

## **Stock Buybacks in Publicly Traded Corporations in the USA: Practice, Shortcomings, and Risks**

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## Abstract

The topic of this thesis is the assessment of the benefits and risks corollary to stock buybacks based on the US experiences with a primary focus on the legal aspects but including the points of view of finance, economics, and business as one of the alternative ways to reward shareholders instead of paying dividends and analyzing the risks of such practice. This analysis is done primarily through the lenses of the relevant corporate laws of New York and Delaware as the jurisdictions having the most experiences with buybacks as well as the model law of the majority of the US states.

The thesis aims to better understand the practice of buybacks by answering the following research questions. First, why are buybacks resorted to in the US, and why is the number of buybacks the highest there? Second, what regulatory mechanisms exist in the US on the federal and state level for supporting stock buybacks? Lastly, can the regulatory tools developed in the US be utilized in other developed economies such as the European Union, United Kingdom, or Japan?

While stock buybacks are widely utilized in the US, they are rarely resorted to in other contemporary economies. The US possesses therefore the most tested legal system for this practice. Consequently, it is the most suitable legal system that can be used as a model that could provide useful insights into the functioning of this practice over the decades of the existence of this mechanism.

Even though the EU is the second biggest player in the globalized world of big corporations and financial markets (with or without Brexit), this practice is marginal in comparison with the US. Consequently, the number of publications on this practice in the EU is scarce. Even less in countries such as Slovakia without a full-functioning stock exchange.

The methodology of this thesis is built on the statutory analysis of law, complemented for deeper understanding with legal scholarly publications along with empirical study based on

relevant case law. As the question in the focus of this thesis transgress the confines of law and tends to change at various times, resorting to general media is a must, particularly the leading financial newspapers. The picture of the real world is complemented by statistics and quantitative data analysis.

## **List of Abbreviations**

DGCL	Delaware General Corporation Law (General Corporation Law, Delaware Code, Title 8, Chapter 1)
ESP	Earnings-per-stock
EU	European Union
MBCA	Model Business Corporation Act
NYBCL	New York Business Corporation Law (Business Corporation Law, Consolidated Laws of New York, Chapter 4)
UK	United Kingdom
US	United States of America
USD	United States dollar
SEC	The United States Securities and Exchange Commission
S&P	Standard and Poor's

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# Introduction

## 1.1. Choice of the topic

Stock buyback (or share repurchase) is a practice in the US primarily used as a corporate finance management tool for rewarding shareholders for their investment in a corporation. The problem that makes research on stock buybacks in publicly traded corporations challenging is that the topic is at the crossroads of corporate and corporate finance law, capital markets, and securities regulation, as well as such other disciplines as finance, economics, and business governance.

On one side, this mechanism provides a useful alternative for directors to reward demanding shareholders and send the appropriate message to the market. On the other hand, stock buybacks can serve as an anti-takeover tool or as an opportunity for insider trading. Stock buybacks then do not need to be used for internal corporate finance purposes but also for other purposes, e.g. to protect more executives themselves than a corporation from hostile takeovers by proposing a self-tender-offer to over-bid, the take-over offers, especially in two-tier proposals. Technically the repurchase can serve shareholders to receive a distribution of funds as it can enable executives to grab control over the company. The abovementioned aspects make stock buybacks in publicly traded corporations in the US a suitable topic for the master thesis with a broader scope of legal fields and multijurisdictional dimensions.

While stock buyback is an ordinary transaction in the US, this mechanism is relatively marginal outside of the US; for lawyers as well. In light of that, we ask three key questions. The first of the research questions of this thesis is aimed at whether and if yes, why this practice is so unique for the US corporate environment and so relatively uncommon for other comparable developed capitalist economies.

Law influences business practice and vice versa. Hence, in the second place we need to ask what is the regulatory environment in the US and other jurisdictions that makes the US different.



Since exchanges in London, Frankfurt, Amsterdam, or Tokyo are functioning and are among the major ones after the New York Stock Exchange and NASDAQ Stock Market, it is reasonable to ask why stock buybacks in publicly traded corporations in the UK, the EU, or Japan are not practiced more, what other jurisdictions can change?<sup>1</sup> Or, put the other way around, why European and other non-US corporations are not using stock buybacks as extensively as their US counterparts?

### **1.2. Limitations of the scope of the thesis**

The topic of stock buybacks is broad, therefore the limitation to stock buybacks as an alternative to dividends and as a hostile take-over mechanism is needed. Other alternatives to dividends are briefly covered only to paint a broader picture and maybe overly ambitiously spark the curiosity of readers that would use this thesis somewhere at the starting point for their research for a thesis topic. The same applies to other tools to prevent hostile take-over that will be described only as a frame for stock buybacks as one of the possible options.

### **1.3. Methodology and jurisdictions**

The main methodology of this thesis is the analysis of relevant statutory law and case law, which provide both practical insight into the stock buybacks and an assessment of legal issues connected to this practice. Along with this, to understand the subject matter, the related issues, and solutions, as well as to develop one's own opinion, scholarly articles are also used as sources. Finally, articles in financial news are very helpful for the practical side of risk connected to this practice with the added value of verified sources. We also implemented

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<sup>1</sup> For comparison of the biggest stock exchanges see: 'New York's stockmarkets are thrashing Hong Kong and London' (*The Economist*, 7 March 2023) <<https://www.economist.com/finance-and-economics/2023/03/07/new-yorks-stockmarkets-are-thrashing-hong-kong-and-london>> accessed 15 June 2023.

statistics and data analysis to work with a relatively objective comparison of the US stock buybacks and buybacks practiced outside of the US.

Since this topic is highly practical, an interdisciplinary analysis is required, too. Taking a look at the problem of stock buybacks purely from the perspective of law would not bring much added without an insight into business thinking and the economy behind the stock buybacks. It is inevitable to look at the issues connected to stock buybacks from the perspective of the economy or business and corporate finance management, and to some extent also public policies. This overlap of fields brings significant challenges to the author – by profession a lawyer – to comprehend and use in the right way the business backgrounds of the stock buybacks practice to bring added value to this thesis instead of providing purely descriptive text.

This thesis refers mainly to the US legal system, specifically the laws of the state of New York and Delaware as the leading jurisdictions as far as stock buybacks are concerned within the US for the laws that are crucial for the regulation of this practice. We also provide partial and short comparisons of the regulation and practice of stock buybacks, if any, with other famous jurisdictions such as the EU, the UK with other Common law countries, or Japan. As we stated earlier, the choice of jurisdictions is not ignorant of the existence of other major economies but rather respects the very limited scope of the master thesis.

Providing other jurisdictions leads to the use of the comparative method. This method is used more for showing different perspectives and providing answers to the lack of stock buybacks in other economies than for finding the perfect solution in the melting pot of various approaches and regulations.

#### **1.4. The roadmap to the thesis**

To reach the goal of this thesis and answer the set questions, the structure is adjusted to this expected outcome.

The first chapter explains the place of the alternatives to dividends within the US business practice and corporate finance law and provides a closer look at the stock buybacks as chosen as one of the alternatives, its risks, and its application. The conclusion of the first chapter brings a short analysis of whether the US is alone in pioneering stock buybacks in comparison to other countries.

Connected to the outcomes from the first chapter, the second chapter assesses the shortcomings and criticism of stock buybacks and the comparison of law and practical data of other jurisdictions. The conclusion of the second chapter provides a comparative analysis of other jurisdictions and their public policies and answers the question of the influence of the level of regulation on the application of stock buybacks.

Finally, the conclusion provides the answers to research questions and provides a short list of recommendations on whether and how should other compared jurisdiction approach the stock buyback practice. This thesis strives to provide a puzzle picture on which we can answer whether stock buybacks are the functional equivalent of dividends and risks of this practice, whether they are US-specific practices, and whether the law and regulation influence the application of stock buybacks.

## 1. Stock Buybacks as a Corporate Finance Practice

One of the main incentives for investors to purchase stocks of a corporation is the right to dividends which represents “[a] portion of a company’s earnings or profits distributed pro rata to its shareholders, usually in the form of cash or additional shares.”<sup>2</sup> However, not all the time is a corporation willing to pay dividends to its shareholders. A corporation can either retain the profits or distribute the funds to shareholders through dividends or its equivalent. In the US, this decision is in the hands of executives and dependent on their business judgement and a dividend policy.<sup>3</sup>

The reasoning for such a decision might be to keep or to re-invest the profit. “If instead the corporation pays no cash dividends to its stockholders, it has the whole million dollars to invest internally. Such reinvestment will tend to raise the capital value of its stock.”<sup>4</sup> One of the malevolent oppressive reasons is the device of freeze-out to squeeze out the minority shareholders by not declaring the dividends.<sup>5</sup>

Of course, shareholders have a solution if a corporation decides to not pay the dividends – to sell their stocks. However, this option requires (i) an existing market for such stocks; (ii) liquidity or attractiveness of such stocks; and (iii) a selling price of a stock higher than an original acquiring price. A liquid market might be problematic in case of a close corporation in which the leaving shareholder is dependent on a limited number of shareholders and their will to acquire the stocks.<sup>6</sup> Especially if a majority shareholder has enough stocks and does not need any more voting rights to effectively control a corporation. Also, this scenario might create an issue of non-market prices of stock when the majority shareholder will make minority

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<sup>2</sup> Bryan A. Garner, *The Black’s Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 547.

<sup>3</sup> William W. Bratton, *Corporate Finance* (7<sup>th</sup> edn, Foundation Press 2012) 795.

<sup>4</sup> Milton Friedman, *Capitalism and Freedom* (first published 1962, The University of Chicago Press 1982) 130.

<sup>5</sup> *Donahue v. Rodd Electrotape Co. of New England, Inc.*, 367 Mass. 578, 328 N.E.2d 505 (Mass. 1975).

<sup>6</sup> For definition of close corporation see for example Sec. 342 of the DGCL.

shareholders sell their stocks for a lower price. These problems are not purely hypothetical as showed by the milestone decision of the Supreme Judicial Court of Massachusetts in the case of *Donahue v. Rodd Electrottype Co.*<sup>7</sup> These issues are not reserved only for close corporations. Outlined issues can as well appear in big publicly traded corporations but for different causes. Especially since the attractiveness and sell prices of stock might decline on the public capital market within a few seconds. Even if the market is plausible, “[o]wners want to be able to realize a return on an ongoing basis and not have to wait until they sell their interests in the company”.<sup>8</sup>

This might be also a problematic scenario from a business and economic point of view. Unhappy shareholders can decide to sell their stocks, price of the stocks may fall along with the trust in a corporation on the market. Or the unsatisfied shareholders with the expectation of the pro rata part of a corporation’s profit, to which they have a right, can sue a corporation as it happened in the groundbreaking Michigan Supreme Court case of *Dodge v. Ford*.<sup>9</sup> Executives are therefore put under pressure to satisfy their investors to distribute the spare cash among shareholders.<sup>10</sup>

Law reacted to these scenarios. For instance, the Model Business Corporation Act (the “MBCA”) sets the terminology to the real world of dividends and its alternatives by defining “Distribution” as “a direct or indirect transfer of money or other property (except its own shares) or incurrence of indebtedness *by a corporation to or for the benefit of its shareholders in respect*

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<sup>7</sup> *Donahue v. Rodd Electrottype Co. of New England, Inc.*, 367 Mass. 578, 328 N.E.2d 505 (Mass. 1975).

<sup>8</sup> Linda O. Smiddy & Lawrence a Cunningham, *Corporations and Other Business Organizations, Cases, Materials, Problems* (LexisNexis 2010) 493.

<sup>9</sup> *DODGE et al. v. FORD MOTOR CO. et al.*, 204 Mich. 459, 170 N.W. 668 (Mich. 1919). Michigan Supreme Court decided in favor of Dodge brothers that they have a right to dividends. This precedent is connected to the Milton Friedman’s economic idea of shareholders primacy, which means that the main purpose of the corporation is to produce profit for shareholders. See: Milton Friedman, *Capitalism and Freedom* (first published 1962, The University of Chicago Press 1982) 133.

<sup>10</sup> Dan McCrum, 'Lex in Depth: the case against share buybacks' *Financial Times* (London, 30 January 2018), <<https://www.ft.com/content/e7fb2144-fbae-11e7-a492-2c9be7f3120a>> accessed 15 June 2023.

*of any of its shares.*<sup>11</sup> A distribution may be in the form of a declaration or payment of a dividend; a purchase, redemption, or other acquisition of shares; a distribution of indebtedness; or otherwise.” (Emphasis added).<sup>12</sup> This example shows how the law does not presume dividends to be the only distribution of funds among the shareholders. Distribution under MBCA creates a bigger term encompassing the dividends and its functional equivalents.

In conclusion, it is better to provide shareholders with functional equivalents of dividends, especially when they were paid previously if such a move is performed within the legal limits than to avoid all forms of distribution.

### **1.1. Functional equivalents to dividends**

As we outlined, when a corporation (or its executives) does not want to declare dividends, they need to maintain social peace with its shareholders by solving the three issues of existing market, liquidity, and profitability. The issue of whether there is an existing market for the stocks is problematic and can be solved in case of a close corporation for example by changing the governing documents to allow the sale of stocks outside of current shareholders or initiating an IPO and enter one of the stock exchanges. On the other hand, liquidity and profitability can be solved by various tools to mitigate the risk of dissatisfaction of the shareholders with such a decision. These tools can be either direct or indirect. Direct way as a stock buyback provides some shareholders with funds without the need for any additional steps while indirect tools require more additional activity of the shareholders, such as finding a purchaser of the stocks. The palette of indirect mechanisms is bigger and includes for example:

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<sup>11</sup> Model Business Corporation Act, American Bar Association, Committee on Corporate Laws.

<sup>12</sup> Sec. 1.40(6) of the MBCA. According to the American Bar Association, MBCA was adopted by 36 states in the US. See: American Bar Association 'State Enactments of MBCA' available at [https://www.americanbar.org/content/dam/aba/administrative/business\\_law/corplaws/enactment-table.pdf](https://www.americanbar.org/content/dam/aba/administrative/business_law/corplaws/enactment-table.pdf).

*Stock splits*

This device is based on “[t]he issuance of two or more new shares in exchange for each old share without changing the proportional ownership interests of each shareholder.”<sup>13</sup> For instance, each stock is split into three smaller stocks. A stock with a par value of USD 90 is divided into three stocks with a par value of USD 30. The par value of the shareholders’ assets stays the same but because individual stocks are smaller, they are cheaper (from USD 90 to USD 30). This practice brings more liquidity because “[s]tock split lowers the price per stock and thus makes the stock more attractive to potential investors.”<sup>14</sup> Therefore, a shareholder that is expecting a return on its investment, when dividends are not offered, can sell its stocks more easily and monetize his investment. This solves the problem of liquidity. Little profitability can also occur if the price range (dependent on a splitting ratio) is established at the optimal level. Then not only interest of the public in these new smaller stocks is increased, but to some degree also their market value.<sup>15</sup>

*Reverse stock splits*

As the name suggests, this is opposite to the stock splits. By definition, it is a “reduction in the number of a corporation’s stocks by calling in all outstanding stocks and reissuing fewer stocks having greater value.”<sup>16</sup> The greater value of a stock can be attractive for some investors having a bigger budget, e.g. institutional investors.<sup>17</sup> Which again, might solve liquidity and profitability issues through not only higher value accumulated from adding-up par values of

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<sup>13</sup> Bryan A. Garner, *The Black’s Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 1555.

<sup>14</sup> Ibid.

<sup>15</sup> Richard T. McDermott, *Legal Aspects of Corporate Finance* (3<sup>rd</sup> edn, Lexis Publishing 2000) 619.

<sup>16</sup> Bryan A. Garner, *The Black’s Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 1555.

<sup>17</sup> Chung, Kee H. and Sean Yang, 'Reverse Stock Splits, Institutional Holdings, and Share Value' [2015] *Financial Management* 44. 1, 177, 177–178.

previously smaller stocks but also from the increase of the market value overall because of the involvement of famous investors pushing the market value up.<sup>18</sup>

### *Spin-offs, split-offs, and split-ups*

In these cases, not only stocks are split, but also a corporation itself. During spin-offs, a division of an original corporation becomes an independent corporation, and stocks in this new corporation are distributed to shareholders of an original corporation while they keep their stocks in both corporations.<sup>19</sup>

If a successful business of an original corporation is separated into individual corporation, shareholders get proportionally stocks in a new corporation. As a result, a shareholder can sell these stocks connected to successful business easier since they are more attractive. If the spin-off is performed diligently and with careful planning and marketing, it can provide shareholders both with profitability and liquidity.

In case of split-offs, the shareholders get stocks in the new corporation in return for stocks of an original corporation.<sup>20</sup> Split-ups are technically split-offs in which the original corporation ceases to exist.<sup>21</sup>

The logic of more attractive stocks is the same, therefore expected higher liquidity and profitability are also possible if the split-off or split-up is performed with due care.

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<sup>18</sup> Ibid., 207.

<sup>19</sup> Bryan A. Garner, *The Black's Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 1531.

<sup>20</sup> Bryan A. Garner, *The Black's Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 1531.

<sup>21</sup> Ibid.



## *Tracking stocks*

Besides the stock splits and splitting a corporation itself is a tracking stock tool, also called designer stocks. These are the stocks issued by a parent corporation to track a certain segment or division of a corporation. These stocks are connected to the earnings and cash flow of the division and do not represent an ownership interest in a subsidiary.<sup>22</sup> As in case of the spin-off, tracking stocks with appropriate strategy can lead to profitability and liquidity of the selling shareholders.

### **1.2. Stock buybacks as a distributing mechanism**

All the indirect tools for rewarding the shareholders are by their nature problematic for executives from the point of view of conflict management since they require additional steps from shareholders to receive the equivalent of the dividends. In the example of the stock split, a shareholder must look for a purchaser of the new more liquid stocks and sell them to generate revenue that will be equivalent to unpaid dividends. The fewer actions required from dissatisfied shareholders, the better.

As seen in the definition of “Distribution” by MBCA, the law counts into this phrase also the practice of “a purchase, redemption, or other acquisition of shares”.<sup>23</sup> Stock buybacks or stock repurchases as a form of redemption are “the reacquisition of a security by the issuer.”<sup>24</sup> However, there is a difference between a redemption in the narrow sense and a repurchase. While the terms and conditions of redemption are generally set in the articles of association and do not require a bilateral agreement between a corporation and its shareholders, the repurchase

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<sup>22</sup> William W. Bratton, *Corporate Finance* (7<sup>th</sup> edn, Foundation Press 2012) 586–587. For more insight into use of tracking stocks see also: Peter H. Huang and Michael S. Knoll, 'Corporate Finance, Corporate Law and Finance Theory' [2000] 74 S Cal L Rev, 175, 187–188 or York Schnorbus, 'Tracking Stock in Germany: Is German Corporate Law Flexible Enough to Adopt American Financial Innovations' [2001] University of Pennsylvania Journal of International Economic Law 22.3, 541.

<sup>23</sup> Sec. 1.40(6) of the MBCA.

<sup>24</sup> Bryan A. Garner, *The Black's Law Dictionary* (first published 1891, West – A Thomson Reuters Business 2009) 1390.

is built on an agreement of both parties that a corporation buys back its stocks from shareholders based on a stock buyback program.<sup>25</sup> In the decision-making of directors of a corporation, stock buyback is a viable alternative to dividend payment.<sup>26</sup>

To make stock buybacks effective distribution of funds, shareholders to which dividends are not paid should receive some equivalent of the value of dividends.<sup>27</sup> To motivate shareholders to sell their stocks, companies mostly offer price higher than the market value (so-called self-tender offer). To shareholders that decide to exit a corporation all three issues are solved. Stocks are liquid since there is a purchaser – a corporation itself and profitability are ensured by a self-tender offer. In case of a close corporation, even the market was created by the decision to buy back the stocks.<sup>28</sup>

Loyal staying shareholders are offered a collection of benefits. The critical indicator here is the Earnings-per-stock (ESP).<sup>29</sup> In a simplified way, the ESP is calculated as:

$$\frac{NI \text{ (Net income)}}{NS \text{ (Number of stocks)}} = EPS$$

For example, a corporation has a profit of USD 100,000 and 100 stocks. After paying out the dividends, ESP would be as follows:

$$\frac{USD\ 100,000}{100} = USD\ 1,000 \text{ per share (1.00 \% capitalization)}$$

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<sup>25</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 170.

<sup>26</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 52.

<sup>27</sup> Compared to dividends, the stock buybacks do not have to be applied pro rata and to all shareholders. Stock buyback can be applied only to some of a corporation's shareholders. See: William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 743.

<sup>28</sup> For a publicly traded corporation the existence of the market is not an issue per se, therefore we do not assess the existence of the market for the stocks further in this thesis.

<sup>29</sup> William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 743.

If a corporation buys back 20 stocks (and the selling shareholders get their profit), EPS for the remaining shareholders would change as follows:

$$\frac{USD\ 100,000}{80} = USD\ 1,250\ per\ share\ (1.25\ \% \ capitalization)$$

In the stock buyback scenario, the profit is distributed among the staying shareholders through the increased EPS of the stock (from 1 % to 1.25 %). The higher ESP is important for investors as an indicator of potential profit.<sup>30</sup> The market value of the stocks normally rises after the stock buyback in addition to decreasing the pool and increasing the ESP of the stocks. This does happen progressively over the years rather than rapidly.<sup>31</sup> In the end, value is distributed to the shareholders not through direct payment but via the economic outcome of the stock buyback. Shareholders either will see an increase in the market value of the stocks they hold if they decide to stay or get revenue from selling their stocks back to a corporation, mostly for a price exceeding the market.

Also, the pool of stocks for staying shareholders is reduced after the stock buyback. Staying shareholders then have under a simple common stock scenario higher profit with future dividends and stronger voting right since their percentage of participation rose higher. To sum it up, after a successful stock buyback, the staying shareholders have stocks (i) with higher ESP, which makes them more attractive to investors and therefore more liquid, (ii) with stronger voting rights and dividends, and (iii) higher market value of the stock over the years which makes them more profitable. Stock buybacks therefore also solve the liquidity and profitability

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<sup>30</sup> For elaborated, more detailed explanation of benefits of the stock buybacks for shareholders see for example William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 743.

<sup>31</sup> *Ibid.*, 744.

aspect for staying shareholders in case they decide to sell their stocks in the future. The letter to shareholders of Berkshire Hathaway, Warren Buffet stated that the stock count influences the ownership interest in a corporation. The condition is that “repurchases are made at value-accretive prices”. Staying shareholders lose if a corporation overpays.<sup>32</sup>

Of course, this applies under the ideal condition that other factors will not influence the price of the stocks or that the corporation will not issue new stocks which would dilute the acquired stronger voting and dividend rights. This risk might make stock buybacks a less pleasing alternative to some shareholders. Dividends or profitable sale are profits here and now. Benefits for staying shareholders are covered with various “what-ifs” which might be unattractive for a conservative investor with an aversion to risk.

The motivations of corporation executives for such a decision from a dividend-alternative perspective are taxes, signaling to potential investors and shareholders, and improving the debt-capital ratio. Mostly it is a tax regulation under which in the US and also in Europe capital gains are more favorably taxed than dividends.<sup>33</sup>

However, this benefit of stock buybacks is under political threat in the US. First, the administration of the US President Biden passed a 1 % excise stock buybacks tax effective as of January 1, 2023. This tax is “levied on net buybacks, meaning total shares repurchased minus new shares issued during the year”. To understand why even 1 % is a problem for corporations, we need to keep in mind that until this year, stock buybacks were not taxed at all. The expectation from this tax reform is to make corporations pay out dividends instead of buying

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<sup>32</sup> “When the share count goes down, your interest in our many businesses goes up. Every small bit helps if repurchases are made at value-accretive prices. Just as surely, when a company overpays for repurchases, the continuing shareholders lose. At such times, gains flow only to the selling shareholders and to the friendly, but expensive, investment banker who recommended the foolish purchases.” See: Warren E. Buffet, ‘To the Shareholders of Berkshire Hathaway Inc.’ (*BERKSHIRE HATHAWAY INC.*, 25 February 2023) <<https://www.berkshirehathaway.com/letters/2022ltr.pdf>> accessed 15 June 2023, 6.

<sup>33</sup> ‘All cashed up: Share buybacks in Europe’ (*The Economist* , 14 August 1998) <<https://www.economist.com/finance-and-economics/1998/08/13/all-cashed-up>> accessed 15 June 2023; William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 743.

back their own stocks.<sup>34</sup> Another idea behind this is to motivate corporations to reinvest. In direct criticism of the big oil-industry corporations President Biden proposed in his State of the Union Address quadrupling this tax to incentivize the reinvestment.<sup>35</sup>

Furthermore, dividends are expected to be paid regularly while executives can perform stock buybacks only when needed, hence they do not set expectations of shareholders for future payouts.<sup>36</sup> Executives must consider the fact that stock buybacks send the signal to the public and investors that a corporation does not see current investment opportunities in which it can invest surplus cash and decides to return a profit to shareholders. But at the same time, a corporation represented by its executives believes there will be opportunities in the foreseeable future and does not want to bind itself to a long-term commitment of dividends.<sup>37</sup> The question is how this signal and potential response of the public and investors fits into for instance business plans, marketing, or PR of a corporation. Moreover, by economic logic, a corporation is more interested in stock buyback during the sale on the market, when stocks are undervalued. Hence, the stock buyback undervaluation signals the trust of management in corporation's stocks.

This might be problematic in emerging markets in central and eastern Europe, as we assume.

From a practical experience in these countries, such as Slovakia, the markets might not function

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<sup>34</sup> Jennifer Williams-Alvarez 'The 1% Stock-Buyback Tax Hasn't Slowed Repurchases. A Proposed 4% Tax Might.' (*The Wall Street Journal*, 2 March 2023) <<https://www.wsj.com/articles/the-1-stock-buyback-tax-hasnt-slowed-repurchases-a-proposed-4-tax-might-f87044eb>> accessed 15 June 2023.

<sup>35</sup> "If they had, in fact, invested in the production to keep gas prices down — instead they used the record profits to buy back their own stock, rewarding their CEOs and shareholders. Corporations ought to do the right thing. That's why I propose we quadruple the tax on corporate stock buybacks and encourage long- — long-term investments. They'll still make considerable profit." See: 'President Biden's State of the Union Address' (*The White House*, 7 February 2023), <<https://www.whitehouse.gov/state-of-the-union-2023/>> accessed 15 June 2023. For criticism and more information about possible consequences of this tax see: Jennifer Williams-Alvarez 'The 1% Stock-Buyback Tax Hasn't Slowed Repurchases. A Proposed 4% Tax Might.' (*The Wall Street Journal*, 2 March 2023) <<https://www.wsj.com/articles/the-1-stock-buyback-tax-hasnt-slowed-repurchases-a-proposed-4-tax-might-f87044eb>> accessed 15 June 2023.

<sup>36</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 55.

<sup>37</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 55, 170, 184. See also: William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 744 or Eilís Ferran, *Principles of Corporate Finance Law* (Oxford University Press 2008) 205.

properly for various reasons. Either because of rough history, improper regulation, underqualified staff of an exchange, securities market institutions and service providers, or unpleasant public perception of the stock exchange. In this environment, the message of the stock buyback is not delivered to major players in the economy since they might not be active in the particular emerging market. In the first place, a publicly traded corporation might struggle to find shareholders willing to sell their stocks back to a corporation. This poses an existential threat to the successful facilitation of a stock buyback. If stocks are not repurchased, stock buyback is a failure. In the second place, even if the stock buyback is performed, the underdeveloped stock market causes a partial absence of benefits of the stock buyback for staying shareholders. The ESP will rise but there would be minimal or no growth in the stocks' market value. In the worst-case scenario, the market value will even drop.

Struggles to perform the stock buyback and subsequently provide shareholders with a higher market value of their investment as a part of a distribution of funds to shareholders (along with higher ESP and stronger rights) might be reasons for the rare practice of stock buybacks in the emerging markets of the central and eastern Europe. The successful signaling is therefore not an inevitable consequence of the stock buyback on emerging markets but rather a precondition for the widespread existence of this practice.<sup>38</sup>

Last but not least important in the eyes of a corporation's executives is keeping the debt at the desired level.<sup>39</sup> However, these are not the only motivations for stock buybacks. Professor Eilís Ferran offers a whole list of arguments for - and against - stock buybacks. To name a few, stock

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<sup>38</sup> Lack of information might be cause also by non-existing reporting of such practice in central and eastern European region. It is possible in our opinion that directors and shareholders in close corporations will use stock buybacks, especially in the Limited Liability Corporations after exit of a shareholder as in Sec. 120 and 113(5)-(6) of the Slovak Act No. 513/1991 Coll. Commercial Code, as amended, when a corporation buy back its stock from leaving shareholder and in time limit of six months will transfer ex-shareholder stock to a current shareholder(s) or new shareholder(s). By this mechanism can one shareholder strengthen its position within a corporation or manipulate with market price of a stock to generate profit which would be in the US labelled as market manipulation or insider trading.

<sup>39</sup> William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 744.

buybacks make stocks of a corporation actively traded which attracts new investors willing to invest more than current shareholders. The specific reason is to facilitate employee stock schemes. Another incentive might be a defense mechanism against a hostile takeover.<sup>40</sup> Additional use of stock buybacks is enhancing the compensation of CEOs.<sup>41</sup>

### 1.3. Methods and risks

#### 1.3.1. Methods of stock buybacks

Concerning the methods of stock buybacks, the options are quite colorful. A public corporation decides whether it is going to repurchase a portion of its own stocks on the secondary market as if it was buying any other stocks of any other corporation (open market) or using a public self-tender offer.<sup>42</sup> The third option is offering repurchases directly to individual shareholders through a financial intermediary.<sup>43</sup>

Self-tender offer can be made either without targeting a specific group of shareholders, or targeting such a pre-determined group of shareholders, e.g. employees or minority shareholders. In the past, targeted stock buybacks were often used for hostile takeovers as a greenmail. The acquirer threatens and greenmails the executives of the company with the risk of a hostile takeover after acquiring some minimum number of stocks to influence the composition of the board of directors. Greenmail involves a request for an overpriced self-tender offer to make a profit on the stock buyback. However, this practice was effectively banned by punitive tax treatment.<sup>44</sup>

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<sup>40</sup> Eilís Ferran, *Principles of Corporate Finance Law* (Oxford University Press 2008) 203–208.

<sup>41</sup> Shilon, Nitzan, 'STOCK BUYBACK ABILITY TO ENHANCE CEO COMPENSATION: THEORY, EVIDENCE, AND POLICY IMPLICATIONS' [2021] *Lewis & Clark Law Review* 25.1, 303, 317.

<sup>42</sup> Eilís Ferran, *Principles of Corporate Finance Law* (Oxford University Press 2008) 214. See also: James Forjan, David Durr, and John Theis, 'An Investigation of the Relationship Between Dutch Auction Repurchase Tender Offers and Cash Dividend Payments' [2000] *Managerial Finance* 26.8, 29, 30.

<sup>43</sup> James Forjan, David Durr, and John Theis, 'An Investigation of the Relationship Between Dutch Auction Repurchase Tender Offers and Cash Dividend Payments' [2000] *Managerial Finance* 26.8, 29, 30.

<sup>44</sup> William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 744.

Non-targeted self-tender offer can set the repurchase price of stock either as a fixed price above the market value or as a so-called Dutch auction.<sup>45</sup> In the Dutch auction, a corporation states the number of stocks that it intends to buy back over the stipulated timeframe in the price range of bids.<sup>46</sup> The Dutch auction was originally used in Netherlands' tulips market. The price starts at the maximum set by the seller and decreases. A bidder can take a chance and bid when the price is low enough. This motivates the bidder to not wait for the lowest possible price since a lower price attracts more and more bidders. In case of stock buybacks, the risk for a bidder lies in offering too high tender price. Since a corporation chooses the curve of lowest bidders, offers too close to an upper limit of the price range may result that lower bidders will get a chance to sell back the stocks. Again, this motivates the bidding shareholders to offer the price as close to an upper limit to fulfill profitability and at the same time low enough to offer them liquidity.

### 1.3.2. *Anti-takeover measure*

Stock buybacks might be an effective anti-takeover measure.<sup>47</sup> The most famous case in this regard is *Unocal v. Mesa Petroleum*. Briefly, Mesa Petroleum had the ambition to acquire Unocal and applied a so-called two-tiered offer. The first offer targeted 37 % of outstanding stocks for a value of USD 54 and for the rest Mesa Petroleum offered undervalued junk bonds. To prevent the takeover by Mesa Petroleum, executives of Unocal did a self-tender offer to repurchase at USD 72 per stock. This buyback would indebt the company so much that the

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<sup>45</sup> Zhen Li, Ching-Chung Kuo, 'Design of discrete Dutch auctions with an uncertain number of bidders' [2013] *ANNALS OF OPERATIONS RESEARCH*, 211.1, 255, 255.

<sup>46</sup> Ibid., 255–256 and Laurie Simon Bagwell, 'Dutch Auction Repurchase: An Analysis of Shareholder Heterogeneity' [1992] *The Journal of Finance* 47.1, 71, 72. For comparison of open market repurchase, fixed self-tender offer, and the Dutch auction see: Comment, Robert and Gregg A. Jarrell, 'The Relative Signalling Power of Dutch-Auction and Fixed-Price Self-Tender Offers and Open-Market Share Repurchases' [1991] *The Journal of Finance*, 46.4, 1243, 1247–1249.

<sup>47</sup> Song, Ok-Rial, 'Hidden Social Costs of Open Market Share Repurchases' [2002] *The Journal of Corporation Law* 27.3, 425, 476.



takeover would not make sense anymore. The Delaware Supreme Court approved the stock buyback in this case as an anti-takeover measure.<sup>48</sup>

In *Cheff v. Mathes*, the predecessor of *Unocal v. Mesa Petroleum*, the corporation used a targeted self-tender offer to avoid being taken over. The existence of the threat and good faith helped the directors of the corporation to be granted with business judgment rule, i.e. protecting them from assessing their actions as unlawful.<sup>49</sup> In *Unitrin, Inc. v. American General Corp.* the Delaware Supreme Court not necessarily excluded repurchase as an anti-takeover measure but demanded the court to very precisely assess the draconian nature of the response and then the reasonability of the response.<sup>50</sup> The US case law brings us to the conclusion that it is not easy to use stock buybacks as a protective measure but not prohibited by law. This mechanism puts a lot of pressure on corporate governance lawyers. The board of directors must act in a way that in case of dispute is going to be granted with the business judgment rule. Courts are sensitive to this application of stock buybacks since they strip shareholders of their rights while directors grab control of a corporation's faith.

### 1.3.3. Risks and shortcomings of stock buybacks

The previous sub-chapter closed with one of the shortcomings of stock buybacks if used as a defensive measure against a hostile takeover. Directors can use this tool to grab a power that is in contrast with their fiduciary duties and are de facto limiting the voice of shareholders. Case law of corporate governance addressed this risk over the years.

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<sup>48</sup> *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, Fed. Sec. L. Rep. (CCH) P92,077 (Del. June 10, 1985).

<sup>49</sup> *Cheff v. Mathes*, Del.Sup., 41 Del. Ch. 494, 199 A.2d 548 (Del. 1964). For deeper analysis see for example: 'Corporations: Good Faith Defense of Corporate Policy Held Sufficient to Justify Repurchase of Stock with Corporate Funds' [1965] Duke LJ 412.

<sup>50</sup> "The Court of Chancery should have directed its enhanced scrutiny: first, upon whether the Repurchase Program the Unitrin Board implemented was draconian, by being either preclusive or coercive and; second, if it was not draconian, upon whether it was within a range of reasonable responses to the threat American General's Offer posed." See: *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995).

Stock buybacks also pose two significant risks to the capital market – insider trading and market manipulation. Insider trading is done by misusing informational asymmetry. Insider trading can be conducted both on the open market and in self-tender offers. Insider trading on the open market takes the form of buying stocks “before the announcement of a stock buyback” and subsequently selling the stocks back to a corporation or enjoying the benefits of the stock buyback. This practice is rare because it is easy to spot backward the purchasing activity of an insider before the buyback and the possible profit is lower than in the case of a self-tender since the price on the open market is more regulated.<sup>51</sup>

The self-tender offers and Dutch auctions offer variations of conduct that can be assessed as insider trading, depending on the motivation of an insider, i.e. whether an insider needs a corporation to buy its stocks back at a low or high price. An insider can gain profit from the indirect or direct transfer of value. Indirect transfer of value depends on who will gain. While selling above the actual stocks’ value (selling high) brings profit to selling shareholders, in selling low it is vice versa since staying shareholders benefit from shareholders selling the stocks below their actual value.<sup>52</sup> The direct transfer of value occurs when an insider sells the stocks acquired before the announcement of the stock buyback for a higher price.<sup>53</sup> Problematic might be proving the intention of manipulating the market. Facts in *Ala. Farm Bureau Mut. Cas. Co. v. Am. Fid. Life Ins. Co.* are similar to other cited stock buybacks cases – the corporation started buyback to prevent the takeover by another corporation. In addition, buyback led to a boost in the price of stocks. Plaintiff Alabama Farm alleged the American Fidelity that their stock buyback violated the rules prohibiting market manipulation. These rules require in the words of the court “intentional or willful conduct designed to deceive or defraud

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<sup>51</sup> Song, Ok-Rial, 'Hidden Social Costs of Open Market Share Repurchases' [2002] The Journal of Corporation Law 27.3, 425, 469.

<sup>52</sup> Fried, Jesse M., 'Insider Signaling and Insider Trading with Repurchase Tender Offers' [2000] The University of Chicago Law Review 67.2, 421, 455–458.

<sup>53</sup> *Ibid.*, 461–462.

investors.”<sup>54</sup> Which was not sufficiently proved. This case shows that the burden of proof on the plaintiff to provide evidence of the intention of market manipulation is almost impossible to bear.<sup>55</sup>

Market manipulation is more serious since it does not only bring profit to the insider that unfairly used the non-public material information about the well-intended stock buyback. Market manipulation can happen through the bad faith stock buyback, specifically by the intentional announcement of the repurchase simply to increase the price of the corporation’s stocks to sell them above their actual value.<sup>56</sup>

An interesting case of insider trading and manipulation is *Crane Co. v. Westinghouse Air Brake Co.* Here the target company used the stock buybacks as a defensive mechanism too. But the court found this conduct violating the Securities Exchange Act of 1934 as well as Rule 10b-5 of the SEC regulation.<sup>57</sup> The main argument of the court aimed at the deception of an ordinary investor that saw the price increase.<sup>58</sup>

Various ways of executing stock buybacks bring diverse risks and shortcomings. These potential negative attributes of stock repurchases are effectively mitigated. Boards of directors are restricted from restricting shareholders’ rights primarily by the rich case law of corporate governance. Ambitions to perform insider trading or market manipulation have legislative and

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<sup>54</sup> Ala. Farm Bureau Mut. Cas. Co. v. Am. Fid. Life Ins. Co., 606 F.2d 602 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980).

<sup>55</sup> Ala. Farm Bureau Mut. Cas. Co. v. Am. Fid. Life Ins. Co., 606 F.2d 602 (5th Cir. 1979), cert. denied, 449 U.S. 820 (1980). See also: Song, Ok-Rial, 'Hidden Social Costs of Open Market Share Repurchases' [2002] The Journal of Corporation Law 27.3, 425, 475–476.

<sup>56</sup> Song, Ok-Rial, 'Hidden Social Costs of Open Market Share Repurchases' [2002] The Journal of Corporation Law 27.3, 425, 428, 430.

<sup>57</sup> Securities Exchange Act of 1934, 15 U.S.C. 78a; Rule 10b-5 Sec. 10; 48 Stat. 891; 15 U.S.C. 78j.

<sup>58</sup> “An ordinary investor watching the tape could only conclude that there was a wide-based demand for Air Brake stock and that it would be unprofitable to tender his stock to Crane at that time.” in *Crane Co. v. Westinghouse Air Brake Co.*, 419 F.2d 787 (2d Cir. 1969), cert. denied, 400 U.S. 822 (1970). See also: Song, Ok-Rial, 'Hidden Social Costs of Open Market Share Repurchases' [2002] The Journal of Corporation Law 27.3, 425, 476, note 266.

regulatory responses in the first place in the Stock Exchange Act of 1934 and SEC Rule 10b-5.<sup>59</sup>

The third big risk is that a court might consider stock buyback unenforceable as happened in the case of *Flying Mailmen Service* in which a speculative shareholder concluded the stock buyback agreement and secured it, in case of default in performing this agreement, by all corporate assets of the corporation. After some time the shareholder tried to get these assets from the insolvent corporation. The bankruptcy judge did not allow such a move. This case presents on one side the risk of an unenforceable stock buyback agreement, on the other what risks can appear after the collision of bankruptcy and stock buybacks.<sup>60</sup>

#### 1.4. The practice of stock buybacks in the US

To see how big the world of stock buybacks is, we need to look at the numbers. One of the most watched deal makers on the stock market is the Oracle of Omaha, Warren Buffet. Since he serves as the long-time Chairman of the Board of Berkshire Hathaway, the moves of Berkshire Hathaway are deemed as investment decisions of Warren Buffet himself. In the first quarter of 2023, Berkshire Hathaway bought back its own stocks worth \$4.4 billion.<sup>61</sup> But the informational value of numbers without comparison to other numbers is non-existent. To put this amount of stock buybacks into perspective, we need to connect it to the sum of \$13.3 billion

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<sup>59</sup> Securities Exchange Act of 1934, 15 U.S.C. 78a. Rule 10b-5 Sec. 10; 48 Stat. 891; 15 U.S.C. 78j. However, some say that SEC is overregulating, see: 'To Protect Investors, Businesses, U.S. Chamber Sues SEC Over Stock Buyback Rule' (*U.S. Chamber of Commerce*, 12 May 2023) <<https://www.uschamber.com/finance/corporate-governance/quick-take-how-stock-buybacks-promote-efficiency-and-strong-capital-markets>> accessed 16 June 2023. This lawsuit is regarding new SEC rule hardening the disclosure obligations.

<sup>60</sup> *Matter of Flying Mailmen Service, Inc.*, 539 F.2d 866 (2d Cir. 1976). For more details see: 'Bankruptcy Treatment of Secured Stock Repurchase Agreements: In re Flying Mailmen Service, Inc.' (1977) 90 Harv L Rev 1540.

<sup>61</sup> Warren Buffet was leading Berkshire Hathaway for 58 years. See: Eric Platt, 'Warren Buffett's Berkshire Hathaway dumps billions of dollars of US stocks' (*Financial Times*, 7 May 2023), available at <<https://www.ft.com/content/6289bb84-01dd-4260-8b70-c9c455a159e7?fbclid=IwAR1rS32hhU5ZN7DOSkKK3ptdu560XNUUnOiqPG7Am3GpwiMOOBSLTJF40ohk>> accessed 15 June 2023.

that Berkshire Hathaway earned on selling some of the stocks.<sup>62</sup> Now it is clear that Berkshire Hathaway reinvested in stock buybacks a whole one-third (33 %) of this revenue.

Data confirm that stock buybacks are rising in its volume quarterly. This trend of stock buybacks is reaching new and new records. The last quarter of 2021, still a pandemic year of economic crisis, ended with a \$270.1 billion expenditure on stock buybacks. Compared to the first quarter of 2022 with its additional \$10.9 billion repurchase investments rose by 4 %.<sup>63</sup>

The surge of the stock buyback practice is stunning per se. Of course, compared to the whole stock market buybacks represent around 2 % of its value and 1 % of stocks traded for S&P 500 firms each year.<sup>64</sup> But the most important information comes with overlapping the data on dividends and stock buybacks. Comparing the same quarters, dividends rose only by 2.8 % from \$133.9 billion to \$137. 6 billion.<sup>65</sup> The following chart from the Report of S&P Dow Jones Indices provides us with the literally bigger picture:

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<sup>62</sup> Ibid.

<sup>63</sup> 'S&P Dow Jones Indices 'S&P 500 Buybacks Set Quarterly and 12-Month Records - Again' Press Release' (*S&P Dow Jones Indices*, 16 June 2022) <<https://www.spglobal.com/spdji/en/documents/index-news-and-announcements/20220616-sp-500-buybacks.pdf>> accessed 15 June 2023, 1.

<sup>64</sup> Schumpeter, 'Six muddles about share buy-backs' (*The Economist*, 31 May 2018) available at <<https://www.economist.com/business/2018/05/31/six-muddles-about-share-buy-backs>> accessed 15 June 2023.

<sup>65</sup> 'S&P Dow Jones Indices 'S&P 500 Buybacks Set Quarterly and 12-Month Records - Again' Press Release' (*S&P Dow Jones Indices*, 16 June 2022) <<https://www.spglobal.com/spdji/en/documents/index-news-and-announcements/20220616-sp-500-buybacks.pdf>> accessed 15 June 2023, 1.

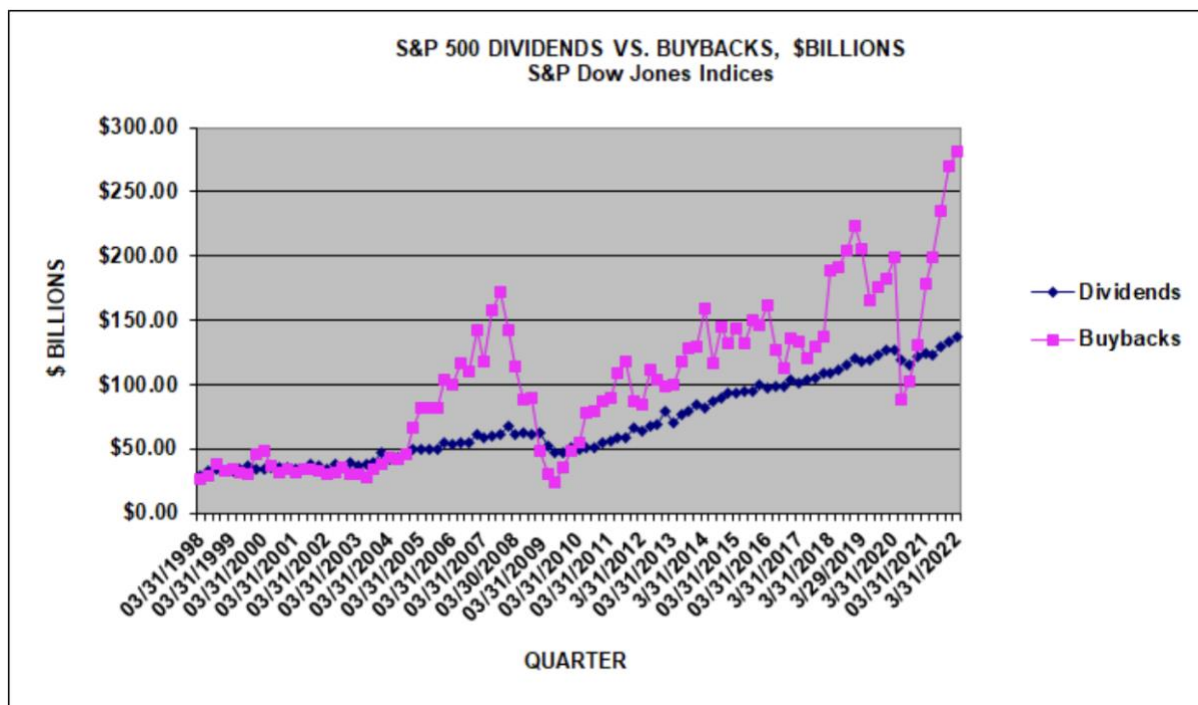


Figure 1: S&P 500 Stock buybacks and dividends<sup>66</sup>

The conclusion is simple – stock buybacks are rather dominant than marginal move in publicly traded corporations on the US market. Lawyers generally consider dividends as a main shareholders’ right and stock buybacks as its functional equivalent, as we outlined in the beginning. However, data shows us that in the US stock buybacks are not only the functional equivalent of dividends; stock buybacks and dividends are functional equivalents *of each other* for over 20 years. The phrasing of Sec. 1.40(6) of the MBCA is then even more welcomed. Because from the latest corporate finance practice to which law is reactive and rarely if ever proactive, it seems that dividends and stock buybacks are variations of funds distribution towards the shareholders.

<sup>66</sup> Ibid., 8.

## 2. Comparative Study on the US and Other Selected Jurisdictions

Stock buybacks bring risks to the market, corporation, and its shareholders, either through market manipulation, insider trading, or depreciation of the equity capital. US law reflects these issues, and we outlined the response of the US law on violations of Rule 10b-5 of the SEC regulation.<sup>67</sup> However, other countries address stock buybacks in their law and regulation differently. Risks and shortcomings of stock buybacks as well as the intention to make them more attractive are treated differently. Various laws, regulations, tax regimes, and history of stock buybacks provide answers to why the US has the most stock buybacks in the world and what other countries can do to follow. Another question is if they can follow and what are the struggles of other jurisdictions if they decide to be inspired by the US.

### 2.1. Pandora's box of stock buybacks

As with many things in this world, stock buybacks have critics and their words are on the point, however poetic. For some, the stock buybacks are “a financial voodoo that exacerbates inequality and depresses investment.”<sup>68</sup>

#### 2.1.1. *Reasons to limit stock buybacks around the world*

The very first argument of critics is that buying its own stocks is an unnatural transaction.<sup>69</sup> This argument is valid. The stakes for shareholders, corporations, and the market are relatively high if the stock buyback takes a wrong malevolent or negligent turn.<sup>70</sup> This is also proved by the number of regulatory conditions and legislative limitations of stock buybacks, which means

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<sup>67</sup> Rule 10b-5 Sec. 10; 48 Stat. 891; 15 U.S.C. 78j.

<sup>68</sup> We put aside already discussed insider trading and market manipulation risks of stock buybacks.

<sup>69</sup> Schumpeter, 'Six muddles about share buy-backs' (*The Economist*, 31 May 2018) available at <<https://www.economist.com/business/2018/05/31/six-muddles-about-share-buy-backs>> accessed 15 June 2023.

<sup>70</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 171.

that even jurisdictions that allow stock buybacks are cautious and very well aware of the possible risks that stock buybacks might bring if unattended.

The biggest risks of stock buybacks in the US are insider trading by executives that are deciding about the stock repurchase or machinations that might empty the treasury of capital in a corporation, the so-called informal reduction of capital.<sup>71</sup> Insider trading laws in European Union are drafted precisely but due to the shorter practice of stock buybacks and significantly lower volume compared to the US, these laws are not so often enforced. Hence the overall insider trading laws are not as much tested in the EU as they are in its Atlantic counterpart.

The law reflects the concerns and addresses the risks of the first argument. Already in the leading UK case from the 19<sup>th</sup> century, *Trevor v. Whitworth* the House of Lords criticized the stock buybacks that can be used either as stock trafficking or unlawful reduction of equity capital of a corporation.<sup>72</sup> Influenced by this case, stock buybacks were prohibited across the pond as well.<sup>73</sup> Later the US law expressly granted corporations the power to perform stock buybacks. For example in Sec. 6.31 of the MBCA or Sec. 160 of the Delaware General Corporation Law (the “DGCL”).<sup>74</sup> However, this legal benevolence towards stock buybacks does not mean anarchy or *carte blanche* for corporations. As well as Sec. 160(a) of the DGCL

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<sup>71</sup> Eilís Ferran, *Principles of Corporate Finance Law* (Oxford University Press 2008) 206.

<sup>72</sup> *Trevor v. Whitworth* [1887] AC 409 (HL). See: Richard T. McDermott, *Legal Aspects of Corporate Finance* (3<sup>rd</sup> edn, Lexis Publishing 2000) 632. For general criticism of stock buybacks nowadays see: Schumpeter, 'Six muddles about share buy-backs' (*The Economist*, 31 May 2018) available at <<https://www.economist.com/business/2018/05/31/six-muddles-about-share-buy-backs>> accessed 15 June 2023 or Dan McCrum, 'Lex in Depth: the case against share buybacks' *Financial Times* (London, 30 January 2018), <<https://www.ft.com/content/e7fb2144-fbae-11e7-a492-2c9be7f3120a>> accessed 15 June 2023. For criticism and counterarguments specifically in the US see for example: Shilon, Nitzan, 'STOCK BUYBACK ABILITY TO ENHANCE CEO COMPENSATION: THEORY, EVIDENCE, AND POLICY IMPLICATIONS' [2021] Lewis & Clark Law Review 25.1, 303, 306–308.

<sup>73</sup> 'Corporations: Good Faith Defense of Corporate Policy Held Sufficient to Justify Repurchase of Stock with Corporate Funds' [1965] Duke LJ 412, 413.

<sup>74</sup> General Corporation Law, Delaware Code, Title 8, Chapter 1. See: William J. Carney, *Corporate Finance: Principles and Practice* (Foundation Press, 2005) 745.



or Sec. 6.40 of MBCA, also Sec. 513 of the New York Business Corporation Law (the “NYBCL”) set requirements to protect the healthy equity capital of a corporation.<sup>75</sup>

Since the times of *Trevor v. Whitworth*, the UK also adopted laws limiting and regulating stock buybacks, lastly the Companies Act 2006.<sup>76</sup> The Companies Act 2006 also gives power to a corporation to acquire its own stocks under Sec. 690(1) but immediately in par. 2 of Sec. 690 sets boundaries in the form of requirements on the ability to issue common stocks after the stock buyback. In other words, again equity capital requirement. Even the very first Sec. 658(1) of the part 18 of the Companies Act 2006 starts on a negative note that stock buybacks are not allowed “except in accordance with the provisions of this Part.” This suggests that the relatively negative opinion of *Trevor v. Whitworth* is still present and UK legislator consider stock buybacks more as a necessary evil than desired corporate practice. This is in contrast to the introductory provision to stock buybacks in Sec. 160 of the DGCL that opens with a positive tone of “every corporation may” followed by limiting formulation “provided, however, that no corporation shall [...]”. MBCA adopted by the majority of the US states sets a similar tone as DGCL – a corporation may buy back its stocks with maintaining registered equity capital at a healthy level.<sup>77</sup>

Both leading jurisdictions are well aware of Pandora's box of stock buybacks, especially for corporations' equity capital. But the US law is trying to avoid the risks of this practice and accepts that it has some benefits and is widely applied. On the contrary, the UK law might wish to avoid this practice if necessary and limit possible damages. This provides part of an answer to why stock buybacks are primarily US practice more or less adopted by other countries, such as the UK. The US regulates, the UK restricts.

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<sup>75</sup> Business Corporation Law, Consolidated Laws of New York, Chapter 4. See: Richard T. McDermott, *Legal Aspects of Corporate Finance* (3<sup>rd</sup> edn, Lexis Publishing 2000) 632–633.

<sup>76</sup> Louise Gullifer, Jennifer Payne, *Corporate Finance Law: Principles and Policy* (3<sup>rd</sup> edn, Hart 2020) 170. Specifically, whole Part 18 (Sec. 658–737) of the Companies Act 2006.

<sup>77</sup> See Sec. 6.31 and 6.40 of MBCA.

The US and the UK are influential with their economy and regulation, but they are not the only modern economies in the world that witness and regulate stock buybacks. Other common law countries such as Canada or Australia have different regulations in some respects. For example, stock buybacks must be approved by the Toronto Stock Exchange before facilitation. US law does not have this condition.<sup>78</sup>

Contrary to the US taxation of dividends harder than stock buybacks, Australian tax law favors dividends more than capital gains of stock buybacks.<sup>79</sup>

Europe also provides interesting examples of stock buybacks regulation. For instance, Swedish law prohibited stock buybacks until the new millennium. Since March 10, 2000, Swedish law follows the standard of the US and the UK and allows stock buybacks if the capital requirements are fulfilled. Swedish law permits stock buybacks only to fully paid stocks.<sup>80</sup> Moreover, only public corporations can buy back their stocks and with a limitation of a maximum of one-tenth of all the corporation's stocks.<sup>81</sup> For example, Sec. 160 of DGCL allows every corporation to buy back its stocks. Sec. 6.31 of MBCA only states that a corporation can perform stock buyback but the definition of "corporation" in Sec. 1.40(4) of MBCA does not exclude private corporations. The same applied to Sec. 513 of NYBCL. However, the third paragraph of Sec. 513 of NYBCL, unlike MBCA and DGCL, also permits only self-acquisition only up to 10 %

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<sup>78</sup> Ikenberry, David, Josef Lakonishok, and Theo Vermaelen, 'Stock Repurchases in Canada: Performance and Strategic Trading' [2000] *The Journal of Finance* 55.5, 2373, 2376.

<sup>79</sup> "In the Australian context there is an additional unique characteristic of dividend imputation favouring dividends, rather than capital gains through repurchases." See: Mitchell, Jason, 'Overseas On-market Buybacks: ASX Disclosure Requirements and Regulation' [2021] *Capital Markets Law Journal* 16.3, 314, 316.

<sup>80</sup> This is identical to requirement set in Sec. 690 of the Companies Act 2006.

<sup>81</sup> Tude, Bjorn, 'Sweden: Share Buy-backs Allowed in Sweden' [2002] *International Financial Law Review* 19.4, 51, 51.

of all the stocks of a corporation but under more detailed specific circumstances.<sup>82</sup> Similarly, Canadian law limits the volume of stock buybacks.<sup>83</sup>

From central and eastern Europe, we use Slovakia and Czech Republic as representatives of the region. Each jurisdiction allows stock buybacks under similar conditions – maintaining equity capital and applicability only to fully paid stocks. Slovak law contains specific provisions allowing Unocal scenario to use stock buybacks as a defensive mechanism against the threat posed to a corporation. Sec. 161a(4) of the Slovak Commercial Code provides corporations the possibility to enact in the articles of association of a stock corporation an exemption from the shareholders’ approval. This exemption is applicable only “if the acquisition of the company’s own shares is necessary to avert major damage to the company that is imminent. The board of directors is then obliged to inform the general meeting at its next meeting about the reasons and objectives of the acquisition of own shares, the number and nominal value of the shares thus acquired, the share of their nominal value in the company’s share capital and the price the company paid for the shares thus acquired.”<sup>84</sup> Czech law contains identical provisions in Sec. 304 of the Act on Commercial Corporations.<sup>85</sup> The provision seems to be profound but practice will sooner or later bring dispute on the interpretation of the scope of an imminent major damage.

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<sup>82</sup> This requirement applies certain business combinations under Sec. 912 of NYBCL. Also, this limitation of 10 % under sec. 513 of NYBCL further applies only to “purchase more than ten percent of the stock of the corporation from a shareholder *for more than the market value* thereof *unless* such purchase or agreement to purchase is approved by the affirmative vote of the board of directors and a majority of the votes of all outstanding shares entitled to vote thereon at a meeting of shareholders unless the certificate of incorporation requires a greater percentage of the votes of the outstanding shares to approve. The provisions of this paragraph shall not apply when the corporation offers to purchase shares *from all holders of stock or for stock which the holder has been the beneficial owner of for more than two years.*” (Emphasis added).

<sup>83</sup> “Once authorized, programs last one year and are limited to the maximum of either 10 percent of public float or five percent of shares outstanding.” See: Ikenberry, David, Josef Lakonishok, and Theo Vermaelen, ‘Stock Repurchases in Canada: Performance and Strategic Trading’ [2000] *The Journal of Finance* 55.5, 2373, 2376.

<sup>84</sup> Sec. 161a(4) of the Slovak Act No. 513/1991 Coll. Commercial Code, as amended. Translation provided by author to which Slovak language is the native language. This provision was adopted through exemption in Art. 60(2) of the Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification) [2004] OJ L169.

<sup>85</sup> Sec. 304 of the Czech Act. No. 90/2012 Coll. on commercial companies and cooperatives (Act on Commercial Corporations).

The EU law gives member states the decision whether they allow stock buyback in their national laws. For this reason, we put the EU regulation after individual member states, not before. The third Company Directive (the “Directive”) harmonizes through Section 4 the most important rules and follows the classic setup and contains a corporation’s capital requirements, maximal 10 % reacquisition threshold, and limitation only to fully paid stocks.<sup>86</sup> An interesting feature is considering a person acquiring a corporation’s stocks on behalf of a corporation as a stock buyback as well.<sup>87</sup> This is reflected also in Slovak and Czech law.<sup>88</sup>

The story of the Japanese stock buybacks law brings us back to taxes. Until the tax-freezing case law from 1995, stock buybacks were not practiced in Japan.<sup>89</sup> From this example and the earlier brief analysis of the US taxation of stock buybacks, we can estimate that taxes are one of the decisive factors in stock buybacks becoming a widespread practice. Even throughout the differently structured economies such as the US and Japan.

Many countries around the world allowed stock buybacks and started to regulate this tool in the 1990s, which is relatively recently compared to the US. We can assume that many jurisdictions recognized the utility of stock buybacks. And this trend is not exclusive to developed markets. Malaysia and Peru permitted stock buybacks in the same year as Finland. Which is sooner than Sweden, Norway, or Denmark.<sup>90</sup>

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<sup>86</sup> Especially Art. 60 of the Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codification) [2004] OJ L169.

<sup>87</sup> Ibid., Art. 59(2).

<sup>88</sup> In Slovak law this formulation is used in Sec. 161a(1) of the Slovak Act No. 513/1991 Coll. Commercial Code, as amended. In Czech law we can find this formulation in Sec. 301(1) of the Czech Act. No. 90/2012 Coll. on commercial companies and cooperatives (Act on Commercial Corporations).

<sup>89</sup> Zhang, Hua, 'Share Repurchases under the Commercial Law 212-2 in Japan: Market Reaction and Actual Implementation' [2002] Pacific-Basin Finance Journal 10.3, 287, 288–290.

<sup>90</sup> Hail, Luzi, Ahmed Tahoun, and Clare Wang, 'Dividend Payouts and Information Shocks' [2014] Journal of Accounting Research 52.2, 403, 452–453, Table A1.

### 2.1.2. *The real value of stock buybacks and short-termism*

The second argument against stock buybacks is more of an economic nature. Cashflow generated by stock buybacks is somehow absurd and by some compared to becoming richer from ATM withdrawals.<sup>91</sup> This applies only if the purchase price is low, and profitability is absent in stock buyback. However, we cannot ignore the possibility that this can happen in case of an open-market purchase. Moreover, stock buybacks can be considered as cosmetic unreal changes of numbers such as ESP but do not bring any real monetized locked value. As we discussed earlier, stock buybacks bring value for staying shareholders only hypothetically under perfectly stable conditions. In a moment of issuing new stocks, the narrow-pool benefit is lost. Same with the volatility of the market which can sink the potentially accumulated higher market value of the stock to unpleasant numbers within a few hours, if not seconds.

The final third argument is stemming from the lack of reinvestment. As we saw earlier, also the President of the United States Joe Biden believes that corporations should reinvest instead of stock buybacks. In basics, if a corporation does not reinvest in innovation; more efficient processes, automation, or other cost cuts; or acquiring new talents or new innovative businesses (mostly startups); the stagnation of a corporation is mostly a death sentence in the highly competitive US economy. In a better case, the lack of reinvestment means disarrangement of the chart of the industry leaders. The most famous example might be the networking corporation Cisco Systems which poured into stock buybacks over the last 20 years \$75 billion instead of reinvesting this surplus cash and was surpassed by Huawei.<sup>92</sup> Lack of reinvestment is associated with economic short-termism. Thinking only until the next financial quarter does not bring much of a long-term future value. That is the hasty conclusion, and the opposite is true since

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<sup>91</sup> Schumpeter, 'Six muddles about share buy-backs' (*The Economist*, 31 May 2018) available at <<https://www.economist.com/business/2018/05/31/six-muddles-about-share-buy-backs>> accessed 15 June 2023

<sup>92</sup> Dan McCrum, 'Lex in Depth: the case against share buybacks' *Financial Times* (London, 30 January 2018), <<https://www.ft.com/content/e7fb2144-fbae-11e7-a492-2c9be7f3120a>> accessed 15 June 2023.

stock buybacks technically convert surplus cash to cheap debt.<sup>93</sup> Why? Because a corporation needs to use the surplus cash now, for instance, because of devaluation through inflation and does not have any suitable investment opportunity. An increase in ESP and making transactions gives stocks recognition in the market. Both are increasing a chance of a corporation obtaining the debt in the future when needed.

On the other hand, even if a corporation and its executives were not pushed by its shareholders to reward them for their investment, limitations of investment opportunities within or outside of a corporation are one of the grounds on which directors decide to write down and announce the stock repurchase program. An example for all is the factory-less corporation Apple which would have needed to expand its headquarters 6-fold if it reinvested cash invested in stock buybacks.<sup>94</sup> Hence, stock repurchase does not necessarily mean unwillingness to reinvest. A corporation can reinvest a reasonable part of its free cash flow and other surplus cash, for which a corporation does not have a sufficient investment, can return to shareholders through the stock buybacks. Reinvestment and stock buybacks are not mutually exclusive. Banning stock repurchases would make companies do potentially unprofitable investments for the sake of reinvestment itself.

To conclude, stock buybacks might be problematic in some respects and some circumstances, but they release economic pressure pot of piled cash within successful companies and prevents unreasonable investments. This does not diminish all possible legal risks mentioned in the first argument which are mitigated or at least predicted and restricted by the law and regulation.

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<sup>93</sup> Roe, Mark J., 'STOCK MARKET SHORT-TERMISM'S IMPACT' [2018] University of Pennsylvania Law Review 167.1, 71, 92–94.

<sup>94</sup> Schumpeter, 'Six muddles about share buy-backs' (*The Economist*, 31 May 2018) available at <<https://www.economist.com/business/2018/05/31/six-muddles-about-share-buy-backs>> accessed 15 June 2023.

## 2.2. Is the US unique in this practice?

While the US is the most tested jurisdiction in this practice, stock buybacks are not limited to the US. We saw that other countries have regulation of stock buybacks as well, but the use is relatively scarce in the rest of the world.<sup>95</sup> But the rise of stock buybacks is not only in the US. Stock buybacks practice is rising even within the EU.<sup>96</sup>

The following chart indicates that even when the practice of stock buybacks in the western part of the EU rose, it still does not even keep up with the volume of dividends:

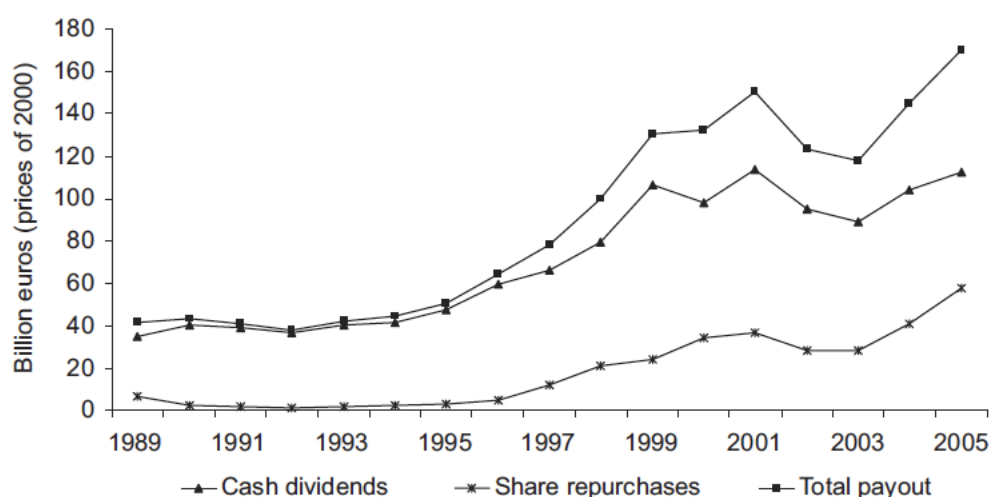


Figure 2: Cash dividends, stock buybacks, and total payout in western EU countries<sup>97</sup>

As we saw on the chart representing the practice in the US, stock buybacks are equal to or even superior to dividends in their use.<sup>98</sup> At least not between the overlapping years of 1998 to 2005.

<sup>95</sup> Sabri, Nidal Rashid, 'Using Treasury "repurchase" Shares to Stabilize Stock Markets' [2003] *International Journal of Business* 8.4, 425, 432–433.

<sup>96</sup> Henk von Eije, and William L. Megginson, 'Dividends and share repurchases in the European Union' [2008] *Journal of Financial Economics* 89.2, 347, 347. This study reviewed the data before the big accession in 2004 that contained former soviet-influenced countries.

<sup>97</sup> Ibid., 355. Ni-Yun Chen and Chi-Chun Liu interpreted this study that total payout of stock buybacks a rose within western EU member states from 17 % to 34 %. See: Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 1.

<sup>98</sup> This conclusion is based on years 1998 to 2005 where both charts overlap in their timescales.

One new study from 2021 shows that “stricter repurchase regulations reduce both actual share repurchases and the cost of debt.”<sup>99</sup> The study also suggests that common law tradition thanks to the inherent feature of the precedential system provides better protection to shareholders and creditors which is correlated to the fact that the difference is not only in strictness but also in law tradition itself. In other words, even stricter regulation in a common law country does not reduce the stock buyback as much as stricter regulation in any civil law jurisdiction.<sup>100</sup> A study on Korean stock buybacks practice provides that the common law model of corporate governance can help effectively mitigate some agency issues and false signaling.<sup>101</sup> This suggests that the common law system, again, provides better protection to shareholders. One of the possible reasons is that specifically law of Delaware puts the burden of proof of business judgment on directors.<sup>102</sup> This prohibits directors from harmful stock buybacks and motivates them to not lose the interests of a corporation and its shareholders from their sight. This in the long term can influence the attractiveness and success of the stock buybacks. It seems that one of the crucial aspects is the protection level which has an impact on trust and willingness to perform stock buybacks but within its limits that protect corporations and shareholders.

The other aspect is whether the regulation constrains stock buybacks for executives and a corporation to perform the stock buyback. The following chart from the study shows why it is at least easier to perform stock buyback in the US than in other leading liberal economies:

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<sup>99</sup> The study assessed three aspects: approval of the stock buybacks within a corporation, separate disclosure, and time limit to perform the stock buyback. See: Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 16.

<sup>100</sup> Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 1.

<sup>101</sup> Han, Seung Hun, Bong-Soo Lee, and Minji Song, 'Frequent Stock Repurchases, False Signaling, and Corporate Governance: Evidence from Korea' [2014] *Corporate Governance : An International Review* 22.6, 482, 498.

<sup>102</sup> 'Corporations: Good Faith Defense of Corporate Policy Held Sufficient to Justify Repurchase of Stock with Corporate Funds' [1965] *Duke LJ* 412, 417.



Country	Approval	Separate Disclosure	Time Limit
<i>English legal origin</i>			
Australia	Board meeting	Daily report	6 months
Canada	Board meeting	Monthly report	12 months
Hong Kong	Shareholder meeting	Daily report	12 months
US	Board meeting	None	36 months <sup>1</sup>
UK	Shareholder meeting	Daily report	18 months
<i>French legal origin</i>			
France	Shareholder meeting	Monthly report	18 months
Italy	Shareholder meeting	Completion Report after 18 months	18 months
Netherlands	Shareholder meeting	Daily report	18 months
<i>German legal origin</i>			
Germany	Shareholder meeting	Contingent report	18 months
Japan	Board meeting	Daily report	12 months
Korea	Board meeting	Completion report after 3 months	3 months
Switzerland	Shareholder meeting	None	36 months
Taiwan	Board meeting	Completion report after 2 months	2 months

Figure 3: Comparison of stock buybacks requirements<sup>103</sup>

The US requires only the approval of the board meeting, which is much more flexible than a decision of hundreds or thousands of shareholders at a General Meeting of a publicly traded corporation. Furthermore, the board of directors can also benefit from the absence of reporting obligations – at least for now – and a longer time limit to buy back stocks according to the buyback program. This regulation, interconnected with a long list of interconnected legal acts and applicable case law, is properly time-tested on deeper and innovative markets with high numbers of participants and transactions. Put simply, more transactions mean a higher chance of deviation from the law to discover a new problem and react to it. This does not imply necessarily stricter regulation as we see. And this low but tested regulation along with common law tradition is helpful for the US stock buyback practice. However, this advantage of the US might get diminished since the SEC relatively recently adopted a new rule that will amend disclosure obligations.<sup>104</sup> The rule will require reporting of “daily repurchase activity on a

<sup>103</sup> Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 19. For more statistics on laws and use of stock buybacks around the world see: Sabri, Nidal Rashid, 'Using Treasury "repurchase" Shares to Stabilize Stock Markets' [2003] *International Journal of Business* 8.4, 425, especially 436, Table 6.

<sup>104</sup> Share Repurchase Disclosure Modernization, SEC Release Nos. 34-97424; IC-34906; File No. S7-21-2, <<https://www.sec.gov/rules/final/2023/34-97424.pdf>> accessed 16 June 2023.

quarterly or semi-annual basis” to protect investors.<sup>105</sup> For now, the rules are as they were. The faith of this rule is uncertain since it is already under judicial scrutiny.<sup>106</sup> It is going to be interesting to see the influence of this rule, if applied, on the practice of stock buybacks.

On the other end of the spectrum is the UK, Japan, or the Netherlands which require shareholders’ approval, daily reports, and 12 or 18 months to complete the stock buyback as proposed.<sup>107</sup> Even another study shows that in 2003 the regulation of stock buybacks in the US was among the most liberal in the developed markets.<sup>108</sup>

It seems that the answer to a successful stock buyback system if measurement is the number of stock buybacks, is a common law system with minimum requirements. But as Thatcherism or Reaganism with minimal public oversight and control over the market brought some negative consequences, easing the regulation cannot be the only solution. In the end, the US tried not to restrict capital markets by regulation during the roaring 1920s and then the Great Depression changed the mind of policymakers and led to the establishment of the SEC.<sup>109</sup> The deregulation of the stock buybacks in the UK in particular, might struggle with a generational cultural barrier inherited from *Trevor v. Whitworth*.

Also, regarding the benefits of common law; this finding is interesting but impractical for the proposal of legislative changes to make stock buybacks a wider applied practice. Changing the legal tradition is technically impossible, especially for countries that fight for regional or global

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<sup>105</sup> 'SEC Adopts Amendments to Modernize Share Repurchase Disclosure' (*U.S. Securities and Exchange Commission*, 3 May 2023) <<https://www.sec.gov/news/press-release/2023-85>> accessed 16 June 2023.

<sup>106</sup> 'Petition for Review filed by Chamber of Commerce of the U.S., Longview Chamber of Commerce, and Texas Association of Business against SEC' (12 May 2023) <[https://www.uschamber.com/assets/documents/US-Chamber-Petition-for-Review-Chamber-v.-SEC-Fifth-Circuit\\_2023-05-17-183630\\_oser.pdf](https://www.uschamber.com/assets/documents/US-Chamber-Petition-for-Review-Chamber-v.-SEC-Fifth-Circuit_2023-05-17-183630_oser.pdf)> accessed 16 June 2023.

<sup>107</sup> Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 19.

<sup>108</sup> Malaysia had similar level of regulation but belongs to emerging markets based to authors of the study. See: Sabri, Nidal Rashid, 'Using Treasury "repurchase" Shares to Stabilize Stock Markets' [2003] *International Journal of Business* 8.4, 425, 427, 436.

<sup>109</sup> Pritchard, A.C., and Robert B. Thompson, *A History of Securities Law in the Supreme Court* (online edn, Oxford Academic 2023) <<https://doi.org/10.1093/oso/9780197665916.003.0002>> accessed 14 June 2023, 26.

legal domination and influence such as Germany or France. If the conclusions of the mentioned study are true, all EU member states except the Republic of Ireland, must cope to some extent with the stricter technocratic EU regulation and their civil law tradition makes them by default run behind the UK and especially even more behind the more liberal US.

## Conclusion

In this thesis, we outlined the motivation to perform stock buybacks. First of all, a corporation has surplus cash and no suitable investment opportunity, and/or executives are under pressure to provide shareholders with rewards for their investment but do not want to create an expectation of recurring payments as dividends are. So they decide to buy back corporation's stocks within a beneficial tax regime. In this case, they reward staying shareholders with higher ESP, smaller stock pool, and stronger rights. Selling shareholders receive immediate rewards through selling their stocks back to a corporation. Alternatively, a corporation may want to attract new investors or defend itself against a hostile takeover through a stock buyback.

Stock buybacks have their risks. Performed without due care they can lower the required equity capital, cause formal insolvency and endanger the creditors. Managers can use the buybacks on the outside as an anti-takeover measure, but they are just fixing themselves in the position and grabbing control over a corporation. Moreover, stock buyback in a big public corporation can pose a broader risk for a market if it is used for insider trading or market manipulation. The law addresses these risks, mostly through general corporate law or through securities law including the regulation of the SEC in the US.

To answer the first question of whether and why is the US on the top of the repurchase mountain we used mostly data analytics. The trend of the last two decades over the world is the rise of stock buybacks. In the US the stock buybacks are equal to dividends and the number of carried out stock buybacks is the highest in the world. But why is it so? We saw that a legal tradition of common law and lighter regulation are important for stock buyback practice. And the US corporate and securities law is governed by the common law tradition while requirements on stock buybacks are lower than in any other modern economy. This is a win-win situation for the US. As we saw in the exact sentences from excerpts from selected US states' laws, the language is more friendly on stock buybacks. Competing economy, the UK, cannot compete

with the US not because of its legal tradition but because of strict regulation that is visible even in the legislative language.

The second question required a comparison of regulation in the US with other leading jurisdictions. Data analysis and comparison of legal acts suggest that the approach of law, the strictness of regulation, and the taxation of stock buybacks are key factors.

The third question was why the practice of stock buybacks is not used in the rest of the world in a volume equal to the US, what can other countries change to catch up with the US and can they adjust their regulation inspired by the US? The first two sub-questions were answered by cited studies – common law and low regulation are key factors in whether corporations will use this opportunity or not. That is why US corporations do not hesitate to announce stock buyback while their counterparts in the EU, UK, Canada, Australia, or Japan think twice about whether it is easier to just pay out dividends or perform one of the functional equivalents. Taxes do play a role also. In Japan, freezing taxes helped stock buybacks to rise in numbers. The third sub-question has a short answer – not much. The UK seems to be still under the influence of case law having rather a negative perception of stock buybacks. Canada follows the mistrustful approach to stock buybacks with stricter regulation but can change this approach. Quebec with civil law tradition is questionable but the main stock exchange is in Toronto. Australian problem seems to be favoring dividends in taxation, which is opposite to the US. On the other hand, it is unrealistic to expect civil law countries to change their legal tradition to common law. Japan influenced by German civil law is also in this bracket.<sup>110</sup> Moreover, the strictness of regulation will probably not go the other way in the highly technocratic EU which influences the whole

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<sup>110</sup> Chen, Ni-Yun and Chi-Chun Liu, 'The Effect of Repurchase Regulations on Actual Share Reacquisitions and Cost of Debt' [2021] *The North American Journal of Economics and Finance* 55, 1, 19. For more statistics on laws and use of stock buybacks around the world see: Sabri, Nidal Rashid, 'Using Treasury "repurchase" Shares to Stabilize Stock Markets' [2003] *International Journal of Business* 8.4, 425, 436, Table 6.

old continent directly towards current member states or through soft power and accession promises from Serbia to Georgia.<sup>111</sup>

We believe that we had provided a brief excursion of stock buybacks as a twin of the dividends in the US, its methods, risk, and shortcomings, and compared its practice with major jurisdictions across the board. Furthermore, with the help of data analysis, we found answers to why the US is the most tested jurisdiction for the stock buyback practice, why other countries are running behind, and whether they can ever catch up. Many of the researched publications suggest a trend of the growing practice of stock buybacks both inside and outside of the US. It seems that two major factors are (i) favorable taxation of stock buybacks compared to dividends and (ii) the general trend of deregulation of financial markets. It is possible that the future will bring more data from other countries and that other jurisdictions will follow the path of the US to make dividends and stock buybacks mutual equivalents. These changes will probably require some time, but the buyback wave seems to be already coming.<sup>112</sup>

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<sup>111</sup> Both countries representing non-EU states on Balkan and Caucasus are interested in becoming part of the EU and transpose or implement willingly part of the EU directives and regulations into their laws and regulation. This soft power of EU was mostly visible on GDPR that globally influenced the trend of data protection regulation.

<sup>112</sup> This trend is already visible in Europe. See: 'European corporate share buyback volumes almost doubled in 2022' (*NBP Paribas*, 13 February 2023) <<https://globalmarkets.cib.bnpparibas/european-corporate-share-buyback-volumes-almost-doubled-in-2022/>> accessed 16 June 2023.

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