June 25, 2007

SECURITIES ALERT

SEC AMENDS SHORT SALE RESTRICTIONS

The Securities and Exchange Commission recently voted to amend the regulations governing short sales. At its June 13, 2007, meeting, the SEC voted to eliminate the "tick test" and to amend several restrictions on short selling contained in Regulation SHO. At its June 20, 2007, meeting, the SEC approved amendments to strengthen Rule 105 of Regulation M, which governs short selling prior to the pricing of a public offering.

TICK TEST ELIMINATED

The tick test, which was adopted in 1938, prohibits short selling of a security in a "down" market by providing that a security may be sold short only (i) at a price above the immediately preceding reported price (plus tick) or (ii) at the last sale price if it is higher than the last different reported price (zero-plus tick). The tick test, which is set forth in Rule 10a-1 under the Securities Exchange Act of 1934, applies only to exchange-listed securities other than NASDAQ-listed securities. However, the NASD and NASDAQ have similar price tests, based on bid prices, that apply to NASDAQ Global Market Securities.

At its June 13, 2007, meeting, the SEC voted to eliminate the tick test and to prohibit any securities self-regulation agency (SRO) from imposing similar price restrictions. The SEC took the action after reviewing the results of a pilot study that exempted a select group of securities from the tick test. Based on the study, the SEC concluded that short sale pricing restrictions are no longer necessary.

REGULATION SHO AMENDMENTS

The SEC also voted to amend certain provisions of Regulation SHO, which governs short sales. Among other things, the SEC approved the following changes:

Elimination of Grandfather Provision. The SEC approved amendments to Rule 203 of Regulation SHO to eliminate the "grandfather" exception to the mandatory closeout requirement for threshold securities. Threshold securities are equity securities with respect to which there is an aggregate fail-to-deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, that equals at least 0.5 percent of the issuer's outstanding shares, and is included on a list disseminated by an SRO. If a clearing broker has a fail-to-deliver position in a threshold security for 13 consecutive settlement days, the broker is required to close out the position by buying securities of like kind and amount to cover the fail. In addition, until the position is closed out, the clearing broker, as well as any other broker-dealers for which it clears transactions, is prohibited from engaging in further short sales in the security without borrowing or entering into a bona fide arrangement to borrow the security. Rule 203 contains a grandfather exception that exempts from the closeout requirement any fail-to-deliver position that was established before the security became a threshold security. At its June 13, 2007, meeting, the SEC voted to eliminate the grandfather exception. Consequently, all fail-to-deliver positions in threshold securities will have to be closed out within 13 consecutive settlement days. To alleviate the effect of the rule change on pre-existing fail-to-deliver positions relying on the grandfather exception, the SEC provided that any such positions in a threshold security on the effective date of the amendment must be closed out within 35 settlement days of the effective date of the amendment.

Change in Closeout Requirement for Rule 144 Threshold Securities. The SEC lengthened the closeout period for fails-to-deliver in threshold securities sold pursuant to Rule 144 from 13 to 35 consecutive settlement days.

Elimination of "Short Exempt" Marking Requirement. As a result of the elimination of the tick test, the SEC also amended Rule 200(g) of Regulation SHO to eliminate the requirement that a short sale be marked "short exempt" if the seller was relying on an exception to the tick test.

RULE 105 AMENDMENTS

At its June 20, 2007, meeting, the SEC voted to amend Rule 105 of Regulation M to prohibit a person who sells short an equity security during the Rule's "restricted period" from purchasing securities in the offering. Rule 105 currently prohibits a person who sells short during the restricted period from covering the short sale with offering securities purchased from an underwriter, broker or dealer participating in the offering. The restricted period generally consists of the shorter of the 5 business days preceding the pricing of the offering or the period commencing with the initial filing of the registration statement and ending with the pricing. By its terms, Rule 105 applies only to registered or Regulation A offerings of securities for cash that are offered on a firm commitment basis.

The SEC voted to amend Rule 105 to prohibit a person from selling short an equity security during the restricted period and then receiving an allocation in the offering. The SEC believes that by establishing a bright-line test prohibiting a short seller from purchasing in the offering (in contrast to the current rule, which prohibits the seller from covering the short sale with offering securities), it will "once and for all put an end to the progression of schemes that have been engineered to camouflage covering activity [in violation of the rule]."[1]

As originally proposed by the SEC, this bright-line test did not contain any exceptions. However, as finally adopted, amended Rule 105 will include two exceptions. First, a person who sells short during the restricted period will not be prohibited from participating in the public offering if the person makes a "bona fide" purchase of the same securities prior to the pricing of the offering. The final rule will include conditions that must be satisfied for a purchase to be "bona fide." Second, the rule will contain exceptions for registered investment companies and certain other entities that make separate trading and investment decisions. For example, amended Rule 105 will not prevent one account from selling short during the restricted period and a related account from purchasing in the offering so long as the accounts

[1] SEC Chairman Christopher Cox, Opening Statement on Proposed Amendments to Rule 105 of Regulation M under the Exchange Act (Dec. 4, 2006).

are not coordinating their trading or sharing profits. In addition to the foregoing, Rule 105 will be amended to clarify that it applies only to equity securities and only to short sales of the security that is the subject of the offering.

EFFECTIVE DATES

The rule changes eliminating the tick test and other price restrictions will be effective immediately upon publication of the rule changes in the Federal Register. The amendments to the closeout requirements of Regulation SHO and the amendments to Rule 105 of Regulation M will take effect 60 days after publication of the amendments in the Federal Register.

PROPOSED AMENDMENTS

At its June 13, 2007, meeting, the SEC voted to re-propose amendments to eliminate the options market maker exception to the closeout requirements of Regulation SHO and to solicit comment on different ways to eliminate the exception. The SEC also proposed for comment a requirement that broker-dealers document the location of securities subject to a long sale.

CONTACT INFORMATION

If you have questions about the SEC's amended regulations regarding short sales, please contact:

C. Kelly Koltes
kkoltes@akingump.com
1 866 AKIN LAW

Austin Beijing Dallas Dubai Houston London Los Angeles Moscow
New York Philadelphia San Antonio San Francisco Silicon Valley Taipei Washington, D.C.