



SEC Proposes Changes to Company Repurchases of Common Stock

On January 25, 2010, the Securities and Exchange Commission proposed amendments to Rule 10b-18 under the Securities Exchange Act of 1934 (the “Exchange Act”), which provides an issuer and certain others with a non-exclusive “safe harbor” from liability for manipulation¹ when they repurchase the issuer’s common stock in the market in accordance with the Rule’s manner, timing, price, and volume conditions.² Rule 10b-18 was originally adopted in 1982, and the proposed amendments are intended to clarify and modernize the safe harbor provisions in light of market developments.

The SEC’s proposed revisions are quite timely (or extremely late, depending on your viewpoint). The downturn in issuer repurchases during the financial crisis should begin to ease as issuers consider repurchasing their undervalued stock. Modernizing Rule 10b-18 may also result in greater transparency as issuers may decide to conduct repurchases within the safe harbor, rather than continue the recent market trend of indirect repurchases through the use of derivatives or repurchases that rely on formula pricing methodologies. The proposed revisions may also address concerns raised regarding the timing of issuer repurchase programs similar to the timing concerns raised in the stock option backdating and charitable donation inquiries.³

The SEC proposes the following significant revisions⁴ to Rule 10b-18:

Expand the timing condition

The proposal would expand the current prohibition against effecting Rule 10b-18 purchases as the opening purchase reported in the regular way consolidated system 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 VWAP transactions

Rule 10b-18 limits an issuer to 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. Many issuers have proposed being able to purchase securities based on the volume-weighted average price (“VWAP”). However, because VWAP transactions are priced on the basis of individual trades executed and reported throughout the trading day,

¹ Rule 10b-18 is a non-exclusive safe harbor from claims of manipulation pursuant to Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

² The Proposing Release is available at <http://www.sec.gov/rules/proposed/2010/34-61414.pdf>.

³ In addition to concerns regarding timing, commentators also have raised a number of other considerations regarding repurchase programs. Cf. e.g., Gumport, M. A., *The Next, Great, Corporate Scandal: Potential Liability of Corporations Engaged in Open Market, 10B-18 Buybacks: A Minority View; Case Histories; Summary of Published Studies; Direction of Future Research* (September 7, 2006). Available at SSRN: <http://ssrn.com/abstract=927111>.

⁴ The SEC also proposes a number of updates to definitions and references to reflect the current provisions of the Rule.

there may be instances where the execution price of an issuer's VWAP purchase effected at the end of that trading day (after the security's VWAP has been calculated) exceeds the highest independent bid or last independent transaction price quoted or reported in the consolidated system for that security and, therefore, will be outside of the safe harbor's current price condition.

In order to provide issuers with additional flexibility to conduct repurchase programs using VWAP, the SEC proposes to except purchases effected on a VWAP basis from Rule 10b-18's price condition if the following criteria are met:

- The purchase must otherwise comply with Rule 10b-18 timing and pricing conditions.
- The security is an "actively-traded security," as defined in Regulation M;
- The purchase is entered into or matched before the opening of the regular trading session;
- The execution price of the VWAP purchase is determined based on all regular way trades effected in accordance with specified conditions that are reported in the consolidated system during the primary trading session for the security;
- The purchase does not exceed 10% of the security's relevant average daily trading volume;
- The purchase is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security;
- The VWAP is calculated in accordance with the provisions of the Rule; and
- The purchase is reported using a special VWAP trade modifier.

These proposed VWAP changes are consistent with many already existing derivative-based, indirect purchase programs.

Limit the disqualification provision in fast moving markets

The SEC acknowledges that the speed at which current markets move, citing "flickering quotes"⁵ specifically, has made it increasingly difficult for an issuer to ensure that every purchase of its common stock during the day meets the Rule's current price condition. Failure of any one of the four conditions of Rule 10b-18 with respect to any sale will disqualify all purchases during that day from the benefit of the safe harbor. The SEC proposes to amend Preliminary Note 1 to Rule 10b-18 and paragraph (d) of the Rule to limit the Rule's disqualification provision in instances where 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 flickering quotes. In these instances, 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.

Modify the "merger exclusion" provision for SPACs

The SEC proposes to amend the provision that extends the time in which the safe harbor is unavailable in connection with an acquisition by a special purpose acquisition company ("SPAC") until the earlier of the completion of such transaction or the completion of the votes by the target and SPAC shareholders (not just the target's shareholders as currently contemplated by the Rule). SPACs were not significant when the Rule was modified in 2003 to address the concern that issuers in contemplation of a shareholder vote upon a merger or acquisition may seek to repurchase shares in order to influence the vote. The proposal outlines the SEC's concerns about the "heightened incentive" of a SPAC issuer to seek to purchase its shares prior to the vote of its

⁵ In footnote 74 to the Release, the SEC states: "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. In many active NMS stocks, the price of a trading center's best displayed quotations can change multiple times in a single second."

shareholders on a merger or acquisition. SPAC issuers will still be able to effect limited repurchases in accordance with the Rule, which reflect the SEC's belief that the limited repurchases cannot have a significant effect on the contemplated merger or other transaction.

Requests for Comments

The SEC is soliciting comments on its proposal and a number of alternatives and questions that it raises in the proposal. Comments will be due 30 days after the proposal is published in the Federal Register.

About Morrison & Foerster

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, Fortune 100 companies, investment banks and technology and life science companies. Our clients count on us for innovative and business-minded solutions. Our commitment to serving client needs has resulted in enduring relationships and a record of high achievement. For the last six years, we've been included on The American Lawyer's A-List. Fortune named us one of the "100 Best Companies to Work For." We are among the leaders in the profession for our longstanding commitment to pro bono work. Our lawyers share a commitment to achieving results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

© 2010 Morrison & Foerster LLP. All rights reserved.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.