

## **Securities Regulation Daily Wrap Up, CORPORATE GOVERNANCE—5th Cir.: SEC responds to petition for review of share buyback rule, (Aug 18, 2023)**

By [Mark S. Nelson, J.D.](#)

The SEC's response and submissions by amici raise numerous arguments about the agency's new share buyback rule, but they also hint at future legal battles to come once the SEC issues its final climate risk disclosure rules.

In some ways the business sector's attack on the SEC's corporate share buyback regulation is a familiar script: question the SEC's economic analysis and, if the required disclosures touch on anything controversial, also raise First Amendment issues. The legal challenge to the SEC's conflict minerals rule followed this pattern and legal challenges to future SEC climate risk disclosure rules will likely follow a similar approach. The SEC's response to the Chamber of Commerce's [petition for review](#) of the Share Repurchase Disclosure Modernization rulemaking, whose timing coincided with the imposition of an excise tax on buybacks under the Inflation Reduction Act, at length seeks to refute the Chamber's First Amendment claims, while also seeking to bolster the rigor of the agency's economic analysis (*Chamber of Commerce of the United States of America v. SEC*, August 9, 2023).

**First Amendment.** The SEC responded to the Chamber's First Amendment claims in two stages. First, the SEC argued that the Supreme Court's *Zauderer* framework applies in which a regulation will be upheld if it addresses purely factual and uncontroversial material. Here, the SEC rejected the Chamber's assertion that *Zauderer* should not apply because no commercial transaction was being proposed.

The SEC also countered the Chamber's argument that the buyback disclosure rule would invite corporate opinions rather than factual disclosures. According to the SEC, the rule does not require companies to state opinions, although a company can make a factual disclosure that references a subjective opinion.

Moreover, the SEC asserted that disclosing the reasons for engaging in regulated market activity (i.e., conducting a share buyback) are inherently "non-ideological" and, thus, uncontroversial. By way of comparison, the SEC suggested that the current debate over the scope of immunity for social media companies under Section 230 of the Communications Decency Act is far more controversial. From the SEC's view, the share buyback rule disclosures are also related to legitimate state interests and do not unduly burden speech.

The SEC further argued in the alternative that, even if *Zauderer* was inapt, the regulation would also survive analysis under the Supreme Court's *Central Hudson* test, which applies intermediate scrutiny to commercial speech limits. Under *Central Hudson*, a regulation must directly advance substantial government interest and be no more extensive than necessary to serve that interest. The SEC argued that the share buyback rule directly advanced the substantial government interest in strengthening investor protection and facilitating capital formation.

Amicus Better Markets [backed](#) the SEC on the First Amendment challenge by the Chamber. According to the group, the SEC's rule should survive if it is reasonably related to a substantial government interest and involves purely factual and uncontroversial information.

**Cost-benefit analysis.** The Chamber's objections to the SEC's cost-benefit analysis for the share buyback regulation centered on whether the SEC paid too little attention to certain studies promoted by the Chamber and its supporters. The SEC argued that it had conducted sufficient economic analysis before promulgating the final share buyback regulation.

Specifically, the SEC said its economic analysis included the potential that buybacks can be used for opportunistic behavior. The agency also said it had considered the impact of the excise tax on stock buybacks imposed by the Inflation Reduction Act, a development that occurred while the agency was considering the proposed rule.

An [amicus brief](#) filed by a group of legal and financial scholars, including former SEC Commissioner Robert Jackson and his former Senior Adviser, focused exclusively on defending the SEC's economic analysis, while taking no position on the First Amendment issues.

According to the legal scholars' brief, academicians can both support buybacks generally while exposing deep flaws about them centered on the potential that corporate insiders may take advantage of information asymmetries to trade while a buyback is in progress. With respect to the SEC's decision to give lower weight to data provided by the Chamber and its supporters, the legal scholars commented that "...federal regulators are not required to pretend that paid advocacy is serious social science, and neither should this Court."

The legal scholars said one of the least contested findings of studies of share buybacks is that signaling can occur in which insiders' behavior suggests their expectations for a company's future prospects. The legal scholars also noted that this proposition depends on what insiders' trading behaviors say about the "meaning" being conveyed via any signaling behaviors.

Much of the legal scholars' brief is devoted to refuting specific data provided by the Chamber and its supporters. In particular, the legal scholars noted that some of the graphics provided by the Chamber appeared to employ vertical axis "manipulation." The amici also claimed that the Chamber's data was cherry-picked from a selective review of the available literature. As a result, the legal scholars said the SEC was justified in assigning lower weight to Chamber-supplied data than was given to other data that had been peer reviewed.

**Amici policy arguments.** Fifteen conservative state amici jointly filed a [brief](#) making primarily policy arguments about why the court should vacate the SEC's share buyback rule. As parties to litigation against the SEC, most states have found themselves shut out of court on Article III standing grounds, but they can still make arguments as amici.

According to the conservative states, they have an interest in the SEC's share buyback rule because of their desire to promote the general economic conditions for residents and businesses operating within their borders, to ensure the "financial success" of state pension funds, and to "promote[] economically sound market conditions" for residents who are retail investors.

Overall, the conservative state amici said they object to the further federalization of corporate law which, with respect to the internal governance of companies, has tended to be a creature of state laws. The SEC's regulation, they suggest, may hinder the ability of companies to return value to investors.

The conservative state amici gave multiple additional reasons to permit share buybacks with less regulation: (1) share buybacks increase investor returns; (2) share buybacks improve liquidity (i.e., in theory, a share buyback allows investors to dispose of shares at a time when there is lower likelihood of a "negative price impact"); (3) share buybacks reduce volatility; (4) share buybacks result in a more efficient allocation of capital; and (5) share buybacks allow companies to pay compensation without diluting share value. For these reasons, the conservative states' brief concluded that the SEC's final share buyback regulation could make share buybacks unattractive.

The case is [No. 23-60255](#).

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