

Corporate and Securities Law Developments **NEWSLETTER**

JANUARY 13, 2003

ISSUER REPURCHASES: SEC Proposes to Amend the Safe Harbor and Impose New Disclosure Requirements

On December 10, 2002, the Securities and Exchange Commission (“SEC” or “the Commission”) proposed amendments to Rule 10b-18 under the Securities Exchange Act of 1934 (“Exchange Act”) concerning issuer repurchases of its common stock.¹ In addition, the Commission proposed amending Regulations S-K and S-B and related Exchange Act forms to require periodic disclosure of all issuer repurchases, including those made in reliance on Rule 10b-18. *The comment period expires on February 18, 2003.*

I. Introduction

In 1982, the Commission adopted Rule 10b-18,² which provides issuers with a safe harbor from liability for manipulation under Sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b-5 under the Exchange Act, when they repurchase their common stock in the market in accordance with the rule’s manner, timing, price, and volume conditions. Rule 10b-18’s safe harbor conditions are designed to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer.³

The proposed Rule 10b-18 amendments are intended to reflect market developments since the rule’s adoption 20 years ago. As proposed, the revised rule would allow issuers whose securities are less susceptible to manipulation

to stay in the market longer and to repurchase a greater number of shares during periods of severe market decline, while, at the same time, maintaining reasonable limits. In addition, the proposed amendments to Regulations S-K and S-B, Forms 10-Q, 10-QSB, 10-K, 10-KSB, 20-F, and proposed Form N-CSR seek to enhance the transparency of all issuer repurchases, including those made pursuant to Rule 10b-18.

II. Rule 10b-18 Amendments

A. Amendments to the Scope of the Rule

1. Eligible Securities

The proposal would amend the definition of a “Rule 10b-18 purchase” to include any “bid or limit order that would effect such purchase” and to codify the SEC staff’s position that the safe harbor is available for repurchases of all common equity securities (*i.e.*, an issuer’s common stock or an equivalent interest, including a unit of beneficial interest in a trust or limited partnership or a depository share). The proposal also amends “the definition of a Rule 10b-18 purchase” to make it clear that the exception for purchases effected pursuant to a merger includes purchases effected “during the period from the time of public announcement of the merger, acquisition, or similar transaction, until the completion of such transaction.”⁴

¹ *Rule 10b-18 and Purchases of Certain Equity Securities by the Issuer and Others*, Release Nos. 33-8160; 34-46980; IC-25845, 67 Fed. Reg. 77,594 (Dec. 18, 2002), available at <http://www.sec.gov/rules/proposed/33-8160.htm> (“Proposing Release”).

² *Purchases of Certain Equity Securities by the Issuer and Others; Adoption of Safe Harbor*, Exchange Act Release No. 33-6434; 34-19244; 1C-12823 (Nov. 17, 1982), 47 Fed. Reg. 53,333 (Nov. 26, 1982).

³ *Id.*

⁴ This would include purchases during any period where the market price of a security will be a factor in determining the consideration to be paid pursuant to a merger, acquisition, or similar transaction.

The SEC seeks specific comment on the scope of eligible securities, including whether 1) the safe harbor should be made available to securities other than common equity (*e.g.*, preferred stock, options, security futures products); 2) the safe harbor should apply to an issuer's repurchases outside the U.S. and, if so, what conditions should attach; and 3) the merger exception should include purchases effected after the time of the shareholder vote and/or the end of the valuation period.

2. Purchases by or for Issuers and Affiliated Purchasers

The proposal does not amend the current definition of "affiliated purchaser" of the issuer.⁵ The SEC seeks comment, however, on whether the scope of the definition is appropriate, or whether, for example, it should be revised to have the same meaning as contained in Regulation M under the Exchange Act.

B. Amendments to the Conditions of the Rule

Rule 10b-18 provides a safe harbor for purchases on a given day. To come within the safe harbor for that day, an issuer must satisfy the Rule's manner, timing, price, and volume conditions when purchasing its own common stock in the market. Failure to meet any one of the four conditions disqualifies the issuer's purchases from the safe harbor for that day.

1. Manner of Purchase

The SEC did not propose amending the requirement that an issuer use a single broker or dealer per day to bid for or purchase its common stock. The SEC seeks specific comment, however, on whether the single broker or dealer condition needs to be amended in order to accommodate issuer repurchases effected through alternative trading systems (*i.e.*, which are registered as broker-dealers) or on electronic communication networks.

2. Timing

The SEC proposed revising the timing condition by using an average daily trading volume ("ADTV") value and public float value test (as defined in 17 C.F.R. 242.100) to determine the time when an issuer must be out of the market before the scheduled close of trading in order to qualify for the safe harbor.⁶ Under the proposed modifications, issuers of securities having an ADTV value of \$1 million or more and a public float value of \$150 million or more⁷ could not bid for or purchase their securities during any of the following periods: 1) in the ten minutes before the scheduled close of the primary (regular) trading session in the principal market for the security, 2) the ten minutes before the scheduled close of the primary (regular) trading session in the market where the purchase is made, or 3) after the termination of the period in which last sale prices are reported in the consolidated system.

For all other eligible securities, issuers could not bid for or purchase their securities during any of the following periods: 1) the 30 minutes before the scheduled close of the primary (regular) trading session in the principal market for the security, 2) the 30 minutes before the scheduled close of the primary (regular) trading session in the market where the purchase is made, or 3) after the termination of the period in which last sale prices are reported in the consolidated system.

With respect to the timing limitations, the SEC seeks specific comment on, among other things, whether 1) the eligibility for the timing limitation should be based on a security's ADTV and an issuer's public float; 2) the timing limitations adequately protect against an issuer affecting the closing price; and 3) the timing limitations should be modified to allow issuers of more liquid securities to effect a Rule 10b-18 purchase as the opening transaction.

3. Price of Purchases

Rule 10b-18's current price limitations vary, depending on the market for the security.⁸ The rule amendments

⁵ Affiliated purchaser is generally defined as a person acting, directly or indirectly, in concert, with the issuer for the purpose of acquiring the issuer's securities or any affiliate that directly or indirectly controls the issuer's Rule 10b-18 purchases, or whose purchases are controlled by, or are under common control with, those of the issuer. 17 C.F.R. 240.10b-18(a)(2)-(3).

⁶ The proposed amendments would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening transaction for the day.

⁷ In calculating the dollar value of the ADTV, any reasonable and verifiable method may be used. Public float value (*i.e.*, the aggregate market value of common equity securities held by non-affiliates of the issuer) is to be determined in the manner set forth on the front page of Form 10-K, even if the issuer of such securities is not required to file Form 10-K. For reporting issuers, the public float value should be taken from the issuer's most recent Form 10-K or based upon more recent information made available by the issuer.

⁸ 17 C.F.R. 240-10b-18(b)(3).

propose applying a uniform price condition that limits issuers to purchasing their securities at a purchase price that does not exceed the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated system. For securities that are not quoted or reported in the consolidated system, an issuer's purchases must be effected at a purchase price that does not exceed the highest independent bid or the last independent transaction price, whichever is higher, displayed and disseminated on any national securities exchange or on any inter-dealer quotation system (as defined in Exchange Act Rule 15c2-11) that displays at least two priced quotations for the security. For all other securities, Rule 10b-18 purchases must be effected at a price no higher than the highest independent bid obtained from three dealers.

In the Proposing Release, the SEC notes that it is considering whether to eliminate the "last independent transaction price" alternative, and keep only the "bid test." The SEC seeks specific comment on this issue, as well as whether the conversion to decimal pricing has made the rule's "bid test" difficult to satisfy, and whether the condition should be based on prices quoted or reported in the "consolidated system," rather than the "principal market" for the security.

4. Volume of Purchases

The SEC believes that market conditions no longer appear to justify excluding block purchases from the volume limitation, so the proposal would eliminate the special treatment of block purchases. The proposed amendments would continue to limit Rule 10b-18 purchases to 25% of the ADTV for the security per day, but would define ADTV as the average daily trading volume, including block purchases made by or on behalf of the issuer, reported for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is effected.

As an alternative intended for issuers of thinly traded securities, the proposal also modifies the volume condition to allow issuers to purchase up to a daily aggregate amount of 500 shares. Thus, an issuer's Rule 10b-18 purchases, on any single day, may not exceed the higher of 25% of the ADTV for that security or a daily aggregate amount of 500 shares.

The SEC seeks specific comment on, among other things, whether 1) there should be an alternative period of time to measure a security's ADTV; 2) the rule should retain the current block transaction exception, but raise the amount of shares constituting a block; 3) a volume limitation based on an ADTV calculation is feasible with respect to purchases of thinly traded securities; and 4) the safe harbor should be available for issuer repurchases involving security futures or options contracts.

C. **Other Amendments**

1. After-Hours Trading

The amendments do not address after-hours trading. On May 21, 1999, however, a registered broker-dealer filed a petition for SEC rulemaking seeking, among other things, amendments to Rule 10b-18's timing and pricing conditions to permit an issuer or an affiliated purchaser of an issuer to effect purchases or make bids during "after-hours" trading sessions subject to the present conditions, but with the additional proviso that trades and bids must be at prices lower than the last reported price on the primary exchange or market on which the security of the issuer is traded.⁹ The SEC seeks comment on the applicability of Rule 10b-18 to after-hours trading and the petition for rulemaking.

2. Alternative Conditions

On September 23, 1999, the SEC adopted an amendment to Rule 10b-18 modifying the timing condition to include in the safe harbor issuer purchases made at the reopening and during the last half-hour prior to the scheduled close of trading or at the next day's opening if a market-wide trading suspension was in effect at the scheduled close of trading.¹⁰ The proposal would increase the safe harbor's alternative condition by increasing the current 25% volume limitation to 100% of the ADTV for that security.

In addition, on June 13, 2001, the New York Stock Exchange ("NYSE") proposed making the safe harbor available to an issuer for a category of purchases effected by an independent trustee during a period of unusual volatilities in the issuer's stock.¹¹ The SEC seeks comment on its own amendments, as well as the NYSE's petition for rulemaking.

⁹ Purchases of Certain Equity Securities by the Issuer and Others, Exchange Act Release No. 41,905 (Sept. 23, 1999), 64 Fed. Reg. 52,428 (Sept. 29, 1999).

¹⁰ Purchases of Certain Equity Securities by the Issuer and Others, Exchange Act Release No. 41,905 (Sept. 23, 1999), 64 Fed. Reg. 52,428 (Sept. 29, 1999).

¹¹ The NYSE's Petition for Rule-Making is publicly available in File No. 4-446 in the Commission's Public Reference Room.

III. Disclosure Amendments

The SEC also proposed amending Regulations S-K and S-B, and Forms 10-Q, 10-QSB, 10-K, 10-KSB, 20-F under the Exchange Act, and proposed Form N-CSR under the Exchange Act and the Investment Company Act,¹² to require periodic disclosure of issuer repurchases of shares or other units of any class of the issuer's equity securities that are registered pursuant to Section 12 of the Exchange Act. The disclosure requirement would be independent of the Rule 10b-18 safe harbor.

New Item 703 of Regulations S-K and S-B and new Item 15(e) would require issuers to disclose in their Forms 10-Q (10-QSB), 10-K (10-KSB), and 20-F:

- the total number of shares (or units) purchased for the previous quarter;
- the average price paid per share;
- the identity of broker-dealer(s) used to effect the purchases (except in the case of Form 20-F);
- the number of shares (or units) purchased as part of a publicly announced repurchase plan or program;¹³ and

- the maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs.

New Item 6 of proposed Form N-CSR would require closed-end management investment companies that are registered under the Investment Company Act to provide similar disclosure.

* * *

If you would like a copy of the SEC release, or if you have any questions, contact:

Brandon Becker +1 (202) 663-6979
Brandon.Becker@wilmer.com

Soo J. Yim +1 (202) 663-6958
Soo.Yim@wilmer.com

Anitra Cassas +1 (202) 663-6012
Anitra.Cassas@wilmer.com

¹² Regulations S-K and S-B set forth the standard filing instructions for forms under the Securities Act and the Exchange Act. Forms 10-K (KSB) and 20-F are filed by issuers (small business issuers) and foreign private issuers, respectively, to satisfy annual reporting obligations and Form 10-Q (QSB) is filed by issuers (small business issuers) to satisfy quarterly reporting obligations. Proposed Form N-CSR would be used by registered management investment companies to file certified shareholder reports with the Commission under the Sarbanes-Oxley Act of 2002. See Exchange Act Release No. 46,441, Investment Company Act Release No. 25,723 (Aug. 30, 2002), 67 Fed. Reg. 57,298 (Sept. 9, 2002); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

¹³ The proposal would also require footnote disclosure of the principal terms of publicly announced repurchase plans or programs, including 1) the date of announcement, 2) the share or dollar amount approved, 3) the expiration date (if any) of the plans or programs, 4) each plan or program that has expired during the period covered by the table, 5) each plan or program that the issuer has determined to terminate prior to expiration, and 6) each plan or program that the issuer has not purchased under during the period covered by the table and whether the issuer still intends to purchase under that plan or program.

WCP Corporate and Securities Practice Group Partners

Jorge E. Alers	Bruce E. Coolidge	Michael R. Holter	William McLucas	Marianne K. Smythe
James E. Anderson	Meredith Cross	Robert F. Hoyt	Thomas E. D. Millsbaugh	Roland Steinmeyer
Philip D. Anker	Charles E. Davidow	Andrew Kaizer	Karen M. Mincavage	Peter K. Vigeland
Robert G. Bagnall	Stuart F. Delery	Glynn D. Key	Duane D. Morse	Andrew N. Vollmer
Brandon Becker	Mark A. Dewire	R. Scott Kilgore	William J. Perlstein	Paul A. von Hehn
Joseph K. Brenner	Colleen Doherty-Minicozzi	Satish Kini	Mark Pollak	John B. Watkins
Russell J. Bruemmer	Stephen P. Doyle	Michael R. Klein	Erika L. Robinson	Harry J. Weiss
J. Beckwith Burr	Jennifer M. Drogula	Alexander Kollmorgen	Frank E. Roitzsch	Andrew B. Weissman
Mark D. Cahn	Van W. Ellis	Yoon-Young Lee	John W. Ryan	Thomas W. White
Richard W. Cass	Gregory J. Ewald	Lewis Liman	Knute J. Salhus	William A. Wilson III
Georg Graf Zu Castell-Castell	Simon Firth	Martin E. Lybecker	Klaus Schubert	James R. Wrathall
Gregorio B. Cater	Andrew N. Goldman	Eric R. Markus	Martin Seyfarth	Soo J. Yim
Louis R. Cohen	James Greig	Robert B. McCaw	Mark S. Shelton	

This letter is for general informational purposes only and does not represent our legal advice as to any particular set of facts, nor does this letter represent any undertaking to keep recipients advised as to all relevant legal developments.

2445 M Street, N.W. Washington, D.C. 20037-1420 Telephone: +1 (202) 663-6000	399 Park Avenue New York, NY 10022 Telephone: +1 (212) 230-8800	100 Light Street Baltimore, MD 21202 Telephone: +1 (410) 986-2800	1600 Tysons Boulevard Tysons Corner, VA 22102-4826 Telephone: +1 (703) 251-9700	4 Carlton Gardens London SW1Y5AA Telephone: +44 (20) 7872 1000	Rue de la Loi 15 Weststraat B-1040 Brussels Telephone: +32 (2) 285 49 00	Friedrichstrasse 95 D-10117 Berlin Telephone: +49 (30) 20 22 64 00
--	---	---	---	--	--	--