

SECURITIES ALERT

SEC ADOPTS AMENDMENTS TO RULE 10b-18 AND DISCLOSURE OF ISSUER STOCK REPURCHASES



OVERVIEW

On November 10, 2003, the Securities and Exchange Commission (SEC) adopted amendments to the Rule 10b-18 safe harbor from liability for market manipulation for issuer repurchases of their own equity securities. The SEC also adopted rules requiring periodic disclosure of all issuer repurchases. The SEC adopted these amendments in order to simplify and update the safe harbor provisions in light of market developments since the Rule's adoption and to enhance the transparency of issuer repurchases.

The amendments to Rule 10b-18 include —

- a clarification that the safe harbor is available for certain purchases effected after the announcement and prior to the closing of a merger, acquisition or similar transaction involving a recapitalization. Under the amended Rule, the safe harbor is available —
 - after the announcement of a merger or similar transaction where the consideration consists solely of cash and for which there is no valuation period
 - for purchases effected after the announcement of a merger or similar transaction so long as the issuer's Rule 10b-18 single-day purchases do not exceed the lesser of 25 percent of the four-week average daily trading volume (ADTV), and
 - for block purchases after the announcement of a merger or similar transaction, provided that the issuer does not exceed the average size and frequency of block purchases.
- a modification of the timing condition that applies an ADTV value and public float value test
- a uniform price condition
- an extension of the safe harbor after-hours issuer repurchases while the consolidated system is still open and at prices that do not exceed the lower of the closing price of the primary trading session in the principal market
- an amended volume condition permitting an issuer to purchase one block of its common stock once each week.

The SEC has also adopted rules requiring an issuer to disclose all repurchases of its own stock made in the open market and through private transactions, regardless of whether the repurchases are effected in accordance with the safe harbor rule.

RULE 10b-18

Rule 10b-18 provides issuers repurchasing their common equity securities with a safe harbor from liability for manipulation under Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934. In order to avail itself of the safe harbor protections, an issuer must comply with the Rule's manner, timing, price and volume conditions. However, the protections afforded by the safe harbor are not available to all issuer repurchases even if the Rule's manner, timing, price and volume conditions are complied with. Listed below are certain situations to which the Rule does not apply:

- Rule 10b-18 does not apply to issuer repurchases of securities other than its common equity securities. Common equity securities are an issuer's common stock or equivalent interest. The Rule does not apply to any other type of security, including securities relating to common stock, such as warrants and options.
- Rule 10b-18 applies only during normal market conditions. Issuer repurchases during the occurrence of events involving the issuer, such as mergers, tender offers and distributions, do not fall within the scope of the Rule's safe harbor.
- Rule 10b-18 does not provide a safe harbor from all liability under the securities laws for issuer repurchases. For example, the Rule provides no protection from the Exchange Act's anti-fraud provisions. An issuer could, while in technical compliance with Rule 10b-18, still violate Rule 10b-5 if repurchases occur while the issuer is in possession of material, non-public information about its securities.

It should also be noted that there is no presumption that purchases outside of Rule 10b-18 violate Sections 9(a)(2) or 10(b) of the Exchange Act. In other words, Rule 10b-18 is a non-exclusive safe harbor and issuers can make non-manipulative repurchases of their stock without following the conditions of Rule 10b-18.

AMENDMENTS TO RULE 10b-18

The amendments to Rule 10b-18 modify the Rule's timing, price and volume conditions. They also clarify the scope of the Rule's safe harbor. Rule 10b-18's manner of purchase condition was not changed by the amendments.

Scope of the Safe Harbor

The amendments modify and clarify the scope of Rule 10b-18's safe harbor as follows:

- The SEC staff's position that the Rule's safe harbor applies to repurchases of all common equity securities, not just common stock, has been codified in the Rule by revising the definition of "Rule 10b-18 purchase."
- The definition of "Rule 10b-18 purchase" has also been modified to clarify the scope of the exception from the Rule's safe harbor for purchases effected pursuant to a merger, acquisition or similar transaction involving a recapitalization. The merger exclusion applies to purchases that are effected during the period from the time of public announcement of a merger, acquisition or similar transaction involving a recapitalization, until the earlier of the completion of such transaction or the completion of the vote by target shareholders. However, the exclusion does not extend to transactions in which the consideration is solely cash and for which there is no valuation period.

In addition, the amended Rule 10b-18 safe harbor includes ordinary Rule 10b-18 purchases effected after the announcement of a merger or covered transaction so long as the total amount of the issuer's Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25 percent of the security's four-week ADTV or the issuer's average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction. Moreover, the issuer may effect block purchases provided that the issuer does not exceed the average size and frequency of block purchases during the three full calendar months preceding the date of the announcement of such transaction. In addition, the SEC clarified that the merger exclusion ends on the earlier of the completion of the transaction or the completion of the target shareholder vote (including any subsequent valuation period).

- The definition of "Rule 10b-18 purchase" has been expanded to include any "bid or limit order that would effect such purchase."

Time of Purchases

While the amendments continue to limit an issuer from effecting a purchase under Rule 10b-18 as the opening transaction for the day, there is no longer a blanket prohibition against purchases under the Rule during the last half hour of trading. The Rule now utilizes an average daily trading volume (ADTV) test to determine how long before the scheduled end of trading an issuer must be out of the market.

The modifications to Rule 10b-18 allow issuers with more actively trading securities to stay in the market longer because their more liquid securities are less susceptible to manipulation. Now, issuers with an ADTV of more than \$1 million and a public float value (the value of the issuer's outstanding common stock that is not held by affiliates of the issuer) of \$150 million or more may not make bids or purchases under Rule 10b-18 —

- during the last 10 minutes of the regular trading session of the principal market where the securities are traded, or
- during the last 10 minutes of the regular trading session of the market where the bid or purchase is made.

All other issuers may not make bids or purchases under Rule 10b-18 —

- during the last 30 minutes of the regular trading session of the principal market where the securities are traded, or
- during the last 30 minutes of the regular trading session of the market where the bid or purchase is made.

After-Hours Purchases

The amendment to Rule 10b-18 extends the safe harbor to issuer repurchases effected after hours while the consolidated system is still open and that are effected at prices that do not exceed the lower of the closing price of the primary trading session in the principal market for the security and any lower bids or sale prices subsequently reported in the consolidated system by other markets. After-hours purchases must still comply with the other three conditions of the safe harbor, with the following modifications. An issuer may use a broker or dealer for its after-hours Rule 10b-18 purchases different from the broker or dealer that it used during normal trading hours, because it may be impractical for an issuer to use the same

broker-dealer in both a primary trading session and an after-hours trading session in one day. The amended Rule precludes the issuer from effecting a Rule 10b-18 purchase as the opening transaction of the after-hours trading session but permits the issuer to repurchase until the termination of the period in which last sale prices are reported in the consolidated system. The Rule 10b-18 volume calculation carries over from the regular trading session.

Price of Purchases

Rule 10b-18's former price limitations varied depending on where the security was traded. The Rule's price limitations are now applied uniformly to the extent possible. All issuers whose common stock is quoted and reported in the consolidated system are subject to the same limitations, regardless of the market on which their securities are traded. However, issuers whose common stock is not reported or quoted in the consolidated system must comply with different price limitations. Price limitations under amended Rule 10b-18 are as follows:

- Issuers whose common stock is quoted and reported in the consolidated system may not purchase their securities under the Rule at a price that exceeds the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported on the consolidated tape (regardless of where the securities are traded).
- Issuers whose common stock is not quoted or reported in the consolidated system, but whose common stock's bid and transaction prices are displayed or disseminated on any national securities exchange or any inter-dealer quotation system, may not purchase their securities under the Rule at a price that exceeds the highest independent bid quoted or the last independent transaction price reported, whichever is higher, by such national exchange or quotation system.
- All other issuers may not purchase their securities under the Rule at a price that exceeds the highest independent bid obtained from three dealers.

Volume of Purchases

The amendments to Rule 10b-18 added block purchases into the calculation of the Rule's volume limitation and into the calculation of an issuer's ADTV. Previously, block purchases had not been included in the calculation of either. Under the amended volume condition, to qualify for the safe harbor, an issuer's total volume of Rule 10b-18 purchases effected on any single day must not exceed 25 percent of the ADTV, which includes any block-size purchases by or on behalf of the issuer for that day. Issuers, however, can include their block-size purchases when calculating their security's four-week ADTV.

The amendment also allows issuers to make within the safe harbor one block purchase per week, provided that the issuer does not make any other Rule 10b-18 purchases on that day. However, shares purchased by the issuer relying on this amended block exception may not be included when calculating a security's four-week ADTV. This amended block exception is intended to provide issuers with lightly traded securities greater flexibility in carrying out their repurchase programs.

In addition, for purchases during the trading session immediately following the end of a market-wide trading suspension, the Rule's volume limitation was increased from 25 percent to 100 percent of an issuer's ADTV.

DISCLOSURE OF ISSUER REPURCHASES

The SEC has also adopted rules requiring periodic disclosure of all issuer repurchases of shares or other units of any class of its equity securities registered pursuant to Section 12 of the Exchange Act. The new disclosure requirements were implemented by revising Regulations S-K and S-B, and Forms 10-K, 10-KSB, 10-Q, 10-QSB, 20-F and N-CSR (which is used by closed-end funds). The new disclosure requirements are independent of the Rule 10b-18 safe harbor. Therefore, all issuer repurchases must be reported regardless of whether they satisfy the conditions of Rule 10b-18.

New Items 703 of Regulations S-K and S-B require that the following information regarding issuer repurchases be presented on a monthly basis in tabular form on Forms 10-Q, 10-QSB, 10-K and 10-KSB:

- the total number of shares or units purchased, including both open market and private transactions
- the average price paid per share or unit
- the number of shares or units purchased as part of a publicly announced repurchase plan or program
- the maximum number (or approximate dollar value) of shares or units that may yet be purchased under the plans or programs.

The tables presented in Forms 10-K and 10-KSB must present such information with respect to the last three months of the issuer's fiscal year.

Closed-end funds are required to present the same monthly information in a table on a semi-annual basis on Form N-CSR.

Foreign private issuers must present in a table the same information annually on Form 20-F. The disclosure should relate to the issuer's securities in ordinary share form, whether ordinary shares or depositary receipts were actually repurchased. The price data should be presented in the currency used in the issuer's primary financial statements.

In footnotes to the tables, issuers must also disclose the following information with respect to any publicly announced repurchase plan or program:

- the date the plan or program was announced
- the share or dollar amount approved
- the expiration date, if any, of the plan or program
- each plan or program that has expired during the time period covered by the table
- each plan or program the issuer has determined to terminate prior to its expiration
- each plan or program that the issuer has determined to terminate prior to expiration or under which the issuer does not intend to make further purchases.

The issuer must also present in footnotes to the tables information regarding the nature of any transaction for purchases made other than those pursuant to a publicly announced repurchase plan or program. This includes information with respect to open market and privately negotiated purchases, purchases pursuant to issuer tender offers and purchases in satisfaction of outstanding put rights.

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