

## Proposed Amendments to Rule 10b-18 Issuer Repurchase Safe Harbor

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In Release No. 34-61414, the Securities and Exchange Commission ("SEC") is proposing amendments to Rule 10b-18 under the Securities Exchange Act of 1934 ("Exchange Act"), which provides issuers with a safe harbor from liability for manipulation when they repurchase their common stock in the market in accordance with the Rule's manner, timing, volume, and price conditions. The proposed amendments are intended to clarify and modernize the safe harbor provisions in light of market developments since Rule 10b-18's adoption in 1982.

### **Proposed Amendments to Rule 10b-18:**

The SEC is proposing amendments to the current safe harbor rule, particularly by:

- modifying the timing condition 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 (in addition to the current prohibition against effecting Rule 10b-18 purchases as the opening purchase reported in the consolidated system);
- relaxing the price condition for certain volume-weighted average price ("VWAP") transactions;
- limiting the "disqualification provision" (i.e., the current provision that failure to meet any one of the four conditions with respect to any of the issuer's repurchases during the day will disqualify all of the issuer's Rule 10b-18 purchases from the safe harbor for that day) in fast moving markets under certain specific conditions; and
- modifying the "merger exclusion" provision to extend the time in which the safe harbor is unavailable in connection with an acquisition by a special purpose acquisition company ("SPAC").

#### *1) Modifications to the Timing Condition*

The SEC proposes to modify Rule 10b-18's timing condition to preclude Rule 10b-18 purchases as the opening purchase in the principal market for the security and the market where the purchase is effected. Specifically, the proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase in the consolidated system and would amend Rule 10b-18(b)(2)(i) to preclude the issuer from being the opening purchase in both the principal market for the security and the market where the purchase is effected.

The SEC notes that the opening transaction in the principal market for the security and in the market where the repurchase is effected can be a significant indicator of the direction of trading, the strength of demand, and the current market value of a security. Thus, the amendment is designed to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule, allowing the market to establish a security's

price based on independent market forces, without undue influence by the issuer.

### *2) Relaxation of the Price Condition*

The SEC proposes to except from Rule 10b-18's price condition purchases effected on a VWAP basis, provided certain criteria are met. Specifically, the proposal would amend Rule 10b-18(b)(3) to except those Rule 10b-18 VWAP purchases that satisfy the criteria set forth in proposed Rule 10b-18(a)(14).

To qualify for the proposed exception, the VWAP purchase must be for a security that qualifies as an actively-traded security (as defined under Rule 10(c)(1) of Regulation M; i.e. issuers with a security that has an average daily trading volume value of \$1 million or more and a public float value of at least \$150 million). Additionally, the VWAP purchase must be entered into or matched before the regular trading session opens, and the execution of price of the VWAP matched trade must be determined based on a full trading day's volume. Furthermore, the issuer's VWAP purchase must not exceed 10% of the average daily trading volume for the security and must not be effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security. Finally, the VWAP purchase must be reported using a special VWAP trade modifier in order to indicate to the market that such purchases are unrelated to the current or closing price of the security.

The proposed VWAP exception from the Rule's price condition is intended to provide issuers with greater certainty and flexibility in effecting VWAP transactions within the safe harbor, without increasing the potential for price manipulation by the issuer. In using VWAP as a pricing mechanism to effect repurchases, issuers give up control over the pricing of their executions, reducing the risk of potential manipulation.

### *3) Limitations on the "Disqualification Provision" in Fast Moving Markets*

Currently, Rule 10b-18 provides that if an issuer fails to meet any one of the Rule's four conditions (manner, timing, volume, and price) with respect to any of the issuer's repurchases during the day, all of the issuer's Rule 10b-18 purchases will be disqualified from the safe harbor for that day (the "disqualification provision"). Due to the increased speed of contemporary markets, as evidenced by flickering quotes, it is increasingly difficult for an issuer to ensure that every purchase of its common stock during the day will meet the Rule's current price condition.

In response, the SEC proposes to amend Preliminary Note 1 to Rule 10b-18 and Rule 10b-18(d) 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. Under these amendments, only the non-compliant purchase, rather than all of the issuer's 10b-18 purchases for that day, would be disqualified from the safe harbor. This proposed limitation of the disqualification rule would allow an issuer in fast moving markets to effect one otherwise compliant Rule 10b-18 purchase that was inadvertently purchased outside of the safe harbor, due to flickering quotes, without disqualifying all of the issuer's other purchases from the safe harbor for that day.

### *4) Modifications to the "Merger Exclusion" Provision*

Currently, Rule 10b-18 precludes purchases effected during the period from the time of public announcement of a merger, acquisition, or similar transaction involving a recapitalization, until the earlier of the completion of such transaction or the completion of the vote by the target shareholders (the "merger exclusion"). Thus, ordinarily it is the target shareholder vote that determines the completion of the merger exclusion period for purposes of Rule 10b-18.

The proposed amendments would add a provision that extends the time in which the safe harbor is unavailable in connection with a SPAC acquisition until the completion of the vote by the SPAC shareholders. Specifically, the proposal would amend Rule 10b-18(a)(13)(iv) to provide that, in connection with a SPAC transaction, the merger exclusion would apply to purchases that are effected during the period from the

time of public announcement of a merger, acquisition, or similar transaction until the earlier of such transaction or the completion of the vote by both the target shareholders and the SPAC shareholders.

The SEC perceives unique conflicts of interests associated with SPAC acquisitions. Due to special incentives and deferred compensation agreements involved with SPACs, SPAC management may attempt to rely on the safe harbor to repurchase a substantial percentage of shares of the SPAC's common stock in the open market if they believe that SPAC shareholders will vote against an acquisition, or to otherwise ensure that the acquisition will be approved. Thus, by extending the merger exclusion to the time of the vote by the shareholders of the SPAC, the SEC aims to maintain reasonable limits on the safe harbor and prevent it from being used in contexts where there is a heightened incentive to engage in substantial repurchase activity solely in order to facilitate a corporate action.