

# SEC Internal Controls Case Demonstrates Agency's Focus On MNPI Issues In The Stock Buyback Context

*October 19, 2020*

Late last week – for the first time in 40 years – the SEC announced a settlement of an internal controls case against an issuer arising from its repurchase of its own shares. The SEC found that Andeavor bought back \$250 million of stock without first engaging in an adequate process to ensure that the company did not have material non-public information (MNPI) related to on-again, off-again takeover negotiations with Marathon Petroleum Company. Andeavor, now a subsidiary of Marathon, was ordered to pay a \$20 million penalty and to cease and desist from future violations of the Securities Exchange Act's internal controls provisions.

This case is a wake-up call – particularly in the current environment where stock buybacks are frequent market occurrences – that the SEC will be monitoring such activity, scrutinizing companies' controls and decision-making when the buyback coincides with market-moving events, and bringing cases with potentially meaningful penalties even where there is no finding that the company violated the federal securities laws' antifraud provisions by actually trading on the basis of MNPI.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors

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NEW YORK

**Matthew Salerno**  
+1 212 225 2742  
[msalerno@cgsh.com](mailto:msalerno@cgsh.com)

**James Langston**  
+1 212 225 2784  
[jangston@cgsh.com](mailto:jangston@cgsh.com)

**Jeff Karpf**  
+1 212 225 2864  
[jkarpf@cgsh.com](mailto:jkarpf@cgsh.com)

**Nicolas Grabar**  
+1 212 225 2414  
[ngrabar@cgsh.com](mailto:ngrabar@cgsh.com)

**Francesca Odell**  
+1 212 225 2530  
[flodell@cgsh.com](mailto:flodell@cgsh.com)

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WASHINGTON DC

**Matthew Solomon**  
+1 202 974 1680  
[msolomon@cgsh.com](mailto:msolomon@cgsh.com)



## Facts

The short order is worth a read in its entirety, and can be found [here](#), but the basic facts are: (1) in 2015 and 2016 Andeavor's Board of Directors authorized a stock repurchase of up to \$2 billion but only in compliance with a corporate policy that prohibited buybacks while the company was in possession of MNPI; (2) in February 2018, at the instruction of Andeavor's CEO, the company entered into a 10b5-1 plan under which over several weeks it repurchased \$250 million of shares at prices between \$97 and \$103 per share; (3) at the time the buybacks were commenced and the 10b5-1 plan was approved, however, Andeavor and Marathon CEOs had recently paused advanced takeover discussions, but were scheduled to hold meetings to continue discussing a potential merger, which ultimately culminated in a deal at \$150 per share announced on April 30, 2018; (4) Andeavor did not confer with persons (including the then-CEO, who was leading the discussions for Andeavor) reasonably likely to have MNPI to assess the deal's probability; and (5) as result, in the SEC's view, the company's internal controls were insufficient insofar as the company "failed to appreciate that the probability of Marathon's acquisition of Andeavor was sufficiently high at the time as to be material to investors."

## Key Takeaways

- *SEC reviews with the benefit of hindsight.*
  - Most fundamentally, the order demonstrates that the SEC will – with the benefit of hindsight – reach its own conclusions as to whether companies have adequate processes in place to ensure that there is no MNPI when a stock buyback is implemented (including by way of a 10b5-1 plan).
- *Companies should establish and regularly review and update robust and well-documented policies.*
  - This action counsels in favor of robust and well-documented policies and procedures to ensure all relevant internal stakeholders are consulted and any relevant information is considered prior to launching a stock buyback plan. Instituting policies and procedures of this type should position companies well to respond to any later regulatory inquiry with a credible and effective narrative demonstrating compliance, but only if the policies and procedures are actually followed. The record also matters. If internal documents tell a story that differs from the narrative established in discharging the policies and procedures, the SEC will be more likely to second guess whether the company's policies and procedures work in practice.
- *Companies should exercise caution when adopting 10b5-1 plans or authorizing trading while a highly material event is more than remote.*
  - While a 10b5-1 plan can offer protection in connection with stock repurchases, the SEC will carefully consider whether the company possessed MNPI at the time the plan was entered into (or amended). Here, the SEC took issue with the fact that the buybacks were completed just two weeks before the parties reached an agreement in principle on terms and five weeks before the deal was signed, suggesting that in the SEC's view Andeavor may have had MNPI at the time the 10b5-1 plan was adopted.
  - Implementing a longer waiting period between the 10b5-1 plan and subsequent trading can be helpful, but even this will not fully protect a company where in the SEC's view there was MNPI at the time the plan was implemented, assuming other controls are not (in the SEC's view) sufficient.
- *Although the SEC did not pursue insider trading charges in Andeavor, the potential implications for MNPI assessments and potential insider trading concerns should also be considered.*
  - The order leaves unresolved whether it would have been sufficient if Andeavor had undertaken a more robust process in which the CEO and other key executives who might have

possessed MNPI had been interviewed by counsel, and after completing and documenting that investigation counsel had concluded that the company was not in possession of MNPI. While there was no finding of insider trading liability, the SEC's order makes plain that, in its view, the status of the takeover was material. Although that view is debatable, it provides a potentially important data point on where the SEC may seek to draw the line in assessing when negotiations reach the tipping point into constituting MNPI. One wonders whether the SEC conducted an investigation focused principally on insider trading but, for settlement purposes, elected to resolve the matter with a controls violation and a substantial penalty.

— *Is this a sign of more buyback scrutiny to come from the SEC?*

- Finally, we note that the SEC is adept at undertaking investigations into potential improprieties of all stripes regarding companies' stewardship of MNPI. In the stock buyback context, for example, the Enforcement Division need only look at significant increases in stock prices and work backwards to see which companies did buybacks, and then "test" for potential improprieties. We may well see more investigations and cases in this area, especially given the political focus on buybacks, so now is an excellent time for companies revisit their insider trading policies, controls related to MNPI, policies in connection with blackout periods, and other MNPI-related policies, and ensure that if the SEC comes knocking the company has done all it can to guard against the agency second-guessing its actions.

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