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SEC Proposes Amendments to Issuer Repurchase Rule

Rule 10b-18: Safe Harbor from Liability for Market Manipulation

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A company may elect to repurchase its securities for various legitimate business reasons. Most companies structure their repurchases to comply with the non-exclusive, "safe harbor" of Rule 10b-18 of the Securities Exchange Act of 1934 (the "Exchange Act"). This provision shields companies from market manipulation claims under Sections 9(a)(3) and 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act if the repurchases are effected in the open market and comply with the Rule's manner, timing, price, and volume conditions.

On January 25, 2010 the Securities and Exchange Commission issued a release proposing amendments to Rule 10b-18 in order to modernize the Rule in response to market developments. The proposal seeks to:

- Modify the timing condition to additionally preclude from the safe harbor stock repurchases as the opening purchase in (1) the principal market for the security and (2) the market where the purchase is effected
- Allow companies with actively traded securities to repurchase their stocks on a VWAP basis
- Reduce the risk that a company will have non-compliant purchases as a result of fast moving market conditions
- Extend the time in which the safe harbor is unavailable in connection with an acquisition by a special purpose acquisition company

This alert briefly explains the most significant sections of the proposal.

Increased Restrictions on Timing of Purchases

The proposal seeks to modify the timing condition to preclude stock repurchases as the opening purchase in the principal market for the security and in the market where the purchase is effected (in addition to the current prohibition against effecting repurchases as the opening purchase reported in the consolidated system.)

Current Rule: Under the current Rule, to qualify for the Rule 10b-18 safe harbor a company's purchase may not be the opening regular way purchase reported on the consolidated system. A purchaser is not disqualified under the current rule, however, even if it is the opening purchase in the principal market for its security or the opening purchase in the market where the purchase is effected, provided there is already an opening purchase reported in the consolidated system that day.

Timing Conditions: The SEC proposes to modify Rule 10b-18's timing condition to preclude a company's repurchase from being the opening purchase in both the principal market for the security and in the market where the purchase is effected. (The proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase reported in the consolidated system.) The SEC is concerned that the opening transaction in the principal market for a security and in the market where a repurchase is effected "can be a significant indicator of the direction of trading, the strength of demand, and the current market value of a security."

Potential Delay in Early Purchases: This change would be significant in a situation where the principal market has a delayed opening in a stock, and another exchange's smaller opening transaction is reported in the consolidated system first. In such a situation, the proposed amendments would require the company to wait until both of these opening transactions were reported in the consolidated system (rather than just the first transaction) before it could effect a Rule 10b-18 purchase within the safe harbor that day.

Pricing Exceptions for Actively Traded Securities

The proposal would give safe harbor protection to companies that effect repurchases using alternative pricing mechanisms, such as VWAP.

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Current Rule: Currently, Rule 10b-18's protection only extends to a company bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the purchase is effected.

Conditions for Exception: Understanding that companies might need additional flexibility to effect repurchases using alternative pricing mechanisms, the proposal seeks to except from Rule 10b-18's price condition stock repurchases effected on a volume-weighted average price ("VWAP") basis, provided certain criteria are met:

- **Actively Traded Securities:** The VWAP purchase must be for a security that qualifies as an actively-traded security as defined under Rule 101(c)(1) of Regulation M.
- **Purchase Condition and Price Determination:** The VWAP purchase must be entered into or matched before the regular trading session opens and the execution price of the VWAP matched trade must be determined based on a full trading day's volume.
- **Limits:** The company's VWAP purchase must not exceed 10% of the average daily trading volume in the security and must not be effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.
- **Calculation:** The VWAP must be calculated by adding up the dollar amounts traded for each transaction in the security (price multiplied by shares traded) and then dividing by the total number of shares traded for the day.
- **Reporting:** The VWAP purchase must be reported using a special VWAP trade modifier in order to indicate to the market that such purchases are unrelated to the current or closing price of the security.
- **Other Passive Pricing Mechanisms:** The SEC is also considering whether to except other passive pricing mechanisms from the Rule's price condition. Particularly, the SEC indicated that it is considering expanding the proposed exception to include company transactions effected through electronic trading systems that match and execute trades at independently derived prices, such as orders effected at the mid-point of the national best bid or offer (Mid-Peg Orders).
- **Potential Exception for Electronic Trading Systems:** Additionally, the SEC indicated that it is considering whether to except from Rule 10b-18's price condition purchases that are effected in an electronic trading system that matches buying and selling interests at various times throughout the day if a range of conditions are present.

Decreased Risk of Noncompliant Purchases as a Result of Flickering Quotes

The proposal seeks to limit the disqualification provision in fast moving markets under certain specific conditions, requiring that only noncompliant purchases, rather than all of the company's 10b-18 purchases for that day, are disqualified from the safe harbor.

Current Rule: Currently, Rule 10b-18 provides that failure to meet any one of the four conditions with respect to any of a company's repurchases during the day will disqualify all of the company's repurchases from the safe harbor for that day.

Flickering Quotes: In recognition by the SEC that the increased speed of today's markets has made it increasingly difficult for a company to ensure that every purchase of its common stock during a day will meet Rule 10b-18's current price condition, the SEC proposed to disqualify only the non-complying purchases. By limiting the disqualifying purchases, the SEC is seeking to reduce the effects of inadvertent disqualifying purchases.

Noncompliant Purchase: The SEC proposal applies to situations in which an issuer's repurchase order is entered in accordance with the Rule's four conditions but is immediately thereafter executed outside of the price condition solely due to rapid and repeated changes in the current national best bid (so-called "flickering quotes."). In such situations, only the noncompliant purchase, rather than all of the issuer's other Rule 10b-18 purchases for that day, would be disqualified from the safe harbor.

Additional Restrictions for SPACs: "Merger Exclusion" Provision

The proposal seeks to modify the "merger exclusion" provision to extend the time in which the safe harbor is unavailable in connection with an acquisition by a special purpose acquisition company ("SPAC").

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SPACs: A SPAC is a shell, developmental stage, or blank-check company that raises capital in initial public offerings, generally for the purpose of acquiring or merging with a target. The SEC addressed the need to prevent the safe harbor from being used in situations where there is a heightened incentive for the issuer to engage in substantial repurchase activity solely to facilitate a corporate action, like a favorable vote on a SPAC acquisition.

Safe Harbor Unavailable Before Vote: The proposed amendments would add a provision that extends the time in which the safe harbor is unavailable in connection with an acquisition by a SPAC until the completion of the vote by the SPAC stockholders. Therefore, in addition to the vote of the target stockholders, the SPAC stockholders must vote before the safe harbor's protection is available.

The SEC solicited comments on the proposed changes to Rule 10b-18, including comments in response to specific questions raised by the SEC with respect to particular aspects of the proposal. The comment period expires on March 1, 2010. Although the SEC may modify the proposed changes to Rule 10b-18, we expect the changes to Rule 10b-18 will be implemented before July 1, 2010.

[Click here to view the full text of the current Rule 10b-18.](#)

[Click here to view the full text of the SEC's proposal in PDF format.](#)