



FENWICK & WEST LLP

Corporate and Securities Law Update

SEC Issues Final Rule Regarding Issuer Stock Repurchases (Effective on December 17, 2003)

November 14, 2003

On November 10, 2003, the SEC adopted amendments to Rule 10b-18, the safe harbor for issuer repurchases, and adopted explicit disclosure requirements for issuer repurchases, whether or not conducted under Rule 10b-18. The text of the new rule can be found at <http://www.sec.gov/rules/final/33-8335.htm>.

I. Rule 10b-18

Rule 10b-18 provides that companies will not be deemed to have violated anti-fraud provisions of the Securities Exchange Act of 1934 if they repurchase their common equity securities within prescribed daily limits on the:

- number of brokers used,
- time of the repurchases,
- prices paid, and
- volume of shares purchased.

The current rule also contains a general provision that repurchases at a time when the company is engaged in a merger or acquisition transaction are not eligible for the safe harbor.

In addition to a number of technical changes, the amended Rule 10b-18 contains two important substantive changes, those being expanded application of the rule when a merger or acquisition is pending and revised treatment of block trades. These changes are briefly summarized below.

Merger and Acquisition Contexts

The current rule's exception for merger and acquisition situations was broadly interpreted to mean that Rule 10b-18 did not apply to purchases in the subject M&A transaction itself, but that a company could conduct Rule 10b-18 repurchases of its own stock while acquiring a third party. This belief was based in part on recognition that repurchases during ongoing M&A events are the subject of other regulation, notably Regulation M.

As amended, Rule 10b-18 now expressly establishes a restricted period that begins when a company publicly

announces an M&A transaction and ends on the earlier of approval of the transaction by the target's stockholders or the closing of that transaction. During this restricted period, an acquiring company may not use the Rule to repurchase its shares, unless either:

- the consideration to be paid in the transaction is solely cash and there is no valuation period, or
- the company's daily repurchases during the restricted period do not exceed the *lesser* of (x) Rule 10b-18's standard daily limit, or (y) the average daily repurchases actually made by the company under Rule 10b-18 during the three month period preceding the announcement of the transaction (special measurements apply if the company made block purchases during such three month period).

By way of example, if a company had not done any Rule 10b-18 purchases during the three-month period prior to announcing an acquisition of a third party where the company would use its shares as merger consideration, the company could not make any repurchases in reliance on the safe harbor until the third party's stockholders approved the deal or the deal closed.

If a company that has completed few or no Rule 10b-18 share repurchases prior to the commencement of an M&A restricted period nonetheless wants to repurchase shares during that period, the company may wish to explore whether repurchasing within the standard Rule 10b-18 volume limitations (but in excess of its actual daily average over the preceding three month period) would have a manipulative effect on the trading prices of its shares. The SEC went to some length to emphasize that trading outside the express terms of the rule did not give rise to a presumption that such trading was manipulative, although it did note that a company might have an incentive to manipulate its stock price while a stock merger was pending.

Block Purchases

Currently under Rule 10b-18 block purchases (as defined in the rule) are not subject to the Rule's volume limitations. Further, the volume limitations that do apply to non-block trades are stated as a percentage of average daily trading volume (ADTV) over a four week period, and securities purchased in a block trade cannot be counted for the purpose of calculating ADTV.

Under the amended Rule 10b-18, block purchases on any given day **will be** counted against that day's volume limitations, and shares purchased in a block trade **will be** included in calculating ADTV. So while the current rule excludes block purchases from the numerator and denominator in calculating volume limitations, the new rule includes block purchases in both. In deference to companies whose stock is thinly traded, the new rule allows companies to make one block trade per week that is not subject to the volume limitations, provided no other repurchases are made on the day of such block trade. As with the current formulation, shares purchased in these limited block trades cannot be included in ADTV.

Other Changes

The new rule makes a number of other changes to the conditions of Rule 10b-18, including allowing broadly traded companies to continue repurchasing until the last 10 minutes of the primary trading session in the principal market for the stock, as compared with a 30 minute closing buffer for other securities. Another change relates to expressly extending the safe harbor to certain after hours trading, subject to additional price restrictions.

II. Disclosure of Repurchases

The SEC also adopted new disclosure requirements for repurchases. In each quarterly report on Form 10-Q and in the annual report on Form 10-K the company must provide a table showing, on a month-by-month basis:

- the total number of shares purchased,
- the average price paid per share,
- the total number of shares purchased under publicly announced repurchase programs, and
- the maximum number of shares that may be repurchased under these programs (or maximum dollar amount if the limit is stated in those terms).

Footnote disclosures will be required to disclose the principal terms of publicly announced repurchase plans, including the date announced, dollar or share amount approved, expiration date, plans that expired during the

period, and plans that the issuer has terminated during the period or plans under which the issuer does not intend to make purchases. If any shares are repurchased other than pursuant to a publicly announced program, the table must include a footnote showing the number of shares so purchased and the nature of the repurchase transaction (for example, purchases of unvested securities, purchases under an issuer tender offer, or purchases pursuant to a stockholder's exercise of a put right against the company).

The discussion above simply summarizes the new rules, which, especially in the case of the Rule 10b-18 amendments, represent technical changes to an already technical regulation. Should you have any question about these new requirements, please feel free to contact any member your Fenwick & West team. You may also contact Dan Winnike (dwinnike@fenwick.com), Horace Nash (hnash@fenwick.com), Jeff Vetter (jvetter@fenwick.com) or Rob Freedman (rfreedman@fenwick.com) who contributed to this update.

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Our Offices

Silicon Valley Center
801 California Street
Mountain View, CA 94041
Phone: (650) 988-8500
Fax: (650) 938-5200

Embarcadero Center West
275 Battery Street
San Francisco, CA 94111
Phone: (415) 875-2300
Fax: (415) 281-1350

877 West Main Street
Suite 706
Boise, ID 83702
Phone: (208) 331-0700
Fax: (208) 331-7723