . . . wonderful.”¹²

Mr. Buffet notes that not every issuer repurchase is great for the issuer or its shareholders, but is too diplomatic to point to the repurchases with which he disagrees. The decisions of whether and when to repurchase shares have been a matter of business judgment, not a legal or public policy concern. Shareholders are the ultimate judge of whether an issuer’s management was wise – either because it repurchased shares or because it didn’t.

Shareholders also may prefer issue repurchases to dividends for tax reasons. When a company declares and pays a dividend, the shareholder has no choice as to whether or not to take the dividend and must report the payment as ordinary taxable income. By comparison, a buyback normally raises the value of the remaining shares but has no immediate tax implications for shareholders who choose not to sell. Such investors need not recognize income unless they choose to sell their shares. Moreover, investors who subsequently sell may time their sales to ensure that their profits are subject to capital gains tax rates, rather than ordinary income.¹³

¹² Warren E. Buffet, [Letter to Berkshire Hathaway Shareholders for 2020](#), Feb. 27, 2021.

¹³ CFI, [Dividend vs Share Buyback/Repurchase Enhance yield or boost EPS?](#)

Recent Concerns

Despite the business case for repurchases and the rules that govern them, some observers have raised serious objections to issuer repurchases. The authors of one article in the Harvard Business Review state the following:

- "Buybacks' drain on corporate treasuries has been massive. The 465 companies in the S&P 500 Index in January 2019 that were publicly listed between 2009 and 2018 spent, over that decade, \$4.3 trillion on buybacks, equal to 52% of net income, and another \$3.3 trillion on dividends, an additional 39% of net income." ***
- "With the majority of their compensation coming from stock options and stock awards, senior corporate executives have used open-market repurchases to manipulate their companies' stock prices to their own benefit and that of others who are in the business of timing the buying and selling of publicly listed shares. Buybacks enrich these opportunistic share sellers — investment bankers and hedge-fund managers as well as senior corporate executives — at the expense of employees, as well as continuing shareholders."
- "In contrast to buybacks, dividends provide a yield to all shareholders for, as the name says, *holding* shares. Excessive dividend payouts, however, can undercut investment in productive capabilities in the same way that buybacks can. Those intent on holding a company's shares should therefore want it to restrict dividend payments to amounts that do not impair reinvestment in the capabilities necessary to sustain the corporation as a going concern. With the company plowing back profits into well-managed productive investments, its shareholders should be able to reap capital gains if and when they decide to sell their shares."¹⁴

In 2018, then-SEC Commissioner Robert J. Jackson, Jr. raised several concerns about stock buybacks. In particular, he claimed that corporate executives use buybacks to drive up the price of the issuer's stock and then sell their shares shortly thereafter. The Commissioner and his staff examined 385 buybacks in the 15 months preceding his remarks.

First, we found that a buyback announcement leads to a big jump in stock price: in the 30 days after the announcements we studied, firms enjoy abnormal returns of more than 2.5%. That's unsurprising: when a public company in the United States announces that it thinks the stock is cheap, investors bid up its price.

What did surprise us, however, was how commonplace it is for executives to use buybacks as a chance to cash out. In half of the buybacks we studied, at least one executive sold shares in the month following the buyback announcement. In fact, twice as many companies have insiders selling in the eight days after a buyback announcement as sell on an ordinary day. So right after the company tells the market that the stock is cheap, executives overwhelmingly decide to sell.

¹⁴ Lazonick, Sakinç, and Hopkins, *Why Stock Buybacks are Dangerous for the Economy*, Harvard Business Review, Jan. 7, 2020. See also Lazonick, *Profits Without Prosperity*, Harvard Business Review, Sept. 2014.

* * * * *

Now, let's be clear: this trading is not necessarily illegal. But it is troubling, because it is yet another piece of evidence that executives are spending more time on short-term stock trading than long-term value creation. It's one thing for a corporate board and top executives to decide that a buyback is the right thing to do with the company's capital. It's another for them to use that decision as an opportunity to pocket some cash at the expense of the shareholders they have a duty to protect, the workers they employ, or the communities they serve.¹⁵

In a 2019 letter responding to an inquiry from U.S. Senator Christopher Van Hollen, Jr. (D MD), Commissioner Jackson stated that further study showed that “when executives unload significant amounts of stock upon announcing a buyback, they often benefit from short-term price pops at the expense of long-term investors. SEC rules do not address insiders' incentives to pursue buybacks at the expense of buy-and-hold American investors.”¹⁶

Commissioner Jackson's 2019 response concludes:

To be sure, this analysis does not show whether insiders' sales *cause* lower long-run returns or whether insiders correctly anticipate that returns will be lower so sell opportunistically. But from the perspective of ordinary American investors saving for retirement, I cannot see why that distinction should matter. Whether insider sales cause the stock to fall or simply reflect insiders' view that the buyback won't add value in the long run, the opportunity to cash out stock-based pay gives executives reason to pursue buybacks that do not produce long-term value. Those incentives deserve attention from the SEC.¹⁷

Discussion

In this section, I examine some of the specific objections to Rule 10b-18 and issuer buybacks and discuss whether those criticisms hold water.

Objection: Rule 10b-18 is Inconsistent with the SEC's Mandate to Eliminate Manipulation from the Securities Markets.

Some criticize the SEC for what they believe is an agenda of favoring corporate management at the expense of other aspects of society and using the federal securities laws as a

¹⁵ [Remarks](#) of the Honorable Robert J. Jackson, Jr. Commissioner, *Stock Buybacks and Corporate Cashouts*, Remarks to the Center for American Progress, June 11, 2018.

¹⁶ [Letter](#) from the Honorable Robert J. Jackson, Jr. Commissioner, SEC, to the Honorable Christopher Van Hollen, U.S. Senate, March 6, 2019, at 2.

¹⁷ *Id* at 5.

means to that end. For example, Professor Lazonick states that Rule 10b-18 was a departure from the anti-fraud mission of the SEC that Congress established when it enacted the Exchange Act.

The rule was a major departure from the agency's original mandate, laid out in the Securities Exchange Act in 1934. The act was a reaction to a host of unscrupulous activities that had fueled speculation in the Roaring '20s, leading to the stock market crash of 1929 and the Great Depression. To prevent such shenanigans, the act gave the SEC broad powers to issue rules and regulations.

During the Reagan years, the SEC began to roll back those rules. The commission's chairman from 1981 to 1987 was John Shad, a former vice chairman of E.F. Hutton and the first Wall Street insider to lead the commission in 50 years. He believed that the deregulation of securities markets would channel savings into economic investments more efficiently and that the **isolated cases of fraud and manipulation that might go undetected did not justify onerous disclosure requirements for companies**. The SEC's adoption of Rule 10b-18 reflected that point of view.¹⁸

Response.

I disagree with Professor Lazonick's characterization of Chairman Shad, the Commission at that time, and of Rule 10b-18. During Chairman Shad's tenure, the SEC:

- brought some of the biggest insider trading cases in the history of the Commission;¹⁹
- supported legislation that permitted the SEC to seek civil penalties against those who traded on inside information;²⁰
- oversaw the creation of the EDGAR system to enhance access to public companies' SEC filings;²¹ and
- directed the SEC to combine Securities Act of 1933 (Securities Act) and Exchange Act disclosures into an integrated system²².

¹⁸ Lazonick, *Profits Without Prosperity*, Harvard Business Review, Sept. 2014 [**emphasis added**]. Professor Lazonick writes frequently on this topic.

¹⁹ "During his tenure, Mr. Shad vowed that the SEC would come down on insider trading with "hobnail boots," and the agency's staff presented him with an inscribed pair after its successful prosecutions." Vise, *Former SEC Chief John Shad Dies*, Washington Post, July 9, 1994.

²⁰ [Statement](#) of the Honorable John S.R. Shad, Chairman, SEC, *et. al*, as reported in Hearing before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy & Commerce, U.S. House of Representatives, on H.R. 559, Apr. 13, 1983, Serial No. 98-33, Ninety-Eighth Congress, First Session, at 5.

²¹ *e.g.*, [Hearing](#) Before the Subcommittee on Oversight and Investigations, Committee on Energy & Commerce, U.S. House of Representatives, Mar. 14, 1985, Serial No. 99-23, 99th Cong. 1st. Sess.

²² [Statement](#) of the Honorable John S.R. Shad, Chairman, SEC, to the Subcommittee on Securities of the Senate Committee on Banking, Housing and Urban Affairs, U.S. Senate, Mar. 25, 1983, at 46. *See also* discussion at 46-49.

In short it is an unfair caricature of John Shad, and the SEC that he chaired, to claim that he ignored minor amounts of fraud in exchange for greater market efficiency. Suggesting that Rule 10b-18 was part and parcel of an SEC that tolerated fraud simply does not square with the facts.²³

Improper Use of Corporate Resources.

Some observers believe that management should use corporate profits for purposes other than issuer repurchases. The authors of one study suggest that public companies should spend more of their profits by increasing rank and file employees' compensation, rather than by buying back their stock: "U.S. publicly traded companies across all industries spent almost 60% (58.6%) of their profits on buybacks between 2015 and 2017, leaving fewer funds (relative to growth of profits) for other productive purposes, such as corporate investment, job creation, and raising wages."²⁴

In particular, the study identifies companies that could raise employees' compensation above minimum wage, rather than spending money on buybacks:

- The restaurant industry spent more on buybacks than it reported in profits between 2015 and 2017, which suggests that these companies are borrowing or are using other cash reserves to fund buybacks. The five companies spending the most on buybacks each year are McDonald's, YUM Brands, Starbucks, Restaurant Brands International, and Domino's Pizza. These companies could pay the median worker an average of 25% more each year if those corporate funds were spent on wages instead.
- Starbucks could give each worker at least \$7,119 more a year; McDonald's could raise pay by almost \$3,853; and Domino's Pizza and Restaurant Brands International could pay each of their workers over \$2,000 more annually.

²³ Regardless of one's views of Chairman Shad, it is noteworthy that Congress subsequently amended each of the federal securities laws to ensure that the Commission balances protective measures with market efficiency. In the National Securities Markets Improvements Act of 1996, Congress added the following language to every one of the federal securities laws:

CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION — Whenever pursuant to this title the Commission is engaged in rulemaking, or in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

Pub. L No. 104-290, Oct. 11, 1996, Section 6.

²⁴ Tung and Milani, [Curbing Stock Buybacks: A Crucial Step to Raising Worker Pay and Reducing Inequality](#), Roosevelt Institute, July 2018, at 7 (Roosevelt Institute Study). See also Stewart, [Stock buybacks, explained](#), [Vox](#), Aug. 5, 2018.

- The top spenders on buybacks in retail are Home Depot, Walmart, CVS, Lowe’s, and Target. On average, these companies spent 87% of their net profits on buybacks, and they could pay the median worker in their respective companies an average of 56% more each year. The average ratio of CEO pay to median worker compensation among these companies is 587 to 1 — with average CEO total compensation at over \$13 million.²⁵

Another article focused on Home Depot:

On a conference call with investors in February 2018, [Craig Menear, the chairman and CEO of Home Depot] and his team mentioned their “plan to repurchase approximately \$4 billion of outstanding shares during the year.” The next day, he sold 113,687 shares, netting \$18 million. The following day, he was granted 38,689 new shares, and promptly unloaded 24,286 shares for a profit of \$4.5 million. Though Menear’s stated compensation in SEC filings was \$11.4 million for 2018, stock sales helped him earn an additional \$30 million for the year.

By contrast, the median worker pay at Home Depot is \$23,000 a year. If the money spent on buybacks had been used to boost salaries, the Roosevelt Institute and the National Employment Law Project calculated, each worker would have made an additional \$18,000 a year.²⁶

Some observers complain about income equality in American society and point to buybacks as one manifestation of that inequality. Critics who believe that American corporations disproportionately benefit the wealthy in society also may object to what they believe to be:

- unfairly low minimum wage laws;
- the failures of corporations to share profits with employees and communities;
- the failures of corporations to reinvest in their businesses; and
- the failures of legislatures and corporations alike to protect American jobs.

For example, one article reported that in 2018, Harley-Davidson announced a “nearly \$700 million stock buyback plan” shortly after announcing that it would close a plant in Kansas City.²⁷ Further,

²⁵ *Id.* at 8.

²⁶ Useem, *The Stock-Buyback Swindle*, [The Atlantic](#), August 2019.

²⁷ Stewart, [Harley-Davidson took its tax cut, closed a factory, and rewarded shareholders](#), Vox, May 22, 2018. However, the Harley-Davidson plant closure is more complicated than just shuttering a plant after a stock buyback. Harley-Davidson shifted some production to York, PA, but also to Bangkok, Thailand. Harley-Davidson identified several reasons for company’s decision, such as high Asian tariffs on motorcycles made in the US and declining domestic sales of motorcycles. Union representatives objected to President Trump’s corporate tax cuts that benefited Harley-Davidson, while laying off workers in Kansas City, MO. See Barrett, *In Washington, union rips Harley-Davidson for closing Kansas City plant while opening in Thailand*, [Milwaukee Journal Sentinel](#), May 10, 2018. In addition, in March 2018, President Trump imposed a 25% tariff on steel and a 10% tariff on aluminum imported from the European Union. The EU responded by increasing the tariffs on U.S. made motorcycles from 6% to 31%. Harley-Davidson shifted production to Thailand to avoid the tariff increase and to remain competitive. See Jones, *Trump’s Tariffs Have Wiped \$1.4 Billion Off Of Harley-Davidson’s Market Cap*, [Forbes](#), Sept. 30, 2019.

Tung and Milani note that “given that women and people of color are overrepresented in the workforces of these three industries, poor job quality combined with high buyback activity deepen existing gender and racial income disparities.”²⁸

Response.

Misuse of corporate resources objections fall into two categories:

- issuer repurchases divert the issuer’s resources from expenditures that would benefit workers and their companies; and
- that buybacks create perverse incentives for senior executives to use stock buybacks to trigger additional compensation.

I discuss each of these issues below.

Diversion of Resources/Allocation of Capital.

Those who believe that Rule 10b-18 prevents issuers from raising wages or making other investments, in effect, are suggesting that the SEC should regulate capital structures of corporations. That would be a radical departure from both the law and the spirit of the federal securities laws. It also would be a policy mistake.

It is axiomatic that Congress employed a disclosure model of regulation when it enacted the Securities Act and the Exchange Act. Eschewing merit regulation, Congress embraced the philosophy of Louis Brandeis that “sunlight is said to be the best of disinfectants; electric light the most efficient policeman.”²⁹ The Securities Act and the Exchange Act prohibit manipulative or fraudulent behavior for public and private offerings, but they do not prescribe how corporations must operate or require them to have a specific corporate structure. Shortly after Congress enacted the Securities Act, William O. Douglas and George Bates described this unique structure:

Harley-Davidson’s 2018 [Form 10-K](#) at Part II, Item 5, indicates that between October 1 and December 31, 2018, the company repurchased approximately 4.9 million shares with an average price of \$40/share. The Form 10-K further notes:

In February 2016, the Company's Board of Directors authorized the Company to repurchase up to 20.0 million shares of its common stock with no dollar limit or expiration date. In February 2018, the Company's Board of Directors authorized the Company to repurchase up to 15.0 million additional shares of its common stock with no dollar limit or expiration date. As of December 31, 2018, 16.4 million shares remained under these authorizations.

Harley-Davidson subsequently increased its dividend in March 2020 and its board authorized an additional stock buyback program of up to 10 million shares. [MarketWatch, Feb. 19, 2020](#). As noted, issuers that increase dividends achieve a goal similar to buybacks, but they may cause their shareholders to pay more taxes.

²⁸Roosevelt Institute Study, *supra*. at note 24. The report also posits that buybacks benefit short-term oriented shareholder, rather than long-term investors. *Id.* at 16.

²⁹ Brandeis, [Other People’s Money and How the Bankers Use It](#), [Chapter V: What Publicity Can Do](#) (1914).

As a matter of fact there are but few of the transactions investigated by the Senate Committee on Banking and Currency which the Securities Act would have controlled. There is nothing in the Act which would control the speculative craze of the American public, **or which would eliminate wholly unsound capital structures.** There is nothing in the Act which would prevent a tyrannical management from playing wide and loose with scattered minorities, or which would prevent a new pyramiding of holding companies violative of the public interest and all canons of sound finance. All the Act pretends to do is to require the "truth about securities" at the time of issue, and to impose a penalty for failure to tell the truth. Once it is told, the matter is left to the investor.³⁰

Congress only granted the SEC authority to regulate capital structures under very limited circumstances:

- The Public Utility Holding Company Act of 1935 (PUHCA). That legislation empowered the SEC to restructure the entire public utility industry in the wake of the [Insull](#) scandal, the Enron of its day.³¹
- The Trust Indenture Act of 1939 (TIA), among other things, prohibits sale of certain debt instruments “unless a formal agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act.”³²

³⁰ Douglas and Bates, *The Federal Securities Act of 1933*, Yale Law Journal, Vol. XLII, No. 2, Dec. 1933, available on the [website](#) of the SEC Historical Society. [**emphasis added.**]

³¹ According to one account:

[PUHCA] was the most radical reform measure of the Roosevelt administration. To deal with the sprawl and inefficiency of public utility empires, such as that of Samul Insull, Section 11, the controversial ‘death sentence’ provision of that act, empowered the SEC to limit each holding company “to a single integrated public-utility system” by compelling divestiture of most geographically dispersed subsidiaries.

Seligman, *The Transformation of Wall Street* (1982), at 122. In subsequent years, Congress limited the scope of PUHCA in several bill that increased competition in the electric generation industry. Ultimately, Congress repealed PUHCA in the Energy Policy Act of 2005. That legislation repealed the “SEC’s authority to oversee mergers and other transactions of public utility holding companies.” At the same time, Congress enacted the Public Utility Holding Company Act of 2005. That legislation granted new authority to the Federal Energy Regulatory Authority [FERC] to review utilities’ books and records. “However, unlike its predecessor, PUHCA 2005 does not impose any of the substantive restrictions that effectively barred many entities from ownership of public utilities.” Congressional Research Service, *The [Repeal](#) of the Public Utility Holding Company Act of 1935 (PUHCA 1935) and Its Impact on Electric and Gas Utilities*, Nov. 20, 2006, at 1. FERC oversees certain aspects of utilities’ operations, such as issuance of securities and assumptions of debt. 18 CFR § 34 *et seq.* Nonetheless, Congress significantly curtailed federal restrictions on utility mergers and combinations.

³² SEC, *The Laws That Govern the Securities Industry* ([Description](#) of the TIA). Section 302 notes that many bond indentures did not make it practicable for bond holders to protect their rights. For example, Section 302(a)(1) of the TIA justified the need for legislation, in part, because in many circumstances:

[T]he obligor fail[ed] to provide a trustee to protect and enforce the rights and to represent the interests of such investors, notwithstanding the fact that (A) individual action by such investors for

- The Investment Company Act of 1940 (Company Act) imposes limitations on structures of investment companies. For example, the Section 18(f) of the Company Act makes it

unlawful for any registered open-end company to issue any class of senior security or to sell any senior security of which it is the issuer ... *Provided*, That immediately after any such borrowing there is an asset coverage of at least 300 per centum for all borrowings of such registered company....

The SEC has issued various exemptive rules, such as Rule 18f-4, that permits funds to use derivative securities without running afoul of the prohibitions in Section 18.³³

Congress has not granted the SEC broad authority to establish capital structures and only has granted narrow authority in limited circumstances. Indeed, Congress narrowed that authority as it gained experience with the results of such efforts.

Finally, when the SEC attempted to assert its authority over publicly-traded companies' capital structures, the Court of Appeals for the District of Columbia ruled in 1990 that the SEC lacked authority to do so. In 1988, the SEC had adopted Rule 19c-4:

barring national securities exchanges and national securities associations, together known as self-regulatory organizations (SROs), from listing stock of a corporation that takes any corporate action with the effect of nullifying, restricting or disparately reducing the per share voting rights of [existing common stockholders].” *** Because the rule directly controls the substantive allocation of powers among classes of shareholders, we find it in excess of the Commission's authority under Sec. 19 of the... Exchange Act ...”

The court rejected the SEC's assertion that it had exceptionally broad discretion under Section 19 of the Exchange Act. The court stated that: “if Rule 19c-4 were validated on such broad grounds, the Commission would be able to establish a federal corporate law by using access to national capital markets as its enforcement mechanism.” Although the court left open the possibility that other statutory provisions would “provide authority for promulgating these or other rules,” the court declined to search for such grounds.³⁴

the purpose of protecting and enforcing their rights is rendered impracticable by reason of the disproportionate expense of taking such action, and (B) concerted action by such investors in their common interest through representatives of their own selection is impeded by reason of the wide dispersion of such investors through many States, and by reason of the fact that information as to the names and addresses of such investors generally is not available to such investors....

Congress amended the TIA in 1990. The amendments allowed trust indentures to include the necessary provisions by incorporation. P. L. No 101-550. The author provided legal assistance on this legislation during his time as a Hill staff member.

³³ Release IC-34084 (Nov. 2, 2020); 85 FR 83162 (Dec. 21, 2020).

³⁴ *The Business Roundtable, Petitioner, v. Securities and Exchange Commission, Respondent*, 905 F.2d 406 (D.C. Cir. 1990), 905 F.2d. 406 (D.C. Cir. 1990). See also, Bainbridge, *The Scope of the SEC's Authority Over Shareholder*

Moreover, Congress has declined to grant the SEC authority to regulate the capital structure of public companies despite ample opportunities. Congress made two extensive revisions to the federal securities laws in the wake of major scandals. In 2002, Congress enacted the Sarbanes-Oxley Act in response to the Enron and WorldCom scandals.³⁵ That legislation “mandated a number of reforms to enhance corporate responsibility, enhance financial disclosures and combat corporate and accounting fraud, and created the ‘Public Company Accounting Oversight Board,’ ... to oversee the activities of the auditing profession.”³⁶ After the Great Recession of 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd Frank Act).³⁷ “That act “set out to reshape the U.S. financial regulatory system in a number of areas including but not limited to consumer protection, trading restrictions, credit ratings, regulation of financial products, corporate governance and disclosure, and transparency.”³⁸ Despite the breadth and scope of both statutes, neither authorized or directed the SEC to regulate the capital structure of public companies. Accordingly, it is unlikely that any effort to do so directly would withstand judicial scrutiny.

It would not be wise for Congress to grant such authority to the SEC if Congress’s goal is to raise workers’ wages or otherwise seek to address income disparity in the United States.³⁹ To achieve the goals that the critics of Rule 10b-18 set forth, the federal government would need to dictate, for each public issuer:

- capital structure, including debt/equity and shares outstanding;
- size of the workforce and its compensation;
- investments in research and development, and
- executive compensation.

Voting Rights, May 2007, UCLA School of Law Research Paper No. 07-16, available at SSRN: <https://ssrn.com/abstract=985707> or <http://dx.doi.org/10.2139/ssrn.985707>. Bainbridge states:

Having once entered the field of corporate governance regulation, the SEC would have been hard-pressed to justify stopping with dual class stock. Creeping federalization of corporate law was a plausible outcome. The D.C. Circuit quite properly foreclosed this possibility. The SEC therefore must continue respecting the line drawn by Business Roundtable.

³⁵ Public Law No: 107-204.

³⁶ SEC, *Sarbanes-Oxley, The Laws That Govern the Securities Industry*.

³⁷ Public Law No: 111-203.

³⁸ SEC, *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, The Laws That Govern the Securities Industry*.

³⁹ Some reports indicate that the CEO compensation is rising out of proportion to the compensation of rank-and-file workers. *e.g.*, in 2019, the Economic Policy Institute observed that “CEO compensation is very high relative to typical worker compensation (by a ratio of 278-to-1 or 221-to-1). In contrast, the CEO-to-typical-worker compensation ratio (options realized) was 20-to-1 in 1965 and 58-to-1 in 1989.” Mishel and Wolfe, *CEO Compensation has grown 940% since 1978*. On the other hand, *Congressional Budget Office* data show relatively stable income distributions between 1997 and 2017, especially after transfers and taxes.

It is difficult to imagine that Congress or the SEC could develop a regulatory system for managing capital structures that would ensure that American businesses could adapt to an ever-changing marketplace. By eliminating Rule 10b-18, but more ominously, seeking to regulate public companies' capital structures and expenditures, the federal government would impose a straightjacket on every public issuer of securities.

The market is a harsh judge of what management does or does not do. An issuer needs cash to repurchase its shares. If the issuer has cash in the bank, it may use those funds to repurchase shares. If it does not, it will need to borrow the money by selling debt securities or by borrowing from a bank. There are opportunity costs for whatever course of action an issuer takes or does not take.

Decisions about how to use an issuer's resources are the responsibility of management, as overseen by its board of directors. The issuer's stock price will fall if the issuer:

- hoards cash for no reason;
- uses too much cash for risky endeavors;
- fails to plan for the future and invest in new technology;
- uses too much money to pay for the buyback (whether from reserves or from loans) and then lacks resources for other initiatives; or
- hires too many or too few employees at salaries that diverge from market rates.

These are among the fundamental decisions that corporate management must make; failure to choose well will jeopardize not only the jobs of the senior executives, but the future of the company as a whole. Markets, not government, are the best measure of whether management's decisions were wise.

Manipulating Measures of Success to Trigger Compensation.

Some critics suggest that issuer buybacks increase stock prices and allow executives to sell their shares at higher prices. The author looked at disclosures for Home Depot and Starbucks, examples noted above. Home Depot, which had a significant stock buyback program,⁴⁰ uses a multitude of measures for awarding compensation⁴¹. These include quantitative standards such as sales, operating profit, and inventory turns. To discourage executives from focusing on quarter-to-quarter profits, Home Depot uses a combination of performance shares, performance-based restrictive stock, and stock options. Some incentives have caps to avoid windfalls from unexpectedly high revenues. Starbucks has similar provisions.⁴² In summary, the compensation plans weigh a variety of factors and compensate executives based on a range of performance

⁴⁰ Home Depot [Form 10-K](#) for the fiscal year ended Feb. 3, 2019, at 19.

⁴¹ Home Depot Definitive Schedule [Form 14A](#), Proxy Statement for Fiscal Year 2018, at 32.

⁴² Starbucks, [Form 10-K](#) for the Fiscal Year Ended Sept. 29, 2019, at page 18; Starbucks Form 14A, Definitive Schedule [Form 14A](#) Proxy Statement for fiscal year ended Sept. 27, 2020.

measures. Executive compensation depends on many factors, not just one measure, such as earnings per share.

It is important to remember that the conditions of Rule 10b-18 seek to minimize the market impact of the repurchases. Further, investors who sell during the buyback period have no idea whether the issuer or another investor is buying their shares. Most long sellers will not object if the price of the stock increases at the time of their sale.

It is easy to criticize executives who sell large blocks of stock and to suggest that they have either manipulated the price of the stock to rise at the time that they sell or that they are trading on inside information. Although it is impossible to prove a negative, the circumstances of executives' stock sales may be complex:

- Senior executives may have accumulated extremely large positions in the issuer's securities. It is only sensible money management for them to sell some of their shares in that issuer and to diversify their investments.
- Officers, directors, and 10% shareholders who buy and sell (or sell and buy) that issuer's securities must avoid running afoul of Section 16(b) of the Exchange Act. Although not a violation of the securities laws, persons in those categories who trade too soon are subject to a lawsuit for disgorgement of any profits.
- Senior managers will not buy or sell shares during certain "blackout periods."
 - To avoid trading on inside information or appearing to do so, senior managers will not buy or sell shares in the issuer in the weeks before the issuer announces quarterly earnings or other material corporate events. It would be more problematic for a senior manager to sell their shares just prior to the issuer's announcement of material news, than after. For this reason, most compliance departments only will allow their employees to trade shares in the companies for which they work during specific windows after major releases.⁴³
 - Section 306(a) of the Sarbanes Oxley Act of 2002 and Regulation BTR prohibit directors and executive officers from selling the issuer's shares during a pension black out period.

Finally, as noted, many corporate executives sell in accordance with [Rule 10b5-1](#) plans. Such plans permit investors to defend against a claim of insider trading by establishing a plan to sell the issuer's shares on an automatic basis.⁴⁴

⁴³ See discussion of then-Commissioner Jackson's views *supra* at text accompanying note 15. It is unclear what - Commissioner Jackson means by selling on an "ordinary day." Public companies issue quarterly earnings statements and must file Form 8-K for any current, material event. Selling eight days or months after the issuer announces a buyback is an indication that the market had ample time to digest the news of the issuer's buyback announcement before the senior manager sold their shares.

⁴⁴ Some critics believe that Rule 10b5-1 offers overly broad protection. For example, they assert that some plans allow persons selling too much authority to alter the plans. By granting the sellers too much flexibility, the plans eliminate the automatic nature of the stock sales, which otherwise should insulate the sellers from the charge that they traded on inside information. Shortly before he left office, SEC Chairman Jay Clayton testified at a Senate hearing: "for senior executive officers using 10b5-1 plans to sell stock, I do believe that a cooling-off period from the time that

Some critics claim that linking executive compensation to earnings per share (EPS) and share prices allow management to “move the goal posts” to suit their needs. For example, an issuer that buys back its shares could raise the earnings per share to a level that triggers additional executive compensation. Because a buyback often raises the issuer’s stock price, management could drive the issuer’s stock price up sufficiently to trigger additional compensation. A 2015 Reuters study observed the following:

255 of [S&P 500] companies reward executives in part by using EPS, while another 28 use other per-share metrics that can be influenced by share buybacks.

In addition, 303 also use total shareholder return, essentially a company’s share price appreciation plus dividends, and 169 companies use both EPS and total shareholder return to help determine pay.

EPS and share-price metrics underpin much of the compensation of some of the highest-paid CEOs, including those at Walt Disney Co., Viacom Inc., 21st Century Fox Inc., Target Corp. and Cisco Systems Inc.

Fewer than 20 of the S&P 500 companies disclose in their proxies whether they exclude the impact of buybacks on per-share metrics that determine executive pay.⁴⁵

Heitor Almeida, a professor of finance with the College of Business at the University of Illinois, says EPS “is not an appropriate target, it’s too easy to manipulate.”⁴⁶

Others disagree and dismiss the idea of management manipulating EPS for their personal benefit as a myth:

Myth #4: Management teams only repurchase stock in an attempt to inflate EPS and meet incentive compensation targets.

Reality: Executives whose compensation depends on EPS did not allocate a greater proportion of total cash spending to buybacks in 2018 than companies where management pay was not linked to EPS.⁴⁷

the plan is put in place or is materially changed, until the first transaction, is appropriate.” Kiernan, [SEC Chairman Urges Corporate Insiders to Avoid Quick Stock Sales](#), [Wall Street Journal](#), Nov. 17, 2020.

⁴⁵ Brettell, Gaffen, and Rohde, [Stock buybacks enrich bosses even when business sags](#), [Reuters Investigates](#), Part 2, Dec. 10, 2015.

⁴⁶ *Id.*

⁴⁷ Kostin and Hunter, [Debunking buyback myths](#), [Goldman Sachs Global Investment Research](#), Goldman Sachs and Co. L.L.C., Issue 77, Apr. 11, 2019, at 4.

Indeed, among the S&P 500, the reverse is true.⁴⁸

Congress should not use Specialized Securities Disclosure Provisions to Achieve other Policy Goals.

When Congress tries to use the federal securities laws to address social problems in different policy arenas, the outcomes are not satisfactory – either in achieving congressional goals or from the standpoint of investor protection. In the Dodd Frank Act, Congress included three provisions that it intended to address policy concerns that it deemed important. The provisions directed the SEC to undertake rulemakings that had nothing to do with the SEC’s core mission. As a consequence, the SEC devoted an enormous amount of resources to discharge those responsibilities, distracting the SEC from its core mission. The three provisions of the Dodd Frank Act at issue are:

- Section 1502 – Conflict Minerals – Requiring issuers to disclose information about certain raw materials that they obtain from the Democratic Republic of the Congo;⁴⁹

⁴⁸ Kostin and Hunter further explain:

The 247 companies in the S&P 500 with incentive compensation programs linked to earnings per share—a metric that would benefit from accretive share buybacks—actually spent a smaller share (28%) of their total cash outlays on repurchasing stock compared with the 253 firms without a performance metric linked to EPS (31%). Moreover, the 49% of S&P 500 firms with EPS-linked compensation accounted for just 45% of total 2018 buybacks (\$362 billion). We also found no relationship between how management teams with compensation incentives tied to total shareholder return (TSR) spent cash relative to those firms with no shareholder return incentive.

Id.

⁴⁹ Section 1502 – Conflict Minerals – Congress enacted this provision because it believed that the “exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to an emergency humanitarian situation.” Accordingly, it amended the Exchange Act, adding a new subsection (p) to Section 13 which directs the SEC to adopt rules requiring reporting issuers to disclose whether “conflict minerals” that are necessary to the functionality or production of an issuer’s product originate in the Democratic Republic of the Congo or an adjoining country. It imposes several other requirements such as requiring reporting companies to have an independent audit of the source and custody of such minerals. The SEC proposed rules to comply with the provision. [Release No. 34-63547](#) (Dec. 15, 2010); 75 FR 80948 (Dec. 23, 2010). The Commission extended the comment period for 30 days. [Release No. 33-9179](#) (Jan. 28, 2011); 76 FR 6110 (Feb. 3, 2011). The Commission subsequently adopted final rules. [Release No. 34-67716](#) (Aug. 22, 2012); 77 FR 56274 (Sept. 12, 2012).⁴⁹ The National Association of Manufacturers (NAM) challenged the rules in the U.S. District Court on several grounds, including a First Amendment claim. The District Court upheld the SEC’s rules. *Nat’l. Ass’n. of Mfrs. v. SEC*, 956 F. Supp. 2d 43, 46 (D.D.C. 2013).⁴⁹ The NAM appealed the District Court’s decision to the U.S. Court of Appeals for the District of Columbia Circuit, which rejected all of the objections except for the First Amendment. The court stated that Section 13 (p)(1)(A)(ii) & (E) and the Commission’s final rule “violate the First Amendment to the extent the statute and rule require regulated entities to report to the Commission and to state on their website that any of their products have “not been found to be ‘DRC conflict free.’”⁴⁹ *Nat’l. Ass’n. of Mfrs. v. SEC*, 748 F.3d 359,374. (D.C. Cir. 2014). On April 29, 2014, Keith Higgins, Director of the Division of Corporation Finance, issued [guidance](#) stating that issuers need not file those aspects of the reports that the Court of Appeals disallowed. The SEC and Amnesty International, an intervenor, petitioned the Court of Appeals for a rehearing in light of a subsequent Court of Appeals decision. However, the Court of Appeals reaffirmed its earlier opinion. The

- Section 1503 – Reporting Requirements Regarding Coal or Other Mine Safety – Requiring issuers to disclose information about mine safety violations;⁵⁰
- Section 1504 – Resource Extraction – Requires issuers involved with resource extraction to disclose information about payments to foreign governments.⁵¹

Congress enacted these provisions with good intentions, but the disclosure requirements related to other public policy concerns. Congress did not give the SEC the discretion not to adopt these rules. The rulemaking for Section 1503 was apparently uneventful, but dealt with issues that are not within the SEC’s expertise. For example, it does not appear that Section 1503 permits the Commission to consider whether an issuer’s mine is material to the issuer’s financial position. Section 1503 and its rules require an issuer with a miniscule mining operation to make these

court noted that “by compelling an issuer to confess blood on its hands, the statute interferes with that exercise of the freedom of speech under the First Amendment.” *Nat’l. Ass’n. of Mfrs. v. SEC*, No. 13-5252 (Aug. 18, 2015) (2015 Opinion). Ultimately, the SEC’s Division of Corporation Finance stated that it “will not recommend enforcement action to the Commission if companies, including those that are subject to paragraph (c) of Item 1.01 of Form SD, only file disclosure under the provisions of paragraphs (a) and (b) of Item 1.01 of Form SD.” Updated [Statement](#) on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule, SEC Division of Corporation Finance, Apr. 7, 2017.

⁵⁰ Section 1503 – Reporting Requirements Regarding Coal or Other Mine Safety – This provision requires issuers that operate coal or other mines to report their safety records to the SEC, in addition to any other requirements of mine safety regulators. For example, Section 1503(a)(1)(A) requires issuers to report on periodic reports information such as the number of citations that the Mine Safety and Health Administration has levied against the issuer. ([The Mine Safety and Health Administration](#) is part of the U. S. Department of Labor.) Section 1503(b)(2) require an issuer to file a current report on Form 8-K if the Mine Safety and Health Administration notifies the issuer that the mine has a pattern of violations of mandatory health or safety standards of a serious nature. Although the provision was self-executing, the SEC proposed and adopted rules.⁵⁰ These rules amended SEC forms 8-K, 10-Q, and 10-K to make accommodations for Section 1503’s requirements.

⁵¹ Section 1504 – Resource Extraction – This provision amended Section 13 of the Exchange Act and directed the SEC to adopt rules requiring issuers engaged in “resource extraction” to include in their annual reports “information relating to any payment made by the resource extraction issuer ... to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals....” In 2010, the SEC proposed rules to implement this section in accordance with the statutory mandate. [Release No. 34-63549](#) (Dec. 15, 2010); 75 FR 80978 (Dec. 23, 2010). The SEC adopted final rules in 2012. [Release No. 34-67717](#) (Aug. 22, 2012); 77 FR 56344 (Sept. 12, 2012) (“2012 Rules”).⁵¹ However, on July 2, 2012, the U.S. District Court for the District of Columbia vacated the 2012 Rules. *American Petroleum Institute v. SEC*, 953 F. Supp. 2d 5 (D.D.C., 2013). The court stated that “the Commission misread the statute to mandate public disclosure of the reports, and its decision to deny any exemption [for countries that prohibit payment disclosure] was ... arbitrary and capricious.” 953 F. Supp. 2d., at 12. *See also: Oxfam America, Inc. v. SEC*, Civ. Action No. 14-13648-DJC. In that case, Oxfam successfully argued that the SEC unlawfully withheld agency action when it did not adopt final rules within the time period that Congress mandated. The U. S. District Court for the District of Massachusetts [ordered](#) the SEC to submit a schedule for completing the rulemaking. On December 11, 2015, the SEC reproposed the rule to implement Section 1504. Release No. 34-76620 (Dec. 11, 2015); [80 FR 80057](#) (Dec. 23, 2015). The Commission adopted final rules again on June 27, 2016. Release No 34-78167 (June 27, 2016); [81 FR 49360](#) (July 27, 2016) (“2016 Rules”). Congress subsequently invalidated the 2016 Rules.⁵¹ On December 18, 2019, the SEC proposed a third set of rules. Release No. 34-877883 (Dec. 18, 2019); [85 FR 2522](#) (Jan. 15, 2020). The Commission adopted those rules on December 16, 2020. Release No. 34 90679 (Dec. 16, 2020); [86 FR 4662](#) (Jan. 15, 2021). *See also: SEC Adopts Final Rules for the Disclosure of Payments by Resource Extraction Issuers*, SEC [Press Release](#) 2020-318 (Dec. 16, 2020).

disclosures whether or not the mining operation had any meaningful implication for investors. If Congress has continuing concerns about mine safety, it should examine the mine safety laws, not amend the securities laws.

The rulemakings for sections 1502 (conflict minerals) and 1504 (resource extraction) were administrative nightmares for the SEC. There were conflicting views as to whether Section 1502 helped or hurt the people of the Democratic Republic of Congo.⁵² These provisions drained the SEC's resources and forced disclosures on issues that have nothing to do with investing.

Mary Jo White, SEC Chair at the time, observed about these Dodd Frank Act mandates:

[Some] mandates, which invoke the Commission's mandatory disclosure powers, seem more directed at exerting societal pressure on companies to change behavior, rather than to disclose financial information that primarily informs investment decisions.

That is not to say that the goals of such mandates are not laudable. Indeed, most are. Seeking to improve safety in mines for workers or to end horrible human rights atrocities in the Democratic Republic of the Congo are compelling objectives, which, as a citizen, I wholeheartedly share.

But, as the Chair of the SEC, I must question, as a policy matter, using the federal securities laws and the SEC's powers of mandatory disclosure to accomplish these goals.⁵³

Congress should not force the SEC to meddle in policy arenas for which it is not well-equipped and divert it from its core mission. SEC disclosure requirements should focus on the standard that the Supreme Court enunciated in *Basic v. Levinson*: "materiality depends on the significance the reasonable investor would place on the withheld or misrepresented information."⁵⁴ Congress's attempts to use the securities laws for unrelated policy objectives have not been successful. Congress should not repeat that error.

⁵² Acting Chairman Piwowar expressed doubt about the efficacy the Conflicts Mineral disclosure requirements after a visit to Africa. He thought that the rules were causing more harm than good. He [requested](#) public comments on whether Section 1502 and the SEC's rules were achieving the humanitarian objective that Congress sought. The Commission received many comments on the efficacy of the requirement. *E.g.*, [comment](#) of Mr. Murairi Janvier Bakihanaye, Civil Society, Goma, The Democratic Republic of Congo, Mar. 21, 2017: "The Dodd-Frank Act is truly worth its weight in gold."

⁵³ Mary Jo White, Chair, SEC, [The Importance of Independence](#), 14th Annual A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, Oct. 3, 2013. Earlier in her remarks, Chair White pointed to an older example when Congress required all federal agencies to consider environmental issues as part of their mandates.

⁵⁴ *Basic Inc. et al v. Levinson et al.*, 485 U.S. at 240.

Recommendation

When reviewing executive compensation and issuer repurchase disclosures, it is difficult to determine whether an issuer repurchase program altered earnings or price per share, thereby triggering any executive compensation. SEC rules require issuers to explain the compensation plans in detail and to describe their repurchase programs. But there is no requirement that issuers explain any nexus between repurchases and executive compensation. Further, the author could not determine whether an issuer was reporting its EPS before or after the repurchase programs and whether or how the repurchase affected the EPS calculation.

Accordingly, I suggest that the SEC amend Regulation S-K (17 C.F.R. § 229.402(d), instruction (7)) as follows:

7. Options, SARs and similar option-like instruments granted in connection with a repricing transaction or other material modification shall be reported in this Table. ~~However, the disclosure required by this Table does not apply to any repricing that occurs through a pre-existing formula or mechanism in the plan or award that results in the periodic adjustment of the option or SAR exercise or base price, an antidilution provision in a plan or award, or a recapitalization or similar transaction equally affecting all holders of the class of securities underlying the options or SARs.~~ *Explain any repricing that occurred to options, SARs, and similar-option-like instruments. Such explanation shall include answers to the following questions:*

- i. Did the issuer (or its affiliate) undertake an issuer repurchase of securities that resulted in a change in the calculation of the issuer's earnings per share (or similar calculation)? and*
- ii. Did such change in calculation cause the issuer to pay a different amount of compensation to the persons specified in Item 402(a)(3) than it otherwise would have, had the issuer (or its affiliate) not repurchased the securities?*

If so, specify the repurchase transaction(s) and the resulting changes to compensation, including the amounts, however paid or allocated.

If the answer to either of the prior questions is yes, identify the calculation and report the amount of earnings per share (or other calculation) before and after the issuer's repurchase and explain the reason for the adjustment.

Such questions would allow shareholders to judge for themselves if management altered the capital structure in a way that resulted in a benefit to those managers. The securities laws trust investors to use good judgment when they have access to material information. These circumstances are no different from other matters of corporate governance.

Conclusion

The federal securities laws and the SEC's administration of those laws have fostered capital markets that are the envy of the world. According to SIFMA. for 2019:

- **Equities:** "U.S. equity markets represent 39.4% of the \$95.0 trillion in global equity market cap, or \$37.5 trillion; this is 3.9x the next largest market, the EU (excluding the U.K.)."
- **Fixed Income:** "U.S. fixed income markets comprise 38.9% of the \$105.9 trillion securities outstanding across the globe, or \$41.2 trillion; this is 1.9x the next largest market, the EU (excluding the U.K.)."⁵⁵

In my view, it would not be wise to repeal Rule 10b-18 with the purpose of reintroducing the uncertainty that caused issuers not to repurchase their shares. Rule 10b-18 creates legal certainty that permits issuers to repurchase their shares without fear of an SEC investigation or private lawsuit. Because the federal securities laws define fraud and manipulation broadly, it was previously risky for an issuer to repurchase its shares even for the most legitimate of reasons. Issuers wishing to avoid controversy would not undertake repurchases for fear that the SEC or a private litigant would charge the issuer with market manipulation. Suggesting that the SEC should withdraw the rule and reestablish that legal uncertainty is not a sensible way to make policy. Besides adding legal uncertainty, a repeal of Rule 10b-18 creates the likelihood that issuers will declare dividends to return cash to shareholders, which is a less efficient way to reward existing shareholders because of the higher tax burden. If Congress or the SEC want to prohibit or curtail issuer repurchases, they should do so deliberately and not by reintroducing a fog of legal ambiguity that discourages legitimate and questionable activity alike.⁵⁶

Further, the SEC should not repeal Rule 10b-18 if its real objective is some other policy goal. As demonstrated above, repeal of Rule 10b-18 will do nothing to address the concerns of some that executive compensation is excessive. Using the federal securities laws to try to achieve other public policy goals does not work well and distracts the SEC from its primary mission. As noted, the SEC has no special expertise in conflict minerals, mine safety, or resource extraction. Congress has numerous federal agencies at its disposal (and can create new ones) that do have relevant expertise in these or any other policy topics.

If the opponents of Rule 10b-18 believe that executive compensation is too high or that public companies are not investing for the future, Congress and the SEC should have that public policy debate directly, not through the backdoor of Rule 10b-18. Similarly, if Congress thinks that workers need a pay raise, it should debate raising the federal minimum wage and weigh the

⁵⁵ SIFMA, 2020 *Capital Markets Fact Book*, Sept. 2020, at 7.

⁵⁶ Section 20(b) of the Exchange Act provides that: "It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person." Although not legally binding on the SEC, it seems to the author that federal government should honor the same admonition. In other words, the government should not seek to achieve indirectly a goal for which it lacks direct authority.

relevant economic arguments.⁵⁷ Those who favor such changes to the operation of public companies must appreciate that the federal government would need to micromanage the operations of public companies to an unprecedented degree. If Congress were to embrace such a policy, many issuers would go private, or remain private longer.⁵⁸ Preventing the public from investing in a broader range of issuers only will contribute to widening the wealth gap in America, not narrowing it.⁵⁹

Additional disclosure, not the elimination of Rule 10b-18 or other policy mandates, would give the public greater insight into stock repurchases and senior managers' compensation at public companies. The recommendation above would help investors assess whether management is using repurchases to enrich itself. More sunlight, not more prescriptive measures, is the better approach.

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Thank you for considering my views. I would be pleased to meet with members of the Commission or the Staff to discuss my suggestions.

Sincerely,

/s/

Stuart J. Kaswell, Esq.

⁵⁷ E.g., Congressional Budget Office, [The Budgetary Effect of the Raise the Wage Act of 2021](#) (Feb. 2021). The report notes, at 8:

CBO projects that, on net, the Raise the Wage Act of 2021 would reduce employment by increasing amounts over the 2021–2025 period. In 2025, when the minimum wage reached \$15 per hour, employment would be reduced by 1.4 million workers (or 0.9 percent), according to CBO's average estimate. In 2021, most workers who would not have a job because of the higher minimum wage would still be looking for work and hence be categorized as unemployed; by 2025, however, half of the 1.4 million people who would be jobless because of the bill would have dropped out of the labor force, CBO estimates. Young, less educated people would account for a disproportionate share of those reductions in employment.

⁵⁸ One study from Nasdaq shows that companies are staying private longer than in prior years. Mackintosh, *The Battle for Public vs. Private Equities*, [Nasdaq](#), Feb. 27, 2020. See also MacArthur, Burack, De Vusser, Yang, and Rainey, [Public Vs. Private Assets: The Big Switch](#), [Bain & Co.](#), Feb. 25, 2019.

⁵⁹ Mackintosh, *supra*.