SEC Imposes Significant Penalty Related to Stock Buyback Not Subject to Proper Internal Controls

On October 15, 2020, the Securities and Exchange Commission ("SEC") issued an order (the "Order")[1] accepting a $20 million settlement with Andeavor LLC ("Andeavor") in connection with what the SEC found to be Andeavor's violation of Exchange Act Section 13(b)(2)(B) due to its failure to devise and maintain internal accounting controls to ensure that certain stock buyback transactions were made in accordance with its Board of Directors' authorization.

Summary

While Andeavor was in the midst of merger discussions with Marathon Petroleum Corporation ("Marathon"), it internally approved a repurchase of $250 million worth of its common shares under a purported Rule 10b5-1 plan. Rather than focus on charging the company or its executives with violating the securities laws by adopting the repurchase plan while in possession of material non-public information, the SEC found that Andeavor violated the Securities Exchange Act of 1934 (the "Exchange Act") because it did not maintain internal accounting controls in order to ensure the buyback was in accordance with the repurchase authorized by its Board of Directors.

Background and Findings

In March of 2017, Andeavor's CEO and the Chairman and CEO of Marathon began discussions of a potential business combination. In August of 2017, they entered into a confidentiality agreement and began to share confidential financial information. By the end of the following month, the two companies had conducted thorough analyses and concluded that a combination of their businesses could be substantially more profitable. However, in October of that year Marathon's CEO requested that the merger discussions be suspended after growing concerned about the potential dilutive impact the transaction might have on Marathon's shares.

On January 30, 2018, Marathon's CEO asked Andeavor's CEO to resume the merger discussions and they planned an in-person meeting for February 23, 2018. Prior to the meeting, Andeavor's CEO and CFO discussed certain materials with the company's financial advisor which indicated that the transaction likely would require up to a 40% premium over Andeavor's share price. Just two days prior to the meeting, Andeavor's CEO directed its CFO to initiate a share buyback to repurchase $250 million of shares pursuant to authorizations granted by the Board of Directors (the

[1] For the full text of the Order, see *In the Matter of Andeavor LLC* (SEC Release No. 90208) available at https://www.sec.gov/litigation/admin/2020/34-90208.pdf?campaign_id=4&emc=edit_dk_20201020&instance_id=23300&nl=dealbook®i_id=93925778&segment_id=41594&te=1&user_id=60c1579f9b2869911e03324db00ebe5e (October 15, 2020). Unless otherwise specified, all quoted statements in this memorandum are taken from the Order.

"Board") in 2015 and 2016 allowing for repurchases, in the aggregate, of up to $2 billion of shares. At the time of the buyback, Andeavor's legal department approved the repurchase under a purported Rule 10b5-1 plan.

On February 23, the merger discussions resumed and the stock buyback began. The stock buyback continued until March 28 and the stock was purchased at prices ranging from $90 to $103 per share. On April 30, 2018, Andeavor announced it would be acquired by Marathon in a transaction that valued the company at over $150 per share.

Although Andeavor had previously conducted stock repurchases, the relevant Board authorizations from 2015 and 2016 required that any repurchase must comply with Andeavor's securities trading policies. These policies in turn prohibited Andeavor from buying, or entering into a Rule 10b5-1 plan to buy, its securities while it was in possession of material non-public information. The SEC found that Andeavor failed to design and maintain internal accounting controls sufficient to provide reasonable assurance that its buyback would be executed in accordance with the authorization. The SEC also stated that Andeavor's legal department approved the buyback plan based on a deficient understanding of all relevant facts and circumstances regarding the discussions with Marathon, which resulted from Andeavor's insufficient internal controls.

The SEC based its findings on the "abbreviated and informal" process that was used to evaluate the materiality of the acquisition discussions. The process did not require conferring with "persons reasonably likely to have potential material information regarding significant corporate developments." For example, no one involved in approving the repurchase discussed the prospects of the Andeavor/Marathon merger with the Andeavor CEO, who was the primary negotiator of the transaction. Those involved in the approval failed to take into account that the probability of the acquisition was high enough to be considered material to investors.

Dissent

On November 13, 2020, Commissioners Hester M. Peirce and Elad L. Roisman released a public statement[2] explaining their reasoning for voting against the Andeavor settlement. In their statement, the commissioners stated they "believe the Commission's findings entails an unduly broad view of Section 13(b)(2)(B) of the Securities Exchange Act."[3] The commissioners pointed out that, although the events may look like insider trading if one looks solely at their timing, the repurchases were made under a Rule 10b-5-1 plan approved in February 2018 at a time when the Andeavor legal department had determined that the company did not have material nonpublic information. Based on these facts, Commissioners Peirce and Roisman believe one cannot conclude that Andeavor acted with the intent necessary for a Rule 10b-5 violation. The two commissioners also asserted that Section 13(b)(2)(B) is not the correct section on which to base civil penalties, noting that although the provision has been seen as a "general internal controls provision" it actually only applies to "internal accounting controls." Since there was nothing indicating that Andeavor's internal *accounting* controls were inadequate in relation to the stock repurchase, the commissioners believe that it was not proper to impose a fine based on Section 13(b)(2)(B).

Conclusion

Without proper internal accounting controls in place prior to the share buyback, Andeavor was found to have violated Exchange Act Section 13(b)(2)(B) and agreed to a civil penalty of $20 million. The key takeaway from this SEC action is the need for the implementation of rigorous and thorough internal accounting controls that govern the process through which companies contemplate and execute stock buybacks. These controls should be designed to

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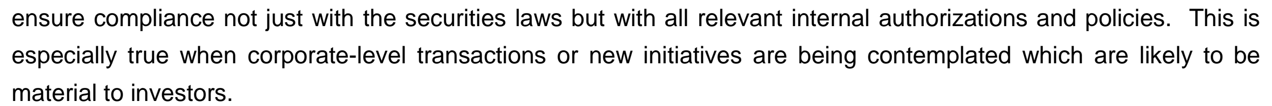
[2] For the full text of the Public Statement, see *Statement of Commissioners Hester M. Peirce and Elad L. Roisman – Andeavor LLC* available at https://www.sec.gov/news/public-statement/peirce-roisman-andeavor-2020-11-13 (November 13, 2020).

[3] *Id.*



ensure compliance not just with the securities laws but with all relevant internal authorizations and policies. This is especially true when corporate-level transactions or new initiatives are being contemplated which are likely to be material to investors.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; or Bruna Amaral at 212.701.3389 or bamaral@cahill.com; or email publications@cahill.com.

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