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SEC Proposes Amendments to Rule 10b-18 and Announces New Rules Governing Disclosure of Issuer Repurchases of Their Equity Securities

The SEC has proposed amendments to Rule 10b-18 under the Securities Exchange Act of 1934, which provides issuers with a safe harbor from liability for manipulation under the Exchange Act when they repurchase shares of their common stock.

The SEC has also proposed new rules requiring periodic disclosure of all purchases by issuers of their equity securities (through open market transactions, private transactions, tender offers or otherwise), regardless of whether or not the purchases were effected pursuant to Rule 10b-18 of the Exchange Act.

The proposed amendments and new rules are subject to a 60-day comment period.

I. Proposed Amendments to Rule 10b-18

Rule 10b-18 provides issuers with a safe harbor from liability for manipulation under Section 9(a)(2), Section 10(b) and Rule 10b-5 under the Exchange Act when they repurchase shares of their common stock in accordance with the manner, timing, price and volume limitations and conditions set forth in Rule 10b-18. The proposed amendments mainly allow issuers whose securities are less susceptible to manipulation to stay in the market longer and to repurchase a greater number of shares during periods of severe market decline.

Purchases

The proposed amendments expand the definition of "Rule 10b-18 purchases" to include any bid or limit order that would effect such a purchase. Rule 10b-18 would continue to apply to purchases by or for an issuer or any affiliated purchaser of the issuer.

Eligible Securities

The proposed amendments would codify the Staff's position that Rule 10b-18 applies to repurchases of all common equity securities (including units of beneficial interests in a trust or limited partnership or depository shares). Rule 10b-18 would continue to be unavailable for repurchases involving securities other than common equity securities, such as preferred stock, warrants, rights, convertible debt securities, options or security futures products.

1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

1615 I. Street, NW
Washington, DC 20036-5694
(202) 223-7300

Alder Castle, 10 Noble Street
London EC2V 7JU England
(44-20) 7367 1600

2, rue du Faubourg Saint-Honoré
75008 Paris, France
(33-1) 53.43.14.14

Fukoku Seimei Building 2nd Floor
2-2, Uchisawaicho 2-chome
Chiyoda-ku, Tokyo 100, Japan
(81-3) 3597-8120

2918 China World Tower II
No. 1, Jianguomenwai Dajie
Beijing 100004, People's Republic of China
(86-10) 6505-6822

12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
(852) 2536-9933

The proposed amendments would also make clear that the exception from the safe harbor provided by Rule 10b-18 for repurchases effected pursuant to a merger, acquisition or similar transaction involving a recapitalization would include repurchases effected during the period from the time of public announcement of the merger, acquisition or similar transaction until the completion of such transaction. This period would also include any period where the market price of a security would be a factor in determining the consideration to be paid pursuant to such merger, acquisition or similar transaction.

Applicability Outside the United States

The SEC's proposing release seeks comments on the question of whether Rule 10b-18 should apply to repurchases by issuers of shares of their common stock effected outside of the United States (e.g., through the means of a foreign stock exchange) and if so, under what conditions. In addition, the release seeks comments on whether Rule 10b-18 should be made available outside of the United States only to foreign private issuers or to foreign companies whose principal market is outside of the United States and under what conditions. Finally, the release seeks comments on whether different conditions would be more appropriate for repurchases outside of the United States than the current conditions provided by Rule 10b-18 as amended.

Manner of Purchases

The proposed amendments do not change the current requirements that the repurchases be effected through a single broker or dealer on any given day. Purchases by or on behalf of several affiliated purchasers of the issuer, or the issuer and at least one affiliated purchaser, would continue to be subject to the requirement that the issuer and any of its affiliated purchasers use the same broker-dealer in effecting purchases under Rule 10b-18. Unsolicited bids and repurchases may continue to be made through any number of brokers or dealers.

Time of Purchases

The proposed amendments would give issuers that have a higher average daily trading volume ("ADTV") and public float value more flexibility in the timing of their repurchases.

Under the proposed amendments, issuers having an ADTV value of at least \$1 million and a public float value of at least \$150 million would not be able to bid for or repurchase their securities (i) as the opening transaction for the day, (ii) during the 10 minutes before the scheduled close of the primary (regular) trading session in the principal market for the security or in the market where the repurchase is made and (iii) after the termination of the period in which the last sale prices are reported in the consolidated system (i.e., after the consolidated tape stops running).

Other issuers would not be able to bid for or repurchase their securities (i) as the opening transaction for the day, (ii) during the 30 minutes before the scheduled close of the primary (regular) trading session in the principal market for the security or the market where the repurchase is made and

(iii) after the termination of the period in which the last sale prices are reported in the consolidated system (i.e., after the consolidated tape stops running).

Price of Purchases

The proposed amendments to Rule 10b-18 would amend the current price conditions under Rule 10b-18 and would require that issuers repurchase their securities at a price that does not exceed:

- for securities that are quoted or reported in the consolidated system, the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated system, regardless of where the securities are traded;
- for securities that are not quoted or reported in the consolidated system, the highest independent bid or the last independent transaction price, whichever is higher, displayed and disseminated on any national securities exchange or on any inter-dealer quotation system that displays at least two priced-quotations for the security; and
- for all other securities, the highest independent bid obtained from three dealers.

Volume of Purchases

Rule 10b-18 currently limits daily repurchases by issuers to an amount not to exceed the greater of (i) 100 shares or (ii) the number of round lots closest to 25% of the ADTV over the four calendar weeks preceding the week in which the repurchase is made. Under current Rule 10b-18, block purchases are excluded from the calculation of the volume of repurchases and the ADTV for the security. The Staff, acknowledging the growing importance of block trading as a percentage of trades on stock exchanges and Nasdaq, has proposed that block purchases be included in the calculation of both the volume of repurchases and the ADTV for the security. The definition of “block” purchases remains unchanged. The proposed amendments also raise the maximum number of shares that can be repurchased under clause (i) above to 500 shares. This would increase the amount that issuers of thinly traded shares can repurchase under Rule 10b-18. In addition, the SEC’s proposing release seeks comments on the question of whether the four-calendar week period would provide a sufficient length of time to measure a security’s ADTV or whether an alternative period should be used, such as two full calendar months or a 60-day rolling period.

Under current Rule 10b-18, notwithstanding the limitations on the time of repurchases described above, repurchases may be made from the reopening of trading until the scheduled close of trading on the day of a “market-wide trading suspension” or at the next day’s opening if the market-wide suspension was in effect at the scheduled close of trading. Currently, these repurchases must be made in compliance with all the other restrictions set forth under Rule 10b-18, including the volume limitations. The proposed amendments however increase the amount of securities that can then be repurchased in these circumstances to the greater of (i) 500 shares or (ii) the number of round lots closest to 100% of the ADTV over the four calendar weeks preceding the week in which the repurchase is made.

Like current Rule 10b-18, the proposed amendments continue to generally exclude after-hours trading from the Rule 10b-18 safe harbor. In addition, the volume in an issuer's securities in an after-hour trading session would not be included in calculating the issuer's volume limitation for that day or the ADTV for the security.

The SEC's proposing release seeks comment on two specific additional proposals, one regarding after-hours trading and another regarding an additional safe harbor for certain additional "special purchases," including following a significant decline in an individual stock.

II. Disclosure of Purchases

The proposed new rules would require periodic disclosure of all purchases by an issuer of its equity securities that are registered under Section 12 of the Exchange Act. These new disclosure requirements would be independent of Rule 10b-18 and would not be limited to purchases effected under Rule 10b-18. The disclosure rule would apply to all purchases made in the open market, privately-negotiated transactions, issuer tender offers, purchases made by the issuer upon another person's exercise of outstanding put rights and any other transaction through which the issuer purchases its equity securities registered under Section 12 and purchases of securities convertible into the issuer's equity securities if those convertible securities and options are themselves equity securities of a class registered under Section 12 of the Exchange Act. In addition, the SEC's proposing release seeks comments on whether these disclosure requirements should exclude purchases made outside of the United States.

The disclosure would be required to be made in tabular form in the issuer's annual report on Form 10-K or 10-KSB and in its quarterly reports on Form 10-Q or 10-QSB, on Form 20-F for foreign private issuers and on Form N-CSR for registered closed-end funds. The disclosure would need to cover all purchases of Section 12 registered equity securities for the quarter (Forms 10-K and 10-Q), the year (Form 20-F) or the semi-annual period (Form N-CSR), including the total number of securities purchased (reported on a rolling-month basis, beginning with the first day of the quarter covered by the report – e.g., if the quarter begins on January 15 and ends on April 15, the chart would show repurchases for the months from January 15 through February 14, February 15 through March 14 and March 15 through April 15), the average price paid per share, the identity of any broker-dealers used to effect the purchases (other than in the case of foreign private issuers), the number of securities purchased as part of a publicly announced purchase plan or program, and the maximum number (or approximate dollar value) of securities that may yet be purchased under the plan or program.

The proposed new rules would also require footnote disclosure of the principal terms of any publicly announced purchase plan or program, including (i) the date of announcement, (ii) the share or dollar amount approved, (iii) the expiration date (if any) of the plan or program, (iv) each plan or program that has expired during the period covered by the table, (v) each plan or program that the issuer has determined to terminate prior to expiration and (vi) each plan or program under which the issuer has not made any purchases during the period covered by the table and whether the issuer still intends to purchase under the plan or program. The table would also need to include a brief disclosure

of the nature of the transaction for purchases made other than pursuant to a publicly announced purchase plan or program.

In the SEC's proposing release, the Staff reiterated that in the past, it had proposed requiring issuers that intended to purchase more than 2% of their stock in a twelve-month period to disclose specified information prior to effecting any repurchases and to disclose this information to the stock exchange on which the stock was listed for trading or to the NASD if the stock was authorized for quotation on the Nasdaq. After receiving comment, the Staff however had determined that an issuer's obligation to disclose information concerning repurchases of its stock should depend on whether the information is material.

The SEC requested comment on whether issuers should be required to disclose repurchase activity on a more frequent basis.

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The descriptions set forth herein are intended to be general in nature. This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

Mark S. Bergman	(44 20) 7367-1601	John C. Kennedy	(212) 373-3025
Richard S. Borisoff	(212) 373-3153	Edwin S. Maynard	(212) 373-3034
Andrew J. Foley	(212) 373-3078	Raphael M. Russo	(212) 373-3309
Paul D. Ginsberg	(212) 373-3131	Valérie Demont	(212) 373-3076

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP

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1285 Avenue of the Americas, New York, NY 10019-6064