

# SEC ADOPTS CHANGES TO RULE 10B-18 COMPANY SHARE REPURCHASE SAFE HARBOR

The SEC recently amended Exchange Act Rule 10b-18, which provides companies a safe harbor from liability for manipulation when they repurchase their common shares in the open market. Rule 10b-18 does not, however, provide companies protection from other federal securities laws (such as prohibitions on insider trading) and non-securities laws (such as state corporation laws prohibiting repurchases which result in insolvency).

The SEC also now requires companies to disclose in their annual and quarterly reports all repurchases, whether in the open market or private transactions. Disclosure is required for any period ending after March 15, 2004.

## THE RULE 10b-18 “SAFE HARBOR”

Rule 10b-18 provides a company with a “safe harbor” from liability for manipulation under Exchange Act Section 9(a) (2) and Rule 10b-5 when it repurchases its shares in the open market.

### Conditions

The “safe harbor” is available only when a company repurchases its shares in the market in accordance with the Rule’s timing, manner, price, and volume conditions on each day it makes such a purchase.

### Timing

The timing condition limits a company from buying at the beginning of trading and near the end of trading. A company may not purchase its shares as the opening trade of the regular trading session or the opening trade of any after-hours trading session, nor may a company purchase its shares during the last 30 minutes of trading, except that certain large companies may repurchase their shares during the last 10 minutes of trading.

### Manner of Purchase

The manner of purchase condition requires trades be effected by a company through one broker or dealer on any single

day. The “single broker or dealer” requirement does not apply to purchases that are not “solicited” by or on behalf of the company. Whether a transaction is “solicited” by or on behalf of a company depends on the facts and circumstances of each case.

When an affiliate of the company is also purchasing shares on the same day as the company, or two affiliates of the company are purchasing shares on the same day, then a single broker or dealer must be used.

For after-hours trading, however, a company may use one broker or dealer to repurchase its shares during a regular trading session and a different broker or dealer to repurchase shares during the subsequent after-hours trading session.

### Price

The price condition specifies the highest price an issuer may bid or pay for its common stock. The recent amendments simplified this condition by applying a uniform price condition that limits all companies to repurchasing their securities at a price that does not exceed the highest independent bid or the last independent transaction price, whichever is higher.

Companies may repurchase their shares during after-hours trading so long as the purchases are at prices that do not exceed the lower of the closing price during the regular session, and any lower bids or sale prices during the after-hours trading session.

### Volume

The volume condition limits the amount of securities a company may repurchase in the market in a single day. To qualify for the safe harbor, a company’s total volume of repurchases effected on any single day must not exceed 25% of the average daily trading volume (“ADTV”) during the four calendar weeks preceding the week in which the repurchase is made.

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### **Inclusion of Block Purchases**

The amendments to Rule 10b-18 now require that any block-size purchases by or on behalf of the company be included in determining whether the 25% threshold has been exceeded. Companies, however, can include their block purchases when calculating ADTV.

A block is defined, as changed by the amendments, to mean a quantity of shares that:

- has a purchase price of \$200,000 or more, or
- is at least 5,000 shares and has a purchase price of at least \$50,000, or
- is at least 20 round lots and either:
  - is at least 1.5 times the trading volume, or
  - in the event that trading volume data are unavailable, is at least 0.1% of the outstanding shares exclusive of any shares owned by any affiliate of the company.
- Finally, a block does not include any amount a broker or dealer, either:
  - acting for its own account, has accumulated for the purpose of selling to the company, if the company knows or has reason to know that such amount was accumulated for such purpose, or
  - has sold short to the company, if the company knows or has reason to know that the sale was a short sale.

### **Single Block Purchase Exception**

To accommodate companies with low average daily trading volumes that rely on block purchases to implement their repurchase programs, the amendments allow companies to make, within the Rule 10b-18 safe harbor, one block purchase per week, provided that the company does not make any other Rule 10b-18 purchases on that day, and the block purchase is not included when calculating ADTV.

### **Repurchases Outside the Scope of Rule 10b-18**

Certain repurchases by a company of its shares are excluded from the safe harbor protection of Rule 10b-18, including:

- repurchases while the company is engaged in a distribution of its securities,
- repurchases when the company is “going private”,
- repurchases which are part of a tender offer, and
- repurchases during certain mergers, acquisitions or recapitalizations.

The merger exclusion, as changed by the amendments, applies to purchases that are made during the period from the time of public announcement of a merger, acquisition or recapitalization, until the earlier of the completion of such transaction, or the vote by the target shareholders (including during any period where the market price of a security will be a factor in determining the consideration to be paid).

The merger exclusion does not extend to:

- transactions in which the consideration is solely cash and there is no valuation period,
- repurchases to be effected after the announcement of a merger so long as the total amount of the company’s repurchases effected on any single day does not exceed the lesser of:
  - 25% of the security’s four-week ADTV, or
  - the company’s average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger, or
- block purchases provided that the company does not exceed the average size and frequency of block purchases under the volume condition during the three full calendar months preceding the date of the announcement of such merger.

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**Repurchases Effected Outside the United States**

In its adopting release, the SEC made clear that the Rule 10b-18 safe harbor is not available for repurchases effected outside of the United States.  
**DISCLOSURE OF REPURCHASES**

Each company must now include in its Form 10-K and 10-Q (or Form 10-KSB and 10-QSB for small business issuers) information about the company’s or its affiliates’ repurchases during the quarter. Foreign private issuers must disclose the same information in their Form 20-F for the year. The information must be set forth in a table as follows:

Period	(a) Total Number of Shares (or Units) Purchased [whether made pursuant to plans or programs publicly announced or not.]	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
Month #1 (identify beginning and ending dates)	Audit Fees (fee billed for services rendered by the auditor for the audit of the annual financial statements and review of the quarterly financial statements)	Audit-Related Fees (fees billed for assurance and related services by the auditor that are reasonably related to the performance of the audit or review of the company’s financial statements and are not reported under column 2)	Percentage of Audit-Related Services that were approved by the audit committee	Tax Fees (fees billed for services rendered by the auditor for tax compliance, tax advice, and tax planning)
Month #2 (identify beginning and ending dates)				
Month #3 (identify beginning and ending dates)				
Total				

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The disclosure must also include, by footnote:

- the number of shares purchased other than through a publicly announced plan,
- the nature of the transaction (such as whether the purchases were made in open-market transactions, tender offers, etc.), and
- for any publicly announced repurchase plan or program:
  - the date each plan was announced,
  - the dollar or share amount approved,
  - the expiration date, if any, of each plan,
  - each plan that has expired during such period covered by the table, and
  - each plan or program the company has determined to terminate prior to expiration, or under which the company does not intend to make further purchases.