

## **SEC Proposes Amendments to Rule 10b-18 - Issuer Repurchases of Equity Securities**

On January 25, 2010, the Securities and Exchange Commission (“SEC”) proposed amendments to Rule 10b-18, providing issuers with a “safe harbor” from liability for manipulation when they repurchase their common stock in accordance with the Rule’s manner, timing, price, and volume conditions.<sup>1</sup> The amendments are intended to update and clarify the safe harbor provisions in light of current industry practices. The proposal, if enacted, will:

- modify the timing condition to preclude Rule 10b-18 purchases as the opening purchase in the principal market for the security and in the market where the purchase is effected;
- relax the price condition for certain volume-weighted average price (“VWAP”) transactions;
- limit the disqualification provision in fast moving markets under certain conditions;
- 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”); and
- update certain definitional provisions.

### **I. Background**

The SEC acknowledges that issuers repurchase their securities for a multitude of business reasons. However, it is concerned that in some instances, an issuer has an interest in the market performance of its securities that may lead to repurchases made in a manipulative manner. Rule 10b-18, adopted in 1982, provides issuers with a safe harbor from liability under Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”) when they repurchase common stock in accordance with the applicable manner, timing, price, and volume conditions designed to minimize market impact.<sup>2</sup> Under the current safe harbor, a failure to meet any one of the four conditions on any one of the issuer’s purchases during the day disqualifies all of the Rule 10b-18 purchases on a given day. The proposed amendments are intended to maintain limits on the safe harbor consistent with the objectives of the Rule while also offering issuers greater flexibility in conducting their repurchase programs and clarifying the availability of the safe harbor.

### **II. Proposed Amendments**

#### **A. Amendments Regarding the Purchasing Conditions**

##### *Timing of Purchases*

Currently, to come under the protection of the safe harbor, an issuer’s purchase may not be the opening regular way purchase reported in the consolidated system; however, the purchase may be the opening purchase in the principal market for its security and the opening purchase in the market where the purchase is effected if there

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<sup>1</sup> See Release No. 34-61414 (January 26, 2010) available at <http://www.sec.gov/rules/proposed/2010/34-61414.pdf> (the “Proposing Release”).

<sup>2</sup> Rule 10b-18 is not the exclusive means of making non-manipulative repurchases.

is already an opening purchase in the consolidated system for the day. The proposed amendment will continue to preclude an issuer from engaging in Rule 10b-18 purchases as the opening purchase reported in the consolidated system. It will also address confusion over situations in which the principal market may have a delayed opening and another exchange's smaller opening transaction is reported in the consolidated system first by prohibiting an issuer from being the opening purchase in either the principal market for the security or in the market where the purchase is effected.

The SEC explains that because opening transactions may be indicative of the direction of trading, opening purchases can have a great effect. This amendment is designed to minimize the impact of issuer repurchases on the market by requiring an issuer to wait until all of the potential opening purchases are reported in the consolidated system prior to making its purchases.

### *Pricing of Purchases*

Currently, Rule 10b-18 limits an issuer to bidding for or buying its securities at a purchase price 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; however, issuers would like to be able to repurchase their securities on a VWAP basis within the safe harbor. Although a VWAP basis has the potential to exceed the highest independent bid or last independent transaction price, the proposed amendment will exempt from the Rule's price condition purchases made on a VWAP basis if certain conditions are met.

To qualify for the exception, the VWAP purchase must:

- be for an actively-traded security;<sup>3</sup>
- “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;”<sup>4</sup>
- “not exceed 10% of the [average daily trading volume (“ADTV”)] 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;”<sup>5</sup>
- be calculated by first calculating the values for every regular way trade reported in the consolidated system, by multiplying each such price by the total number of shares traded at that price; then compiling an aggregate sum of all values; and then dividing this aggregate sum by the total number of trade reported shares for that day;<sup>6</sup> and
- be reported using a special VWAP trade modifier to prevent the issuer’s purchase from providing any price discovery information or influencing the pricing direction.

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<sup>3</sup> As defined under Rule 101(c)(1) of Regulation M.

<sup>4</sup> Proposing Release at 17.

<sup>5</sup> *Id.* at 18.

<sup>6</sup> The Proposed Rule expressly excludes trades effected as the opening purchase, trades during the last 10 minutes, and trades effected at a price that exceeds the highest independent bid or the last independent transaction price, whichever is higher.

The SEC believes that this exception will provide greater flexibility to issuers in conducting their repurchase programs while the conditions will prevent potential abuse.<sup>7</sup>

### *Volume of Purchases*

Currently, an issuer may conduct daily purchases up to 25% of the ADTV in its shares as calculated under the Rule or may otherwise purchase a block of its common stock once each week in lieu of purchasing under the 25% daily volume limitation. The amendment proposes a non-substantive change to the definition of “block” to reference “ADTV” instead of “trading volume” to make the definition more consistent with the current Rule.

## **B. Amendments Regarding the Scope of the Safe Harbor**

### *Fast moving markets*

Currently, the Rule has a general disqualification if any one of the issuer’s repurchases on a given day fails to meet any one of the four conditions; however, “flickering quotes” has made it increasingly difficult for issuers to ensure that each purchase will meet the price condition.<sup>8</sup> The proposed amendment will limit the general disqualification for purchases that are entered in accordance with the Rule’s four conditions but thereafter are executed outside of the price condition solely due to flickering quotes. In these cases, only the non-compliant purchase will be disqualified.

The SEC explains that issuers in fast moving markets will still be able to utilize the safe harbor for compliant purchases, maintaining the protection for inadvertent purchases outside of the condition. Also, in retaining the “last independent price” component as an alternative, issuers have a reliable mechanism to meet the price condition when there are flickering quotes.

### *Merger Exclusion*

Currently, the Rule excludes from the safe harbor purchases during the period from the time of public announcement of a merger, acquisition, or similar transaction involving a recapitalization, until the earlier of its completion or the completion of the vote by the target shareholders. The proposed amendment will add a provision to extend the unavailability of the safe harbor in connection with a SPAC acquisition until the completion of the vote by the SPAC’s shareholders.

The SEC explains that certain corporate events which add an incentive or otherwise increase pressure to bring about a successful conclusion to an action via issuer repurchases do not fall within the definition of a “Rule 10b-18 purchase.” Given the rapid growth of SPAC capital raising, which create conflicts of interest and financial incentives for SPAC management, amending the exclusion to apply to purchases effected during the period from public announcement until the earlier of the transaction or completion of the vote by both the target shareholders and the SPAC shareholders prevents the safe harbor from being taken advantage of in situations other than the normal market conditions for which it is intended.

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<sup>7</sup> The SEC is also considering whether to except other passive pricing mechanisms such as the mid-point of the national best bid and offer (“NBBO”) or “mid-peg” orders. See Proposing Release at 23.

<sup>8</sup> “‘Flickering quotes’ occur when there are rapid and repeated changes in the current national best bid during the period between identification of the current national best bid and the execution or display of the Rule 10b-18 bid or purchase.” Proposing Release at 29 n.74.

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The SEC requests that comments on the proposals be submitted on or before March 1, 2010.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).

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