SULLIVAN & CROMWELL LLP

March 29, 2020

CARES Act Limits Share Repurchases

Coronavirus Aid, Relief, and Economic Security Act Contains Limitation on Share Repurchases for Companies Receiving Assistance

SUMMARY

On Friday, President Trump signed into law the "Coronavirus Aid, Relief, and Economic Security Act," or the "CARES Act," which authorizes the Secretary of the Treasury to make up to $500 billion in loans, loan guarantees, and other investments in support of certain businesses affected by the coronavirus outbreak, as well as states and municipalities. As discussed in a separate memo, certain "eligible businesses" that receive "direct loans" in these programs and certain air carrier and related businesses and businesses critical to maintaining national security that receive loans or loan guarantees in these programs (the "Affected Businesses") may be precluded from repurchasing their listed equity securities while loans or loan guarantees are outstanding, and for a one-year period following the repayment of the loan or expiration of the loan guarantee. This memo discusses certain issues that companies may want to consider when assessing the impact of such repurchase restrictions on their organizations.

ISSUES RELATING TO SHARE REPURCHASE RESTRICTIONS

Subtitle A of Title IV of the CARES Act (the "Coronavirus Economic Stabilization Act of 2020" or "CESA"), includes provisions that preclude an Affected Business from repurchasing any of its or its parent entity's equity securities listed on a national securities exchange while any loans or loan guarantees under CESA are outstanding and for a one-year period following the repayment of the loan or expiration of the loan

guarantee, except to the extent required under a contractual obligation in effect as of the date of enactment of CESA.[1] In certain circumstances, these repurchase limitations may apply to a company's affiliates.

Issuers that expect or wish to preserve their ability to access the applicable assistance should consider the potential impact of these restrictions on their existing repurchase programs and any future programs they might otherwise expect to implement. This memo sets forth certain issues to consider, and we expect that additional issues will emerge as companies begin to work through existing and potential future agreements that include some equity repurchase element.

- *Impact on Employee Equity:* Issuers should consider the terms of restricted stock and other equity awards payable in issuer stock to determine whether those awards require or permit the issuer to repurchase its equity interests, including upon termination of employment or similar events or in respect of the payment of an exercise price or tax withholding obligations (as it is not clear whether the common practice of net settlement would constitute a repurchase). Although existing repurchase obligations would be excluded, new equity awards would not benefit from the safe harbor, unless the issuer were contractually required to grant those awards with such repurchase obligations. Similarly, permissive repurchases (whether existing or future) upon a termination of employment would not be exempt.
- *Optional Repurchases Under Existing Agreements:* Issuers also should survey their existing equity-related agreements to understand whether they may be precluded from exercising rights to repurchase in circumstances where they would otherwise want to do so. For example, companies may have rights of first refusal in connection with transfers by their significant shareholders, although these rights are relatively rare in the public company context.
- *Existing Share Repurchase Plans:* Issuers may have a variety of repurchase plans outstanding and should consider whether these plans need to be amended or terminated. Issuers should also consider the impact of any potential share repurchase limitations on settlement elections and other decisions they may make under existing plans.
    - *Open Market 10b5-1 Repurchase Plans:* Open market 10b5-1 repurchase plans can typically be terminated at the issuer's discretion, although some plans only permit the issuer to terminate at a time when it is not in possession of material non-public information ("MNPI").
        - An issuer that wishes to access assistance available under CESA will need to determine whether repurchases made under an existing share repurchase plan could preclude it from accessing this funding or, if the issuer is unable to terminate the plan, whether such repurchases would benefit from CESA's exception for existing contractual obligations. If the issuer may terminate the relevant share repurchase plan upon notice to a broker-dealer, we expect that the issuer would be required to do so as repurchases would not appear to be "required under a contractual obligation" as of the date of enactment of CESA.
        - Under SEC Staff guidance[2] an issuer may terminate future planned purchases while it is in possession of MNPI because the termination does not involve a purchase or sale of

[1] Although the statutory text refers to repurchases, it remains to be seen if the restriction will also apply to redemptions of convertible debt and listed preferred equity, including in connection with a refinancing entailing the concurrent redemption and issuance of a like amount of convertible debt or preferred equity.

[2] *See* Securities and Exchange Commission, Compliance and Disclosure Interpretations, 120.17 (November 7, 2018), *available at* https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm.

securities, and therefore, would not implicate the anti-fraud rules. If the issuer is contractually required to represent that it is not in possession of MNPI in order to terminate the plan and the issuer is not in a position to make such a representation (or cannot readily disclose the MNPI), the issuer may take the position that it is "under a contractual obligation" to continue repurchases under the plan, although it is not yet clear whether that position would prevail.

- *Rule 10b5-1 Considerations.* Because many share repurchase plans are structured to benefit from the affirmative defense to liability provided by Rule 10b5-1, issuers will want to consider the impact of terminating any existing plan. For example, while termination of a repurchase plan does not necessarily invalidate the affirmative defense provided by Rule 10b5-1, it could affect the defense for prior purchases made under the plan if termination calls into question whether the plan was adopted in good faith. Given the current extraordinary circumstances, issuers may very well conclude that any such risks associated with termination are low, particularly if they are terminating the plan in connection with qualifying for assistance under a CESA program.

- *Accelerated Share Repurchase Programs ("ASRs"):* ASRs raise a number of considerations under CESA. ASRs that incorporate or are based on an ISDA Master Agreement typically do not provide the issuer with the right to terminate a transaction following a termination event except if it becomes unlawful to make or receive any payment or delivery or to comply with the agreement or upon certain force majeure and tax events. At this point, we would not expect that issuers generally will need to terminate ASRs to participate in one of these programs. However, if the relevant agreement provides an issuer with an option to terminate an ASR, the issuer will likely be required to do so as continued equity purchases would not appear to be "required under a contractual obligation."

  - *Voluntary Early Terminations.* If an issuer exercises a right to terminate an ASR pursuant to a termination right in the ASR, or if the issuer and its dealer counterparty decide to terminate an ASR by mutual agreement, the dealer could in some cases be required to deliver additional shares to the issuer. As the delivery would result from a voluntary act of the issuer, it may not benefit from CESA's exception for existing contractual obligations. The prohibition on repurchases would not preclude an early termination that results in a delivery of cash to the issuer.[3]

  - *Settlement Method Elections.* In light of current market conditions, for ASRs that are terminating, either because they have reached their natural end date or because the dealer exercises a right to terminate early due to, for example, a significant drop in stock price, the termination may permit or require the dealer to deliver shares to the issuer. A required delivery of shares to the counterparty would be permitted, but any situation in which an issuer has discretion over whether it receives cash or shares needs to be considered carefully. For example, ASRs may have a default settlement in cash (or shares) but permit the issuer to elect to receive shares (or cash) instead. In that situation, if the default settlement method is cash, a decision by the issuer to elect share delivery would appear to be problematic. Conversely, if the default settlement method is shares, but the issuer may elect to receive cash, it may be difficult to conclude that an issuer is "required under a contractual obligation" to receive shares. However, if the issuer must represent that it is not in possession of MNPI in order to make a cash election and the issuer is not in a position to do so (or cannot readily disclose the MNPI), the issuer may take the position

[3] An issuer also will need to understand whether its dealer counterparty will insist on a representation in connection with any voluntary early termination of an ASR or other repurchase plan to the effect that the issuer is not in possession of MNPI and, if so, whether the issuer is or could be in a position to make such a representation.

that it is "under a contractual obligation" to continue with share settlement, although it is not yet clear whether that position would prevail.

- *Repurchases by Affiliates:* As discussed in our prior memo, affiliates of certain Affected Businesses also may be precluded from repurchasing the listed equity securities. CESA does not define "affiliate." The federal securities laws generally define "affiliate" to include directors, executive officers and significant shareholders of the issuer, as well as entities under common control with the issuer. It would not appear to further the purpose of CESA to prohibit purchases by directors and executive officers, or other entities outside of the corporate group (i.e., significant shareholders) and, indeed, an issuer may not have control over many of those types of purchases. Issuers will want to monitor this issue as details of the programs emerge.
- *Future Plans and Agreements:* Even if issuers do not currently anticipate accessing assistance under CESA, they may wish to preserve future flexibility to be able to do so (or participate in any future programs that may be announced as the coronavirus situation progresses) and, in that regard, issuers will want to consider the impact of a new share repurchase program on their eligibility to participate.[4] In considering future grants of equity awards, issuers may also wish to include exceptions to any repurchase obligations (or provide more time to exercise repurchase rights) to the extent those obligations or exercise of rights would preclude them from participating in any type of government funding or support program.

* * *

[4] ASRs involve additional complexities, including accounting considerations if cash payments upon termination or expiration are included, that issuers should consider before they enter into a new program if they wish to preserve flexibility for future participation in CESA.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers listed below, or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.

CONTACTS

New York

Francis J. Aquila	+1-212-558-4048	aquilaf@sullcrom.com
Thomas C. Baxter Jr.	+1-212-558-4324	baxtert@sullcrom.com
Ari B. Blaut	+1-212-558-1656	blauta@sullcrom.com
Robert E. Buckholz	+1-212-558-3876	buckholzr@sullcrom.com
Whitney A. Chatterjee	+1-212-558-4883	chatterjeew@sullcrom.com
Catherine M. Clarkin	+1-212-558-4175	clarkinc@sullcrom.com
Audra D. Cohen	+1-212-558-3275	cohena@sullcrom.com
H. Rodgin Cohen	+1-212-558-3534	cohenhr@sullcrom.com
Heather L. Coleman	+1-212-558-4600	colemanh@sullcrom.com
Donald R. Crawshaw	+1-212-558-4016	crawshawd@sullcrom.com
Elizabeth T. Davy	+1-212-558-7257	davye@sullcrom.com
Robert G. DeLaMater	+1-212-558-4788	delamaterr@sullcrom.com
Eric M. Diamond	+1-212-558-4044	diamonde@sullcrom.com
Robert W. Downes	+1-212-558-4312	downesr@sullcrom.com
Mitchell S. Eitel	+1-212-558-4960	eitelm@sullcrom.com
Michael T. Escue	+1-212-558-3721	escuem@sullcrom.com
John E. Estes	+1-212-558-4349	estesj@sullcrom.com
William G. Farrar	+1-212-558-4940	farrarw@sullcrom.com
Jared M. Fishman	+1-212-558-1689	fishmanj@sullcrom.com
C. Andrew Gerlach	+1-212-558-4789	gerlacha@sullcrom.com
Wendy M. Goldberg	+1-212-558-7915	goldbergw@sullcrom.com
Shari D. Leventhal	+1-212-558-4354	leventhals@sullcrom.com

Marion Leydier	+1-212-558-7925	leydierm@sullcrom.com
John P. Mead	+1-212-558-3764	meadj@sullcrom.com
Mark J. Menting	+1-212-558-4859	mentingm@sullcrom.com
Scott D. Miller	+1-212-558-3109	millersc@sullcrom.com
Camille L. Orme	+1-212-558-3373	ormec@sullcrom.com
Robert W. Reeder III	+1-212-558-3755	reederr@sullcrom.com
Robert S. Risoleo	+1-212-558-4813	risoleor@sullcrom.com
Stephen M. Salley	+1-212-558-4998	salleys@sullcrom.com
Robert M. Schlein	+1-212-558-4848	schleinr@sullcrom.com
Rebecca J. Simmons	+1-212-558-3175	simmonsr@sullcrom.com
William D. Torchiana	+1-212-558-4056	torchianaw@sullcrom.com
Donald J. Toumey	+1-212-558-4077	toumeyd@sullcrom.com
Marc Trevino	+1-212-558-4239	trevinom@sullcrom.com
Benjamin H. Weiner	+1-212-558-7861	weinerb@sullcrom.com
Michael M. Wiseman	+1-212-558-3846	wisemanm@sullcrom.com
Washington, D.C.		
Eric J. Kadel, Jr.	+1-202-956-7640	kadelej@sullcrom.com
Stephen H. Meyer	+1-202-956-7605	meyerst@sullcrom.com
Robert S. Risoleo	+1-202-956-7510	risoleor@sullcrom.com
Jennifer L. Sutton	+1-202-956-7060	suttonj@sullcrom.com
Andrea R. Tokheim	+1-202-956-7015	tokheima@sullcrom.com
Samuel R. Woodall III	+1-202-956-7584	woodalls@sullcrom.com
Los Angeles		
Patrick S. Brown	+1-310-712-6603	brownp@sullcrom.com
Eric M. Krautheimer	+1-310-712-6678	krautheimere@sullcrom.com
Alison S. Ressler	+1-310-712-6630	resslera@sullcrom.com
London		
Chris Beatty	+44-20-7959-8505	beattyc@sullcrom.com
Kathryn A. Campbell	+44-20-7959-8580	campbellk@sullcrom.com
Oderisio de Vito Piscicelli	+44-20-7959-8589	devitopiscicellio@sullcrom.com
John Horsfield-Bradbury	+44-20-7959-8491	horsfieldbradburyj@sullcrom.com
John O'Connor	+44-20-7959-8515	oconnorj@sullcrom.com
Evan S. Simpson	+44-20-7959-8426	simpsone@sullcrom.com
Palo Alto		
Scott D. Miller	+1-650-461-5620	millersc@sullcrom.com
Sarah P. Payne	+1-650-461-5669	paynesa@sullcrom.com
John L. Savva	+1-650-461-5610	savvaj@sullcrom.com

Paris			
	William D. Torchiana	+33-1-7304-5890	torchianaw@sullcrom.com
Frankfurt			
	Krystian Czerniecki	+49-69-4272-5525	czernieckik@sullcrom.com
Melbourne			
	Waldo D. Jones Jr.	+61-3-9635-1508	jonesw@sullcrom.com
Sydney			
	Waldo D. Jones Jr.	+61-2-8227-6702	jonesw@sullcrom.com
Tokyo			
	Keiji Hatano	+81-3-3213-6171	hatanok@sullcrom.com
Hong Kong			
	Garth W. Bray	+852-2826-8691	brayg@sullcrom.com
	Ching-Yang Lin	+852-2826-8606	linc@sullcrom.com
	Chun Wei	+852-2826-8666	weic@sullcrom.com
Beijing			
	Gwen Wong	+86-10-5923-5967	wonggw@sullcrom.com