Accelerated Share Repurchase Transactions: A Primer for Company Counsel

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When a public company is engaged in or contemplating a share repurchase program, it often considers an accelerated share repurchase (ASR) transaction as one possible way to implement the program. ASR transactions offer a number of potential advantages over traditional open market repurchase programs, including the ability to retire shares on an accelerated basis and potentially more favorable pricing.

An ASR transaction is a privately negotiated contract between a company and an equity derivatives dealer, and is typically documented as a stand-alone, long-form confirmation to a form of ISDA Master Agreement. This relatively short form of contract belies significant complexity: the confirmation for an ASR transaction typically incorporates many defined terms from, and other references to, the 2002 ISDA Equity Derivatives Definitions that can make the terms of the ASR contract difficult for a company to understand, particularly if the ASR contract is executed on an accelerated timeline, as is often the case. This Sidley practice note outlines the business terms, securities law considerations and contract terms that a company should consider before commencing a typical ASR transaction.

Typical Business Terms

Initial Payment and Delivery
On the “prepayment date” (typically within one to three trading days after the date of execution of the contract for the ASR transaction):

- the company pays to the dealer a prepayment amount equal to the aggregate dollar amount that the company commits to repurchase shares pursuant to the ASR transaction; and

- the dealer delivers to the company a number of shares of company common stock equal to a specified percentage (typically 80-85%) of the number of shares determined by dividing the prepayment amount by the most recent closing market price of the company’s common stock prior to execution.

If the ASR transaction includes a cap or a collar on the per share price to be paid by the company, the initial share delivery typically equals the minimum number of shares to be delivered by the company under the terms of the contract. The minimum number of shares is determined after an initial period during which the dealer hedges its exposure to the cap or collar, which may slightly delay the initial share delivery to the company.

The dealer obtains shares for the initial share delivery by borrowing them from stock lenders. Following the initial share delivery, the dealer purchases shares of the company’s common stock in the open market over the term of the ASR transaction to close out the short borrow position and, if applicable, to acquire shares to enable to the dealer to satisfy any obligation it may have to deliver additional shares to the company upon termination of the ASR transaction.
Term/Early Termination Option
A typical ASR transaction (and the averaging period for purposes of determining the final price to be paid by the company for shares of common stock repurchased pursuant to the ASR transaction) has a scheduled termination date, which may be accelerated by the dealer at any time after a specified minimum term. The scheduled termination date and minimum term are subject to a number of transaction-specific and company-specific considerations, including the size of the ASR transaction and the trading volume in the company’s common stock.

Final Price
The final price per share to be paid by the company for shares of common stock in an ASR transaction will generally equal (i) the arithmetic average of a published daily volume weighted average price (VWAP) of the company’s common stock over the averaging period minus (ii) a specified discount. If an ASR transaction includes a cap or a collar on the per share price to be paid by the company and the price determined pursuant to that formula exceeds the cap or is outside the collar, then the final price will be equal to the applicable cap or collar price, as the case may be.

True-Up/Final Delivery
If, as expected (given that the dealer’s initial delivery of shares is typically set at a number of shares that is significantly less than the number of shares determined by dividing the prepayment amount by the most recent closing market price of the company’s common stock prior to execution), the total number of shares that could be purchased by the company at the final price per share is more than the number of shares initially delivered by the dealer to the company, the dealer will be required to deliver additional shares to the company to cover the difference.

If the price of the company’s common stock increases significantly during the term of the ASR transaction, the total number of shares that could be purchased at the final price per share could be less than the number of shares initially delivered by the dealer to the company. In that case, the company will be obligated to deliver either cash or shares (at the company’s election) to the dealer upon completion of the ASR transaction. If the company elects to deliver shares, then the company must register those shares for public resale by the dealer or they will be subject to a liquidity discount to reflect the fact that they are restricted shares that cannot be freely transferred by the dealer.

Securities Law Considerations
Rule 10b-5
Rule 10b-5 under the Securities Exchange Act of 1934 (Exchange Act) provides that, among other things, it is unlawful to “make any untrue statement of a material fact” or to “omit to state a material fact to make the statements made not misleading” in connection with the purchase or sale of any security. Thus, the company must not be in possession of material nonpublic information (MNPI) on the date of execution of the contract for the ASR transaction. Further, if the transaction is subject to a cap or a collar, the company must not be in possession of MNPI during the dealer’s initial hedging period. Following these key dates, the ASR transaction operates as a “10b5-1 plan,” meaning that the company may not (i) control or influence (or attempt to control or influence) the dealer’s decision to make any purchases or sales of the company’s common stock or (ii) amend the ASR transaction at a time when it is in possession of MNPI. If the company is required to deliver cash or shares upon completion of the ASR transaction, it should not elect to change the default settlement option if it is in possession of MNPI.

Disclosure in Exchange Act Filings
A company should determine, in consultation with its counsel, whether the contract for an ASR transaction is a material contract that is required to be disclosed under Item 1.01 of Form 8-K. If it is, the 8-K should be filed before the beginning of the ASR transaction’s averaging period in order to address potential MNPI concerns under Rule 10b-5. Even if a company concludes that the contract for the ASR transaction is not a material contract, the company may conclude, for any of a number of reasons, that it is desirable or prudent to disclose the ASR transaction in a press release and/or under Item 7.01 or Item 8.01 of Form 8-K. Shares actually repurchased in the ASR transaction must be disclosed on a quarterly basis pursuant to Item 703 of Regulation S-K.
Rule 10b-18
Rule 10b-18 under the Exchange Act provides a limited safe harbor from potential market manipulation liability where a company's open market repurchases of its own common equity securities are effected in accordance with the rule's conditions. According to SEC staff guidance, ASR transactions are not eligible for the safe harbor protections provided by Rule 10b-18 because they “are private (off-market) transactions,” while the safe harbor “applies only to open market purchases.” The staff has further noted that “the Rule 10b-18 safe harbor also is not available for the [dealer’s] covering transactions, as these transactions are not agency or riskless principal trades effected on behalf of the issuer.”

This SEC staff guidance does not mean that share repurchases pursuant to an ASR transaction are presumptively manipulative or otherwise fundamentally “suspect.” To address potential market manipulation concerns, however, the size and term of an ASR transaction is typically structured so that the company can show that it could have purchased the same number of shares in an open market repurchase program over the minimum term of the ASR transaction in accordance with Rule 10b-18. The fact that a company has entered into an ASR transaction does not inherently preclude the company from effecting open market repurchases in accordance with Rule 10b-18; however, a company considering effecting open market repurchases when it has a contract for an ASR transaction in place should consult with counsel regarding the potential implications.

Typical ASR Contract Terms

Acquisitions, Dispositions, Mergers and Tender Offers
A typical contract for an ASR transaction gives the dealer the right to adjust the terms of the ASR transaction or to terminate and settle the ASR transaction in the event of:

- an announcement of any acquisition by the company involving the issuance of the company’s common stock,
- an announcement of any acquisition or disposition of assets by the company or any of its subsidiaries for which the aggregate consideration exceeds a specified percentage of its market capitalization, and
- an announcement of any acquisition or proposed acquisition of the company’s common stock by merger or tender offer or ASR transaction.

Dividends
An increase in ordinary quarterly cash dividends above projected quarterly dividends at the time of the ASR transaction typically gives the dealer the right to terminate and settle the ASR transaction (and any change in projected ex-dividend dates typically gives the dealer the right to adjust the terms of the ASR transaction).

Equity Offering
The announcement of an equity offering by the company may result in suspension of the calculation period of the ASR, effectively extending the term of the ASR, or give the dealer the right to terminate and settle the ASR transaction.

Termination Price
If the market price of the company’s common stock falls below a specified termination (typically around 50 percent of current market price), then the dealer typically has the right to terminate and settle the ASR transaction.

Other Terms
In addition to the matters described above, the contract for an ASR transaction typically incorporates a number of additional events, most of which are incorporated from the ISDA Equity Derivatives Definitions, that may give the dealer the right to adjust the terms of the ASR transaction or to terminate and settle the ASR transaction, including:

- stock splits and stock dividends,
- issuance of common stock at less-than-prevailing market prices,
- changes in law,
• loss of stock borrow,
• increased cost of stock borrow,
• market disruption,
• regulatory disruption, and
• nationalization, insolvency and delisting.

1 The actual percentage agreed by the company and the dealer varies and is subject to company-specific considerations, including trading volume and regulatory issues.

2 The published VWAP price used to determine the final price typically excludes transactions during periods of time during the trading day when the company’s purchase of its own shares would not qualify for the limited safe harbor under Rule 10b-18 under the Exchange Act.

3 The discount will depend primarily on the value of the early termination option to the dealer, which, in accordance with option pricing formulas, will in turn depend primarily on the duration of that option, the volatility of the company’s common stock and prevailing interest rates.

4 A company should therefore consider dealer credit risk as part of its evaluation of an ASR transaction.

5 For transactions that are subject to a cap or collar, the dealer’s initial hedging activity will impact pricing and thus could be attributed to the company.

6 If the ASR transaction is disclosed under Item 1.01 of Form 8-K, then the contract for the ASR transaction need not be filed with the Form 8-K, but is required to be filed as an Exhibit to the company’s next 10-Q.

7 See Division of Market Regulation: Answers to Frequently Asked Questions Concerning Rule 10b-18 (last modified November 17, 2004), available here at Question 14.

8 The SEC staff has taken the position that “[a]n issuer may effect privately negotiated repurchases (which are outside the safe harbor) without jeopardizing the availability of the safe harbor for its open market repurchases.” At the same time, the SEC has emphasized that “regardless of whether an issuer’s repurchases technically satisfy the conditions of Rule 10b-18, the safe harbor is not available if the repurchases are fraudulent or manipulative, when viewed in the totality of the facts and circumstances surrounding the repurchases (i.e., facts and circumstances in addition to the volume, price, time and manner of the repurchases).” Indeed, the SEC has further noted that the “safe harbor... does not confer absolute protection from all liability for purchases (e.g., purchases that are part of a plan or scheme to evade the federal securities laws)—even if made in technical compliance with the Rule.”

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