

## SEC Adopts New Rules Regarding Share Repurchases

On November 10, 2003, the Securities and Exchange Commission (the "SEC") released final amendments to Rule 10b-18 under the Securities Exchange Act of 1934, as amended (the "Act"), and amendments to Regulations S-K and S-B and Forms 10-Q, 10-QSB, 10-K, 10-KSB, 20-F and N-CSR.<sup>1</sup> Rule 10b-18 provides a "safe harbor" under the anti-manipulation provisions of the Act and related SEC rules for an issuer and certain related persons repurchasing the issuer's common stock in compliance with the Rule. The amendments to the periodic reporting forms add new items in which issuers will be required to make disclosure regarding repurchases of securities. The amendments to Rule 10b-18 became effective on December 17, 2003. The revisions to Forms 10-Q, 10-QSB, 10-K and 10-KSB will be applicable to reports for periods ending on or after March 15, 2004. The new disclosure requirements with regard to Form 20-F are applicable to reports filed for fiscal years ending on or after December 15, 2004. The new disclosure requirements with regard to Form N-CSR are applicable to reports filed for periods ending on or after June 15, 2004.

### Pre-Amendment Rule 10b-18

The goal of Rule 10b-18 is to minimize the market impact of an issuer's share repurchases. Under Rule 10b-18, an issuer or an "affiliated purchaser"<sup>2</sup> may make bids for and purchases<sup>3</sup> of issuer common stock without being deemed to violate Section 9(a)(2) of the Act or Rule 10b-5, relating to market manipulation, solely by reason of the time or price at which the bids or purchases are made, the amount of such bids or purchases, or the number of brokers or dealers used in connection with such bids and purchases, if they meet the conditions of the Rule.

- All bids or purchases (other than unsolicited purchases) on any single day are made from or through only one broker or dealer. This requirement is intended to prevent the issuer from creating an illusion of widespread market activity.
- Bids and purchases could not be made at the opening and during the last half hour of trading.<sup>4</sup> The SEC notes that

trades made during these periods are considered to be a significant indicator of the direction of trading, the strength of demand and the current market value of the security.<sup>5</sup>

- Bid or purchase prices are not higher than the current independent bid quotation or the last independent sales price, whichever is higher.<sup>6</sup> This provision prevents the issuer from leading the market for the security.
- Aggregate purchases on any single day do not exceed the larger of one "round lot"<sup>7</sup> or the number of round lots closest to 25 percent of the "trading volume"<sup>8</sup> for the security.<sup>9</sup> This provision is intended to prevent the issuer from dominating the market for the security.

Rule 10b-18 also has an exception to the time of purchase restriction discussed above applicable to trading sessions following the termination of a market-wide suspension. Under such circumstances, purchases may be made from the reopening of trading until the scheduled close of trading or at the opening of trading the next trading day, if a market-wide trading suspension is in effect at the scheduled close of a trading session.

### Amendments to Rule 10b-18

The SEC has adopted the following material amendments:

#### *Scope of the Safe Harbor*

- The SEC added two preliminary notes to Rule 10b-18. The first states that the safe harbor is not available for repurchases that, although made in technical compliance with the Rule, are part of a plan or scheme to evade the federal securities laws. The second references the new periodic report disclosure requirements relating to issuer repurchases.
- The SEC merged the definitions of "Rule 10b-18 bid" and "Rule 10b-18 purchase." The amended definition of "Rule 10b-18 purchase" specifies that the safe harbor is available

for repurchases of all common equity securities (including units of beneficial interest in a trust or limited partnership or a depositary share) rather than just common stock.

- Purchases effected during the period from the public announcement of a merger, acquisition or similar transaction until the earlier of the completion of such transaction or the completion of the vote by target shareholders are excluded from the types of transaction that qualify for the safe harbor. The SEC believes that during this time period an issuer has a considerable incentive to support or raise the market price of its stock in order to facilitate the merger or acquisition. However, the exclusion does not extend to purchases made during a transaction in which the consideration offered is solely cash and there is no valuation period, as the SEC believes that an issuer has little or no incentive to support or raise the market price of its stock in these circumstances. In addition, ordinary purchases under the safe harbor are permitted after the announcement of the merger or similar transaction (i) where the total volume of purchases effected on any single day does not exceed the lesser of 25% of the four-week ADTV (as trading volume has been renamed) or the average daily purchases under the safe harbor during the three calendar months preceding the date of the announcement of the transaction, or (ii) in the case of block purchases, where block purchases (to the extent within the safe harbor) do not exceed the average size and frequency of block purchases under the safe harbor during the three calendar months preceding the date of the announcement of the transaction.
- In the proposal, the SEC had asked whether the Rule 10b-18 safe harbor should apply to issuer repurchases effected on non-U.S. markets. The SEC ultimately decided against this course, noting that the Rule was designed to apply to U.S. markets, rather than non-U.S. markets, which may operate differently, and further noted that it would be difficult to craft a rule that was workable for both U.S. and non-U.S. markets.

## *Amendments to the Purchasing Conditions*

- The manner of purchase provision has been amended to clarify that issuers may effect repurchases directly through an electronic communications network (ECN) or alternative trading system (ATS) (which are registered as broker-dealers), but may not use both an ECN or ATS and a non-

ECN or non-ATS broker-dealer on any single day. The SEC believes that doing so may create an illusion of widespread demand. However, there are no restrictions on the ability of an issuer to use a non-ECN or non-ATS broker-dealer (if that broker-dealer is the exclusive broker-dealer used by the issuer on that day) to effect transactions through an ECN or ATS.

- The timing restriction has been amended to permit issuers that meet ADTV and public float tests<sup>10</sup> to make purchases until as late as 10 minutes prior to the scheduled close of trading. For all other issuers eligible to rely on the safe harbor, the timing restriction remains 30 minutes prior to the scheduled close of trading. In either case, purchases under the Rule may not be made at the opening.
- The price restriction has been made uniform across markets to be not higher than the highest current independent bid quotation or the last independent sales price, whichever is higher. For securities not quoted or reported on the consolidated system, the issuer must look to the highest independent bid or the last independent transaction price, whichever is higher, that is displayed or disseminated on any national securities exchange or inter-dealer quotation system that displays at least two independent priced quotations for the security. For other securities, the issuer will need to look to the highest independent bid obtained from three independent dealers.
- The amendments clarify that riskless principal transactions, in which a broker-dealer, after having received an order from the issuer, purchases securities in the market for its own account and then sells them to the issuer, may fall within the safe harbor, subject to certain conditions. The safe harbor will only apply to transactions in which both legs are effected at the same price and only one leg (the purchase on the open market made by the broker-dealer) is reported to the market, provided that the first leg meets the conditions of Rule 10b-18. The broker-dealer must maintain written policies and procedures to assure that the issuer's order was received prior to the offsetting transaction; the offsetting transaction is allocated to a riskless principal account or the issuer's account within 60 seconds of the execution; and the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders effected on a riskless principal basis.



# Client Alert

- Block purchases<sup>11</sup> are now subject to the volume restriction and are included in the calculation of ADTV. Issuers and/or affiliated purchasers have the option to make one weekly block purchase in lieu of the amount that could otherwise be purchased under Rule 10b-18, so long as (1) no other Rule 10b-18 purchase is made that day and (2) the block purchase is not included in calculating the security's four-week ADTV.

## *Applicability of the Safe Harbor during After-Hours Trading Sessions*

- Purchases may be made pursuant to the Rule in after-hours trading prior to the termination of the period in which last sales prices are reported in the consolidated system.<sup>12</sup> The purchase prices may 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. In after-hours trading, a broker different from the broker used during normal trading hours may be used. The purchase may not be the opening transaction of the after-hours trading session.

## *Rule 10b-18 Alternative Conditions*

- In trading sessions following a market-wide trading suspension, the issuer and affiliated purchasers are permitted to purchase 100% of the ADTV, rather than 25%.

## **Disclosure of Issuer Repurchases in Periodic Reports**

Regulations S-B and S-K and Forms 10-Q, 10-QSB, 10-K, 10-KSB, 20-F and N-CSR were amended to require periodic disclosure of all issuer repurchases of equity securities registered under Section 12 of the Act. These amendments are independent of the Rule 10b-18 safe harbor.

Issuers reporting on Forms 10-Q, 10-QSB, 10-K and 10-KSB will be required to disclose (on a month-by-month basis) the total number of shares repurchased during the last fiscal quarter (the fourth fiscal quarter in the case of a report on Form 10-K or 10-KSB), the average price paid per share, the number of shares that were purchased as part of a publicly announced repurchase program and the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or

programs. The table must include footnote disclosure of the number of shares purchased other than through a publicly announced repurchase plan or program (such as open-market or privately negotiated purchases, issuer tender offers, in satisfaction of the issuer's obligations upon exercise of outstanding put options issued by the issuer or other transactions) and the nature of any such transactions. The applicable item also requires footnote disclosure of the following information relating to publicly announced repurchase plans or programs: (i) the date of the announcement of the plan or program; (ii) the share or dollar amount approved; (iii) the expiration date (if any) of the plan or program; (iv) each plan or program that has expired during the period covered by the table; and (v) 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 SEC will not require disclosure of the identity of the brokers or dealers effecting the transactions.

Foreign private issuers filing reports on Form 20-F are required to make similar disclosure on a month-by-month basis for each month covered by the annual Form 20-F filing. Disclosure must include both repurchases of ordinary shares and repurchases of depositary receipts representing such shares. The SEC specified that such disclosure must be based on the currency used in the issuer's primary financial statements.

Closed-end investment companies filing reports on Form N-CSR are required to provide similar disclosure on a month-by-month basis on semi-annual Form N-CSR filings. In connection with this requirement, Form N-23C-1 has been amended to eliminate disclosure of privately negotiated repurchases. In addition, Rule 23c-1(a)(11) was amended to require the filing of any written solicitation to purchase securities with Form N-CSR, rather than Form N-23C-1.

The SEC believes that this information is important to investors. Announcement of a repurchase plan often causes an issuer's stock price to increase. However, the SEC noted that a number of issuers have announced plans and made few or no repurchases under the plan. The SEC believes that the disclosure requirement provides investors the ability to determine whether the issuer has followed through on its announced plan, the impact of the issuer's repurchase activity, and whether a repurchase plan has expired.

<sup>1</sup> Release No. 34-48766 (November 10, 2003).

<sup>2</sup> An affiliated purchaser means, generally, (i) a person acting in concert with the issuer for the purpose of acquiring the issuer's securities or (ii) an affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer or whose purchases are under common control with those of the issuer.

<sup>3</sup> Certain types of bids or purchases are excluded from application of Rule 10b-18. These excluded transactions include, among others, certain transactions relating to mergers, tender offers, and distributions of securities of the issuer.

<sup>4</sup> The conditions varied somewhat depending upon the type of market on which a security was traded.

<sup>5</sup> See Release No. 34-48766.

<sup>6</sup> The conditions varied somewhat depending upon whether the security was reported, exchange-traded, Nasdaq or an "other security" and whether the bid or purchase was made on an exchange.

<sup>7</sup> A round lot is 100 shares or any other customary unit of trading for a security.

<sup>8</sup> The trading volume is the average daily trading volume reported in the four calendar weeks preceding the week in which the bid or purchase is made, excluding, under the pre-amendment Rule but not the amended Rule, block purchases by or for the issuer or an affiliated purchaser. Only U.S. market trading volume data is used to compute trading volume for Rule 10b-18 purposes.

<sup>9</sup> An alternative test for securities not reported, traded on an exchange or quoted on Nasdaq was either (i) one round lot or (ii), when aggregated with all other purchases under the Rule on the day in question and over the preceding five business days, 1/20 of one percent of the outstanding shares of the security, exclusive of shares known to be beneficially owned by affiliates.

<sup>10</sup> \$1 million in ADTV and \$150 million in public float.

<sup>11</sup> A block means a quantity of stock that either (i) has a purchase price of \$200,000 or more, (ii) is at least 5,000 shares and has a purchase price of at least \$50,000 or (iii) is at least 20 round lots (as defined above) and totals 150% of the trading volume (as defined above) for that security, or in the event that trading volume data are unavailable, at least 20 round lots of the security and at least 1/10th of one percent of the outstanding shares of the security, exclusive of any shares owned by an affiliate. A block does not include any amount a broker or dealer, acting for its own account, has accumulated for sale to the issuer or an affiliated purchaser, if the issuer or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose. In addition, a block also does not include any amount that a broker has sold short to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that the sale was a short sale.

<sup>12</sup> For example, the New York Stock Exchange closes at 4:00 p.m. but trading continues after hours at closing prices until 5:00 p.m.

If you have any questions about share repurchase programs and amended Rule 10b-18, or about the new disclosure requirements, please contact your Shaw Pittman attorney or

Thomas J. Plotz  
thomas.plotz@shawpittman.com

202.663.8544

Robert P. Sherley  
robert.sherley@shawpittman.com

202.663.8187