

security's four-week ADTV.<sup>69</sup> To accommodate issuers of thinly traded securities, we also proposed to modify the volume condition to allow issuers to purchase up to a daily aggregate amount of 500 shares, as an alternative to the 25% volume limitation.

### c. Comment Letters

Twenty-six of the 43 comment letters we received discussed the treatment of block purchases, all of which opposed our proposal to eliminate the block exception. Most of the support for retaining the block exception came from companies with moderate or low average daily trading volumes. These issuers say that they rely heavily on the block transactions to implement their repurchase programs and argue that eliminating the block exception would cause their repurchase programs to take much longer to complete.<sup>70</sup> Other commenters opposed eliminating the block exception due to their claims of an absence of evidence that block transactions are manipulative, adversely affect share prices, or are otherwise abusive.<sup>71</sup> Some commenters argued that the block exception should be retained because it stabilizes markets in periods of severe market decline.<sup>72</sup>

<sup>69</sup> See Proposing Release, *supra* note 1, which defined ADTV as the average daily trading volume (including block-size purchases made by or on behalf of the issuer), reported for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is effected. We are adopting this definition of ADTV, except that shares purchased as part of the amended block exception in paragraph (b)(4) under the Rule are not to be included in a security's four-week ADTV. Rule 10b-18 also will continue to include only U.S. market trading volume data in calculating a security's ADTV.

See also Letter from Charles J. Plohn, Jr., Managing Director, Merrill Lynch, Pierce, Fenner, & Smith, Inc. to Larry E. Bergmann, Associate Director, Division of Market Regulation, Securities and Exchange Commission (June 3, 1991), which notes that the utility of effecting purchases in blocks is largely diminished by the inability to include such block purchases in calculating a security's four-week ADTV and the practical difficulty and burden of recording all block purchases and subtracting them from the security's overall trading volume, to calculate trading volume under the Rule.

<sup>70</sup> See, e.g., comment letters from America's Community Bankers; First Virginia Banks, Inc.; and Securities Industry Association (SIA).

<sup>71</sup> See, e.g., comment letters from Fed. Reg. Committee; Merrill; and Sullivan.

<sup>72</sup> The concern about eliminating the block exception during times of severe market distress is addressed by the amended Rule's alternative volume condition, which allows issuers to repurchase as much as 100% of their ADTV (up from 25%) during the trading session immediately following a market-wide trading suspension. The Commission also may use its emergency exemptive authority under Exchange Act Sections 12(k) and 36, 15 U.S.C. 78l (k) and 78mm(a). This would allow issuers to supply liquidity during the rare times of severe market volatility, such as the post-September 11, 2001 market. See note 93, *infra*.

As alternatives to eliminating the block exception, several commenters suggested raising the amount of shares in a block to the NYSE definition (*i.e.*, 10,000 shares or more).<sup>73</sup> Other commenters suggested limiting the number of "block" purchases that can occur on a single day. For example, one commenter suggested allowing issuers to make one single block purchase per day (*i.e.*, on condition that the issuer does not make any other purchases for that day).<sup>74</sup> Another commenter suggested limiting either all issuers or only mid-capitalization issuers to 20 block purchases in a day.<sup>75</sup> Other commenters suggested raising the volume limits, especially for small capitalization companies with limited liquidity, from 25% to 35% (or even 100%) of a security's ADTV.<sup>76</sup>

We believe eliminating the current block exception is essential if we are to maintain a limit on the amount of repurchase activity that is protected under the safe harbor.<sup>77</sup> Block transactions today represent one-half of all market activity; accordingly, these transactions are not the exception, and they have a substantial impact on market prices.<sup>78</sup> Issuers also may attempt to take advantage of the block exception to facilitate corporate transactions. For example, in contested takeovers, bidders might purchase significant blocks of their securities to boost their share price in order to enhance the value of their competing merger proposals. Moreover, during the

<sup>73</sup> See, e.g., comment letters from Fed. Reg. Committee; Merrill; Morgan; and Sullivan. However, raising the amount of shares in a block to 10,000 shares or more would do little to address the concerns of smaller issuers whose securities are thinly traded. Moreover, block-sized trades are likely to be relatively rare for small issuers, because they generally do not have institutional holders. For larger issuers, blocks of 10,000 shares have become commonplace in today's market. In fact, blocks of 10,000 or more shares are nearly half of overall trading on the NYSE and Nasdaq. See *NYSE Fact Book—2002 Data*.

<sup>74</sup> See comment letter from Bank Mutual Corporation.

<sup>75</sup> See, e.g., comment letter from LNR Property Corporation (LNR).

<sup>76</sup> See, e.g., comment letter from Morgan Stanley.

<sup>77</sup> See, e.g., The October 1987 Market Break: A Report by the Division of Market Regulation, U.S. Securities and Exchange Commission (February 1988) at p. 6:11 (noting that, while issuer repurchases provided an important source of liquidity after the 1987 market break, the treatment of blocks under the Rule may effectively negate the volume restriction for many securities).

<sup>78</sup> See, e.g., Steve Thel, "850,000 in Six Minutes—The Mechanics of Securities Manipulation," 79 *Cornell Law Review* 219, at 226-227, n. 39 (January 1994) (finding that large blocks move price more often and to a greater degree than the analysis of trading data indicates). See also Robert W. Holthausen, *et al.*, "The Effect of Large Block Transactions on Security Prices," 19 *Journal of Financial Economics* 237 (1987).

late 1990s, it was reported that many companies were spending more than half their net income on massive buyback programs that were intended to boost share prices—often supporting their share price at levels far above where they would otherwise trade.<sup>79</sup>

These situations illustrate that the potential for manipulative abuse can be exacerbated by the block exception. Moreover, extending a safe harbor for issuer repurchases without any effective limit on the amount of repurchase activity undermines the original objectives of the Rule. For example, the current block exception may allow companies to engage in undisclosed stabilization and market domination, or the exception may be used by companies to engage in aggressive buybacks in order to enhance exchange ratios for their common stock. These activities can mislead investors about the integrity of the securities trading market as an independent pricing mechanism.

The predicate assumption of the commenters—that significant abuse must exist before any revisions to the safe harbor are warranted—may be appropriate for a prohibitive rule, but it is not necessary when the Commission is determining whether a safe harbor is warranted. We believe that safe harbors should facilitate only those activities that clearly present no cause for regulatory concern. In the case of the block exception, there is cause for regulatory concern.

### d. Adopted Amendments to the Volume Condition

After carefully considering the comments received, and upon thorough examination of current market practices and the underlying purposes of the safe harbor, we are adopting the proposed amendments relating to the volume condition's treatment of block purchases, with some modifications in response to comments received. Under the amended volume condition, to qualify for the safe harbor, an issuer's total volume of Rule 10b-18 purchases effected on any single day must not exceed 25% of the ADTV in its security, which includes any block-size purchases by or on behalf of the issuer for that day. Issuers, however, can include their block-size purchases when calculating its security's four-week ADTV.

In view of commenters' concerns that eliminating the block exception would negatively affect issuers with moderate or low average daily trading volumes

<sup>79</sup> See, e.g., The Buyback Boomerang, *Business Week* (September 23, 2002).