

there is no independent opening transaction on a given trading day, the issuer is precluded from making purchases under the safe harbor for that day.

### 3. Price Condition

The price condition specifies the highest price an issuer may bid or pay for its common stock.<sup>16</sup> Rule 10b-18's current price limitations vary depending on whether the security is a "reported," "exchange-traded," "Nasdaq," or "other security," (as defined under the current Rule) and whether the bid or purchase is effected on an exchange.<sup>17</sup> The price condition is intended to prevent the issuer from leading the market for the security through its repurchases by limiting the issuer to bidding for or buying its security at a price that is no higher than the highest independent published bid or last independent transaction price. As such, the price condition uses an independent reference price that has not been set or influenced by the issuer but, instead, is based on independent market forces.

### 4. Volume Condition

The volume condition limits the amount of securities an issuer may repurchase in the market in a single day. The volume condition is designed to prevent an issuer from dominating the market for its securities through substantial purchasing activity.<sup>18</sup> An issuer dominating the market for its securities in this way can mislead investors about the integrity of the securities market as an independent pricing mechanism.<sup>19</sup>

Under the current volume condition, an issuer may effect daily purchases in an amount up to 25% of the ADTV in its shares (the "25% volume limitation").<sup>20</sup> However, the current

25% volume limitation does not include an issuer's block purchases. Moreover, an issuer's block purchases are not included in determining a security's four-week ADTV under the Rule.<sup>21</sup> The current Rule defines a "block" as a quantity of stock that either: (i) Has a purchase price of \$200,000 or more; or (ii) is at least 5,000 shares and has a purchase price of at least \$50,000; or (iii) is at least 20 round lots of the security and totals 150 percent or more of the trading volume for that security or, in the event that trading volume data are unavailable, is at least 20 round lots of the security and totals at least one-tenth of one percent (.001) of the outstanding shares of the security, exclusive of any shares owned by any affiliate.<sup>22</sup>

The definition also provides that a block does not include any amount a broker or dealer, acting for its own account, has accumulated for the purpose of selling to the issuer, if the issuer knows or has reason to know that such amount was accumulated for such purpose. The definition also excludes any amount that a broker or dealer has sold short to the issuer, if the issuer knows or has reason to know that the sale was a short sale.<sup>23</sup>

## III. Amendments to Rule 10b-18

### A. Amendments Concerning the Scope of the Safe Harbor

#### 1. Preliminary Notes to Rule 10b-18

We are adopting the two preliminary notes to Rule 10b-18 as proposed. The first note explains that, as a safe harbor, compliance with Rule 10b-18 is voluntary. However, to come within the safe harbor, an issuer's repurchases must satisfy (on a daily basis) each of the Rule's four conditions. Failure to meet any one of the four conditions removes all of the issuer's repurchases from the safe harbor for that day. Because we are adopting this sentence as part of the preliminary notes to the Rule, we have decided that it is unnecessary to also include this sentence in paragraph (d), as we had

originally proposed. The note also states that the safe harbor is not available for repurchases that, although made in technical compliance with the Rule, are part of a plan or scheme to evade the federal securities laws.<sup>24</sup>

The second note states that, regardless of whether the repurchases are effected in accordance with Rule 10b-18, reporting issuers must comply with the new disclosure provisions, *i.e.*, Item 703 of Regulations S-K and S-B and Item 15(e) of Form 20-F (regarding foreign private issuers), and closed-end management investment companies that are registered under the Investment Company Act ("closed-end funds") must comply with Item 8 of Form N-CSR.

#### 2. Eligible Securities

While not making any substantive changes to the scope of the Rule, we are adopting the proposed amendment to merge the current definition of "Rule 10b-18 bid"<sup>25</sup> into the definition of "Rule 10b-18 purchase" and to clarify that the safe harbor is available for repurchases of all common equity securities (*i.e.*, an issuer's common stock or an equivalent interest, including a unit of beneficial interest in a trust or limited partnership or a depository share). Thus, as adopted, "Rule 10b-18 purchase" means a purchase (or any bid or limit order that would effect such purchase) of an issuer's common stock (or an equivalent interest, including a unit of beneficial interest in a trust or limited partnership or a depository share) by or for the issuer or any affiliated purchaser.<sup>26</sup>

#### 3. Availability of Rule 10b-18 Once a Merger, Acquisition, or Similar Transactions Involving a Recapitalization Is Announced

We proposed to amend the definition of "Rule 10b-18 purchase" to clarify that the current exception for purchases effected "pursuant to a merger, acquisition, or similar transaction

securities (*i.e.*, securities that do not meet the definition of "reported securities" under the current Rule, such as OTC Bulletin Board ("OTCBB") and Pink Sheet securities) do not have timing restrictions under the safe harbor. 17 CFR 240.10b-18(b)(2).

<sup>16</sup> 17 CFR 240.10b-18(b)(3).

<sup>17</sup> 17 CFR 240.10b-18(b)(3).

<sup>18</sup> 1980 Proposing Release, *supra* note 4, 45 FR 70890.

<sup>19</sup> A market can be manipulated even in the absence of price leadership. Following the market closely with purchases or bids essentially places a floor underneath the market at each independent purchase or bid. This may exhaust the available supply of securities that may be offered at that price, which ultimately forces others to raise their bids. See 1980 Proposing Release, *supra* note 4, 45 FR 70890; L. Loss and J. Seligman, *Securities Regulation, 3d Edition*, at 10-E-10 (1999); Kidder, Peabody & Co., 18 SEC 559, 570 (1945); *Halsey, Stuart & Co., Inc.*, 30 SEC 106, 129 (1949) (describing over-the-counter manipulation).

<sup>20</sup> This applies to "reported securities," "exchange-traded securities," and "Nasdaq

securities" under the current Rule. 17 CFR 240.10b-18(b)(4). For "other securities" under the current Rule (*e.g.*, OTCBB and Pink Sheet securities), volume of purchases on a single day may not exceed one round lot or, on that day plus the preceding five business days, 1/20th of one percent (0.0005) of outstanding shares of the security. 17 CFR 240.10b-18(b)(4). Trading volume is currently defined as the average daily trading volume reported to the consolidated transaction reporting system or to the NASD for the security in the four calendar weeks preceding the week that the Rule 10b-18 purchase or bid is to be effected. 17 CFR 240.10b-18(a)(11).

<sup>21</sup> 17 CFR 240.10b-18(b)(4).

<sup>22</sup> 17 CFR 240.10b-18(a)(14).

<sup>23</sup> 17 CFR 240.10b-18(a)(14).

<sup>24</sup> See Adopted Preliminary Notes to Rule 10b-18. See also 1982 Adopting Release, *supra* note 4 and text accompanying *supra* note 5. While an issuer will not be deemed to have violated Sections 9(a)(2) or 10(b) of the Exchange Act, or Exchange Act Rule 10b-5 solely by reason of the manner, timing, price, or volume of such repurchases if they are made in compliance with the safe harbor conditions, the safe harbor is not available if the repurchases are fraudulent or manipulative, when viewed in the totality of the facts and circumstances surrounding the repurchases (*i.e.*, facts and circumstances in addition to the volume, price, time, and manner of the repurchases).

<sup>25</sup> "Rule 10b-18 bid" is currently defined as a bid for securities that, if accepted, or a limit order that, if executed, would result in a Rule 10b-18 purchase. See 17 CFR 240.10b-18(a)(4).

<sup>26</sup> Amended Rule 10b-18(a)(13).