

Corporate Advisor

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The SEC has taken a number of steps to address issues arising from the emergency closure of the U.S. equity markets from September 11, 2001 through September 14, 2001.

The SEC issued emergency orders on September 14, 2001 and September 28, 2001 designed primarily to make it easier for companies to repurchase their own securities. In the wake of past market disruptions, such as the crash of 1987, repurchases by companies have been credited with enhancing liquidity and strengthening financial markets.

The SEC also issued interpretations relating to Section 16 (b), Rule 144 and Rule 10b5-1 that are of interest to company insiders.

Emergency Orders Facilitate Company Repurchases

The following is a summary of the two emergency orders issued by the SEC regarding corporate buybacks.

First Emergency Order (effective September 17 through September 28)

The first emergency order was in effect through September 28, 2001 and provided for the following:

Window Periods. A concern for companies contemplating repurchases during the last two weeks of September was that most calendar year-end companies were in a "black out period" under their anti-insider trading policies. The SEC addressed these concerns in the first emergency order by issuing the following statement: "While the antifraud provisions remain in effect, a registrant's failure to comply with those timing policies for purchases by the registrant of its securities during the period covered by the Order will not by itself be considered as any indication that the registrant may have violated the antifraud provisions." No company should repurchase securities while aware of material nonpublic information, especially favorable news.

Rule 10b-18. Most companies structure their buyback programs to comply with the safe harbor of Rule 10b-18 of the Securities Exchange Act of 1934. This provision shields companies from market manipulation claims if its repurchases comply with certain conditions regarding the number of brokers, timing, volume and price of repurchases. For the period September 17-28, the timing and volume requirements of Rule 10b-18 were modified as follows:

Timing . With respect to timing, the ban on buying at the opening of a session and the last half hour of a session was suspended.

Volume . With respect to volume, the limitation that purchases on any given day (other than block purchases) cannot exceed more than 25% of the average daily trading volume during the past four calendar weeks was modified. The new limitation was that purchases on any given day (other than block purchases) could not exceed more than 100% of the average daily trading volume during the past four calendar weeks, excluding the week of September 10. The calculation remained based on the average daily trading volume over four calendar weeks, but the week of September 10 was disregarded.

Accounting. The first emergency order also stated that the availability of pooling-of-interests accounting would not be affected by corporate repurchases during the period September 17-28.

Section 16(b) Relief. The first emergency order also provided relief from Section 16(b) for corporate insiders as described below under the heading "SEC Clarifies Rules Affecting Insider Transactions".

Second Emergency Order (effective from October 1 through October 12)

On September 28, 2001, the SEC issued its second emergency order, effective from October 1 through October 12, in an effort to continue to facilitate corporate buybacks. This second emergency order provides relief on a more limited basis than the first emergency order.

Rule 10b-18. The second emergency order extends for all companies the relaxed Rule 10b-18 volume condition that was contained in the first emergency order. However, it provides more limited relief from the Rule 10b-18 timing condition.

Timing. The second emergency order modifies the timing condition of Rule 10b-18 only for companies that have average daily trading volume (ADTV) of \$1,000,000 or more and a public float of \$150 million or more. For such companies, the timing limitations in Rule 10b-18 will be satisfied as long as the company does not effect a repurchase that would be (i) the opening transaction in the security or (ii) within ten minutes of the scheduled close of trading on the primary market for such security. Compared to the usual timing condition set forth in Rule 10b-18, which bans repurchases at the opening and during the last half hour of a session, the effect of this relief is to permit companies that meet the ADTV test to repurchase their stock for 20 minutes more than they would ordinarily be able to do. Companies that do not meet the ADTV test must comply with the usual timing condition of Rule 10b-18 as it existed before September 17.

ADTV is calculated in accordance with Rule 100 of Regulation M, which states that ADTV is measured during the two full calendar months immediately preceding, or any 60 calendar days ending within the 10 calendar days preceding, the repurchase. An SEC official has informed us that for this calculation a company should include the trading volume on Monday, September 10 and should disregard the days when the financial markets were

closed (September 11 through September 14). In other words, the period from September 11 through September 14 will have no effect on the calculation.

Volume . For all companies, the modified volume limitation in the first emergency order continues to be in effect until October 12.

Other Rule 10b-18 Conditions. The other two conditions of Rule 10b-18 -- the one broker/dealer condition and the price condition -- are not affected by the second emergency order and must be complied with, as was the case in the first emergency order. These conditions are as follows:

One Broker Dealer. All Rule 10b-18 bids and purchases which are solicited by or on behalf of an issuer on any particular day must be made through a single broker or dealer.

Price. The price which the issuer may bid or pay in a repurchase under Rule 10b-18 may not exceed the higher of (x) the published bid that is the highest current independent published bid or (y) the last independent sale price reported in the consolidated system.

Accounting . For all companies, repurchases made from October 1 to October 12 will continue to have no effect on the availability of pooling-of-interests accounting.

No Section 16 (b) Relief. The second emergency order provides no relief from Section 16(b) for corporate insiders. The relief from the Section 16(b) short-swing profits rule for directors, officers and more than 10% shareholders contained in the first emergency order expired on September 28, 2001.

No Statement Regarding Repurchases During Closed Window Periods. The second emergency order does not contain a statement regarding window period compliance. The first emergency order contained a statement in the preamble to the order that repurchases by a company while the order was in effect would not -- "by itself" -- be considered any indication that the antifraud provisions had been violated by the company. An SEC official has advised us that the absence of a similar statement about repurchases during blackout periods in the second emergency order does not signal a change in the SEC's view on this matter.

With respect to the period during which the second emergency order is in effect, we would suggest that companies contemplating repurchases conduct a serious self-evaluation about whether they are aware of material nonpublic information, especially favorable news. Calendar fiscal year-end companies may be more likely to be aware, or become aware, of such information during the period which the second emergency order is in effect. The third quarter is now over, which was not the case when the first emergency order was issued. For such companies that want to repurchase, it may be appropriate to consider pre-announcing some results.

Lastly, a company that intends to repurchase securities should ensure it has proper corporate approval to undertake such actions, including proper authorization from its board of directors. There are many important legal and other issues relating to buybacks that must be considered in advance.

SEC Clarifies Rules Affecting Insider Transactions

Section 16(b) Relief. Section 16(b) of the Exchange Act subjects directors, certain officers and greater than 10% stockholders of public companies to liability claims for any profit from purchases and sales within less than six months of each other (so-called "short-swing profit"). The first emergency order provided some relief from Section 16(b). Any purchases during the period September 17-28 are not matchable with any sales in the past six months. These purchases are, however, matchable with any nonexempt sales that occur within the next six months. Such purchases must be reported using the "J" code and must contain a footnote specifically referring to the first emergency order. No relief was provided for any sales made during the period September 17-28. Despite this relief from Section 16(b), the SEC made it very clear in the first emergency order that the antifraud provisions of the securities law remain in effect and that no executive should purchase securities while aware of material nonpublic information, especially favorable news. The second emergency order did not contain this Section 16(b) relief.

Rule 144 Volume Limitations. One of the requirements of Rule 144, a safe harbor under which insiders and holders of restricted securities may publicly resell their securities, is that the maximum amount of securities that may be sold in any three-month period may not exceed the greater of (x) one percent of the issuer's outstanding securities or (y) the average weekly trading volume of the issuer's securities. This average is based on trading during the four calendar weeks prior to the filing of the Form 144 with the SEC. Since the markets were only open for one day during the week of September 10, the SEC has stated that the week of September 10 should be excluded from calculations of the average weekly trading volume. The calculation remains based on an average over four calendar weeks, but the week of September 10 is disregarded.

Rule 10b5-1 Trading Plans. One of the requirements of Rule 10b5-1(c), an affirmative defense against insider trading claims, is that the trading plan be entered into in good faith. The SEC has previously issued guidance on whether the termination of a Rule 10b5-1 plan calls into question whether the plan was entered into in good faith. The SEC has now stated its view that termination of a Rule 10b5-1 trading plan during the period between September 11, 2001 and September 28, 2001, inclusive, would not, by itself, call into question whether the plan was "entered into in good faith and not as part of a plan or scheme to evade" the insider trading rules within the meaning of Rule 10b5-1(c).

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