

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-61414; File No. S7-04-10]

RIN 3235-AK54

Purchases of Certain Equity Securities by the Issuer and Others

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (“Commission” or “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, price, and volume 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.

DATES: Comments should be received on or before March 1, 2010.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number **S7-04-10** on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number **S7-04-10**. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Josephine Tao, Assistant Director, Elizabeth Sandoe, Branch Chief, Joan Collopy, Special Counsel, Jeffrey Dinwoodie, Staff Attorney, Office of Trading Practices and Processing, Division of Trading and Markets, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed amendments to Rule 10b-18 (the safe harbor rule for issuer repurchases) [17 CFR 240.10b-18] under the Exchange Act.

I. Introduction

Issuers repurchase their securities for many legitimate business reasons. For example, issuers may repurchase their stock in order to have shares available for dividend reinvestment, stock option and employee stock ownership plans, or to reduce the outstanding capital stock

following the cash sale of operating divisions or subsidiaries.¹ Issuers may believe that a repurchase program is preferable to paying dividends as a way of returning capital to shareholders.² Issuer repurchases also provide liquidity in the marketplace, which benefits shareholders.³

At the same time, an issuer has a strong interest in the market performance of its securities. Among other things, an issuer's securities may be the consideration in an acquisition, or serve as collateral for financing. Since the market price determines the price of offerings of additional securities, an issuer may have an incentive to manipulate the price of its securities.⁴ One way that an issuer can positively affect the price of its securities is to purchase the securities in the open market.⁵ Because issuer repurchases could affect the market price of an issuer's stock, an issuer may be exposed to claims that the repurchases were made in a manipulative manner even when the repurchases were not intended to move market prices.

Rule 10b-18 addresses this concern. In 1982, the Commission adopted Rule 10b-18,⁶

¹ Securities Exchange Act Release No. 19244 (Nov. 17, 1982), 47 FR 53333, 53334 (Nov. 26, 1982) ("1982 Adopting Release"). See also Gustavo Grullon and David L. Ikenberry, "What Do We Know About Stock Repurchases?," 13 *Journal of Applied Corporate Finance*, pp. 31-51 (2000) (noting issuers repurchase their stock for several reasons, including to convey management's expectation of future increases in earnings and cash flow).

² See Securities Exchange Act Release No. 46980 (Dec. 10, 2002), 67 FR 77594 (Dec. 18, 2002) ("2002 Proposing Release").

³ See *id.*

⁴ *Id.*

⁵ *Id.*

⁶ 1982 Adopting Release, 47 FR 53333. Since 1967, the Commission has considered on several occasions the issue of whether to regulate an issuer's market purchases of its own securities. The Commission first proposed Rule 10b-10 to govern issuer repurchases in connection with proposed legislation that became the Williams Act Amendments of 1968. Pub. L. No. 90-439, 82 Stat. 454 (July 29, 1968), reprinted in Hearings on S. 510 before Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 214-216 (1967). The Commission then published for public comment proposed Rule 13e-2 in 1970, 1973, and 1980. Rule 13e-2, which was later withdrawn with the adoption of Rule 10b-18, would have been a prescriptive rule with mandatory disclosure

which provides issuers⁷ with a safe harbor from liability for manipulation under Sections 9(a)(2) and 10(b) of the Exchange Act, and Rule 10b-5 under the Exchange Act, when they repurchase their common stock in the market in accordance with the Rule's manner, timing, price, and volume conditions.⁸ Rule 10b-18's safe harbor conditions are designed to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer.⁹

The safe harbor conditions are intended to offer issuers guidance when repurchasing their common stock in the open market. Rule 10b-18, however, is not the exclusive means of making non-manipulative issuer repurchases.¹⁰ As the Rule states, there is no presumption that an issuer's bids or purchases outside of the safe harbor violate Sections 9(a)(2) or 10(b) of the Exchange Act, or Rule 10b-5 under the Exchange Act.¹¹ Given the widely varying market

requirements, substantive purchasing limitations, and general anti-fraud liability. Securities Exchange Act Release Nos. 8930 (July 13, 1970), 35 FR 11410 (July 16, 1970); 10539 (Dec. 6, 1973), 38 FR 34341 (Dec. 13, 1973); and 17222 (Oct. 17, 1980), 45 FR 70890 (Oct. 27, 1980) ("1980 Proposing Release").

⁷ The safe harbor is also available for "affiliated purchasers" of the issuer. In this Release, the term "issuer" includes affiliated purchasers. See 17 CFR 240.10b-18(a)(3), (a)(13) and (b).

⁸ In other words, an issuer will not be deemed to have violated Sections 9(a)(2) and 10(b) of the Exchange Act or Rule 10b-5 under the Exchange Act, solely by reason of the timing, price, volume, or manner of its repurchases, if the repurchases are made within the limitations of the rule. However, some repurchase activity that meets the safe harbor conditions may still violate the anti-fraud provisions of the Exchange Act. For example, as the Commission noted in 1982 when adopting Rule 10b-18, "Rule 10b-18 confers no immunity from possible Rule 10b-5 liability where the issuer engages in repurchases while in possession of favorable, material nonpublic information concerning its securities." 1982 Adopting Release, 47 FR at 53334. See also Securities Exchange Act Release No. 48766 (Nov. 10, 2003), 68 FR 64952 (Nov. 17, 2003) at n. 5 ("2003 Adopting Release").

⁹ See, e.g., 2003 Adopting Release, 68 FR at 64953.

¹⁰ See 1982 Adopting Release, 47 FR at 53334.

¹¹ See 17 CFR 240.10b-18(d). The safe harbor is available for repurchases of an issuer's common stock (or an equivalent interest including a unit of beneficial interest in a trust or a limited partnership or a depository share). See 17 CFR 240.10b-18(a)(13). See also 2003 Adopting Release, 68 FR at 64954. However, the safe harbor is not intended to define the appropriate limits to be observed by those persons not covered by the safe harbor nor the appropriate limits to be observed when repurchasing securities other than common stock.

characteristics for the stock of different issuers, it is possible for issuer repurchases to be made outside of the safe harbor conditions and not be manipulative.¹²

Since Rule 10b-18's adoption in 1982, there have been significant market changes with respect to trading strategies and developments in automated trading systems and technology that have increased the speed of trading and changed the profile of how issuer repurchases are effected. We understand that the increased speed of today's market activity, as evidenced by flickering quotes, has made it increasingly difficult for issuers to ensure that every purchase of its common stock during the day will meet the Rule's current price condition. As discussed below, currently, failure to meet any one of the four conditions under the Rule with respect to any of the issuer's repurchases during the day will disqualify all of the issuer's other Rule 10b-18 purchases from the safe harbor for that day. Moreover, the opportunity for issuers to effect repurchases using alternative trading strategies or pricing mechanisms, such as repurchases effected on a volume-weighted average price ("VWAP") basis (i.e., where a security's price is generally derived from adding up the dollar amounts traded for each transaction in the security (price multiplied by shares traded) and then dividing by the total number of shares traded for the day), has increased significantly. However, because such transactions may be priced without reference to the quoted price of the stock at the time of execution and, thus, possibly above Rule 10b-18's current price limitation, many issuers that repurchase their shares using such trading strategies must forego the protections of the safe harbor for such purchases.

In connection with the 2003 amendments to Rule 10b-18,¹³ the Commission sought comment as to whether Rule 10b-18's price condition should apply where the issuer has no control,

¹² See 1982 Adopting Release, 47 FR at 53334.

¹³ See 2003 Adopting Release, 68 FR 64952.

directly or indirectly, over the price at which a Rule 10b-18 purchase will be effected, for example, "passive" or independently-derived pricing, such as the VWAP.¹⁴ While the Commission did not adopt an exception for VWAP transactions at that time, it stated that it would take into account commenters' recommendations, as well as current market practices involving VWAP transactions, in considering whether any future changes to Rule 10b-18 were appropriate.¹⁵ Since that time, we understand from the industry that VWAP has become one of the most widely recognized and accepted pricing mechanisms and trading benchmarks.¹⁶

Based on our experience with the operation of Rule 10b-18 and to respond to these market developments, we propose to revise Rule 10b-18 as described below. The proposed amendments are intended to clarify and modernize the safe harbor provisions. In particular, our proposal to modify the price condition would provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor under conditions designed to reduce the potential for abuse. Our proposal to limit the general disqualification provision would also provide issuers with additional flexibility to conduct their share repurchase programs in fast moving markets. At the same time, our proposals to modify the timing condition and the "merger

¹⁴ See 2002 Proposing Release, 67 FR at 77594.

¹⁵ See id., 67 FR at 77599. See also Comment letters from William A. Lupien, Director, and William W. Uchimoto, Executive Vice President and General Counsel, Vie Financial Group, Inc., dated June 26, 2003, and William W. Uchimoto, Executive Vice President and General Counsel, Vie Financial Group, Inc., dated Mar. 3, 2003 (suggesting that the Commission provide an exception from the Rule's pricing condition for issuers' VWAP transactions that meet certain specific VWAP calculation standards) ("Uchimoto Letter").

¹⁶ See, e.g., Uchimoto Letter (noting that VWAP is the most widely recognized and accepted trading benchmark). See also Securities Exchange Act Release No. 54003 (June 16, 2006), 71 FR 36141, 36142 (SR-NASD-2006-056) (noting that VWAP is a benchmark often used by institutional investors to determine whether they received a good price for a large trade).

exclusion” provision¹⁷ under the Rule are intended to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer, and to promote safe harbor availability only during normal market conditions for an issuer.¹⁸

II. Overview of Current Rule 10b-18 Conditions

Rule 10b-18 provides a safe harbor for an issuer’s purchases of shares of its common stock on a given day. To come within the safe harbor for that day, an issuer must satisfy the Rule’s manner, timing, price, and volume conditions when purchasing its own common stock in the market.¹⁹ The current Rule provides that failure to meet any one of the four conditions removes (or disqualifies) all of an issuer’s purchases from the safe harbor for that day.²⁰

A. Manner of Purchase Condition

The manner of purchase condition requires an issuer to use a single broker or dealer per day to bid for or purchase its common stock.²¹ This requirement is intended to avoid the appearance of widespread trading in a security that could result if an issuer used many brokers or dealers to

¹⁷ See 17 CFR 240.10b-18(a)(13)(iv). As discussed below, the “merger exclusion” precludes issuer repurchases 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, including any period where the market price of a security will be a factor in determining the consideration to be paid pursuant to a merger, acquisition, or similar transaction. See also 2003 Adopting Release, 68 FR at 64955.

¹⁸ See 2003 Adopting Release, 68 FR at 64953.

¹⁹ 17 CFR 240.10b-18(b)(1) - (4).

²⁰ See Preliminary Note 1 to 17 CFR 240.10b-18.

²¹ 17 CFR 240.10b-18(b)(1).

repurchase its stock.²² The “single broker or dealer” condition, however, applies only to Rule 10b-18 purchases that are “solicited” by or on behalf of an issuer.²³ Accordingly, an issuer may purchase shares from more than one broker-dealer if the issuer does not solicit the transactions. An issuer must evaluate whether a transaction is “solicited” based on the facts and circumstances of each case.²⁴

B. Timing Condition

The timing condition restricts the periods during which an issuer may bid for or purchase its common stock.²⁵ Market activity at the open and close of trading is considered to be a significant indicator of the direction of trading, the strength of demand, and the current market value of the security.²⁶ Accordingly, the timing condition precludes an issuer from being the opening (regular way) purchase reported in the consolidated system.²⁷ The timing condition also excludes from the safe harbor purchases effected during the last half hour (or during the last ten minutes for actively-traded securities) before the scheduled close of the primary trading session in the principal market for the security and in the market where the purchase is effected.²⁸ Rule 10b-18’s limitation on

²² See 1980 Proposing Release, 45 FR at 70891.

²³ 17 CFR 240.10b-18(b)(1)(i).

²⁴ Although Rule 10b-18 does not define “solicitation,” the issuer’s disclosure and announcement of a repurchase program would not necessarily cause a subsequent purchase to be deemed “solicited” by or on behalf of an issuer. See 1982 Adopting Release, 47 FR at 53337.

²⁵ 17 CFR 240.10b-18(b)(2).

²⁶ 2003 Adopting Release, 68 FR 64953.

²⁷ 17 CFR 240.10b-18(b)(2)(i). For purposes of Rule 10b-18’s timing and price conditions, Rule 10b-18(a)(6) defines “consolidated system” to mean “a consolidated transaction or quotation reporting system that collects and publicly disseminates on a current and continuous basis transaction or quotation information in common equity securities pursuant to an effective transaction reporting plan or an effective national market system plan (as those terms are defined in § 242.600).”

²⁸ 17 CFR 240.10b-18(b)(2). Reliance on the safe harbor under Rule 10b-18 is precluded if a purchase is effected during the 10 minutes before the scheduled close of the primary trading session in the principal market for the

bids and purchases near the close of trading for purposes of qualifying for the safe harbor is to prevent the issuer from creating or sustaining a high bid or transaction price at or near the close of trading. Where there is no independent opening transaction on a given day, an issuer is precluded from making purchases under the safe harbor for that day.²⁹

C. Price Condition

The Rule's price condition specifies the highest price an issuer may bid or pay for its common stock.³⁰ The price condition is intended to prevent an issuer from leading the market for the security through its repurchases by limiting the issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system.³¹ As such, the price condition uses an independent reference price that has not been set by an issuer.³²

For those securities that are not quoted or reported in the consolidated system, the issuer must look to the highest independent bid or the last independent transaction price, whichever is higher, that is displayed and disseminated on any national securities exchange or on any inter-dealer quotation system, as defined in Exchange Act Rule 15c2-11(e)(2), that displays at least

security, and the 10 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for a security that has an average daily trading volume ("ADTV") value of \$1 million or more and a public float value of \$150 million or more; and purchases during the 30 minutes before the scheduled close of the primary trading session in the principal market for the security, and the 30 minutes before the scheduled close of the primary trading session in the market where the purchase is effected, for all other securities. 17 CFR 240.10b-18(b)(2)(ii) and (b)(2)(iii).

²⁹ See 2003 Adopting Release, 68 FR at 64954.

³⁰ 17 CFR 240.10b-18(b)(3).

³¹ See 2003 Adopting Release, 68 FR at 64954.

³² 17 CFR 240.10b-18(b)(3).

two independent priced quotations for the security.³³ For all other securities, the issuer must look to the highest independent bid obtained from three independent dealers.³⁴

D. Volume Condition

The volume condition limits the amount of securities an issuer may repurchase in the market in a single day.³⁵ The volume condition is designed to prevent an issuer from dominating the market for its securities through substantial purchasing activity.³⁶ 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. Under the current volume condition, an issuer may effect daily purchases in an amount up to 25 percent of the ADTV in its shares, as calculated under the Rule (the “25% volume limitation”).³⁷ Alternatively, once each week an issuer may purchase one block of its common stock in lieu of purchasing under the 25% volume limitation for that day.³⁸ The “one block per week” exception to the volume condition is intended to provide issuers with moderate or low ADTV greater flexibility in carrying out their repurchase programs.³⁹

III. Proposed Amendments to Rule 10b-18

³³ 17 CFR 10b-18(b)(3)(ii).

³⁴ 17 CFR 240.10b-18(b)(3)(iii).

³⁵ 17 CFR 240.10b-18(b)(4).

³⁶ See 2003 Adopting Release, 68 FR at 64954.

³⁷ 17 CFR 240.10b-18(a)(1) (defining ADTV for purposes of the safe harbor). See also supra note 28 (noting that “ADTV” means a security’s average daily trading volume).

³⁸ See 17 CFR 240.10b-18(a)(5) (defining “block”). However, shares purchased by the issuer relying on the “one block per week” exception may not be included when calculating a security’s four-week ADTV under the Rule. See 2003 Adopting Release, 68 FR at 64960; 17 CFR 240.10b-18(b)(4)(ii).

³⁹ See 2003 Adopting Release, 68 FR at 64960.

In this release, we are proposing revisions to the safe harbor rule. In particular, we propose to:

- modify 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);
- relax the price condition for certain VWAP transactions;
- limit the disqualification provision in fast moving markets under certain specific conditions;
- modify 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”); and
- update certain definitional provisions consistent with the current Rule.

We solicit any comment on our approach and the specific proposals. We also encourage commenters to present data in support of their positions.

A. Discussion of Amendments to the Purchasing Conditions

1. Time of Purchases

We propose 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 in the market where the purchase is effected.⁴⁰ Currently, to qualify for the safe harbor, an issuer’s purchase may not be

⁴⁰ The proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase reported in the consolidated system.

the opening regular way purchase reported in the consolidated system.⁴¹ Under the current rule, an issuer's purchase, however, may be the opening purchase in the principal market for its security and the opening purchase in the market where the purchase is effected, provided there is already an opening purchase reported in the consolidated system that day.⁴²

However, similar to transactions in the principal market for a security at the end of a trading day,⁴³ the opening transaction in the principal market for a 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.⁴⁴ This is particularly true considering the large trading volume that can occur at the principal market's open as the result of the increased use of electronic opening crosses and opening auctions to establish a security's official opening price for the day. However, we understand from industry sources that the dissemination of market data from these larger opening crosses has led to some confusion as to which opening transaction Rule 10b-18's opening purchase limitation applies when there is a delayed opening in the principal market for a stock.⁴⁵ For example, when a small number of an issuer's shares prints as a regional exchange's opening transaction in the consolidated system

⁴¹ See 17 CFR 240.10b-18(b)(2)(i).

⁴² For example, if the principal market has a delayed opening in the issuer's stock and, therefore, is not the opening purchase reported in the consolidated system that day, the issuer would be able to effect a Rule 10b-18 purchase as the opening purchase in the principal market for its security that day.

⁴³ See supra note 28.

⁴⁴ See, e.g., James Ramage, "Primary Market Still Guides Open," Traders Magazine (June 2008) ("Primary Market"); Raymond M. Brooks and Jonathan Moulton, "The Interaction between Opening Call Auctions and Ongoing Trade: Evidence from the NYSE," 13 Review of Financial Economics, pp. 341-356 (2004); Michael J. Barclay and Terrence Henderschott, "A Comparison of Trading and Non-trading Mechanisms for Price Discovery," Journal of Empirical Finance 15, 839-849 (2008).

⁴⁵ See, e.g., Security Traders Association, "Special Report: STA's Perspective on U.S. Market Structure," at p. 10 (May 2008) (noting that competing venues can open the same stock using different processes and different

and then immediately thereafter, a substantially larger number of the issuer's shares prints in the consolidated system as the official opening transaction in the principal market for the issuer's securities, we understand that some issuers are unsure as to which transaction is the relevant opening transaction for purposes of Rule 10b-18's opening purchase limitation.⁴⁶ Moreover, because the principal market's official opening price has become a widely-recognized benchmark within the industry, we are concerned that this much larger official opening transaction in the principal market may be a more significant indicator of the direction of trading, the strength of demand, and the current market value of a security than the smaller regional exchange's opening purchase reported in the consolidated system that day.⁴⁷

To address these developments, we propose to amend the Rule's opening purchase limitation. Specifically, the proposed amendment would continue to limit an issuer from effecting a Rule 10b-18 purchase as the opening purchase reported in the consolidated system. However, consistent with the limitations placed on purchases at the end of the trading day,⁴⁸ the proposal would amend paragraph (b)(2)(i) of the Rule to also preclude the issuer from being the opening purchase in both the principal market for the security and in the market where the purchase is effected.

As discussed above, similar to transactions at the end of a trading day, the opening transaction in the principal market for the security and in the market where the repurchase is

order flows, which can create confusion for investors if the first reported price is different from the primary market's opening price) ("STA Special Report").

⁴⁶ See, e.g., *id.* See also NYSE Trader "Opening Trades Update -15 Sept. 2008" (noting that different vendors will process trades marked with "OPD" (indicating an out-of-sequence, opening trade) differently for purposes of their VWAP calculations) at http://traderupdates.nyse.com/2008/09/as_previously_reported_the_con.html.

⁴⁷ See, e.g., STA Special Report, *supra* note 45 at pp. 10-11. See also Primary Market, *supra* note 44.

⁴⁸ See 17 CFR 240.10b-18(b)(2)(ii) and (b)(2)(iii).

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 proposed modification to the timing condition is designed to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer. The amendment also would allow issuers to carry out their repurchase programs more effectively by providing issuers with guidance in complying with Rule 10b-18 in the situation described above where the principal market has a delayed opening in a stock and another exchange's smaller opening transaction is reported in the consolidated system first. In such situation, the proposed amendments would require the issuer to wait until both of these opening transactions were reported in the consolidated system (rather than just the first transaction) before it could effect a Rule 10b-18 purchase within the safe harbor that day.

Q. Is the proposed opening purchase limitation appropriate? If not, why not? Are there other aspects of the limitation that the Commission should consider revising? If so, please explain in what way.

Q. Are there aspects of the Rule's end of the day timing limitation that the Commission should consider revising? If so, please explain in what way. For example, for securities that have an ADTV value of \$1 million or more and a public float value of \$150 million or more, Rule 10b-18 currently excludes from the safe harbor purchases of such securities effected during the 10 minutes (rather than 30 minutes) before the scheduled close of the primary trading session in the principal market for the security, and the 10 minutes before the scheduled close of the

primary trading session in the market where the purchase is effected.⁴⁹ Should eligibility for the current end of the day timing limitation, i.e., 10 minutes before the scheduled close of trading, continue to be based on a security's ADTV and an issuer's public float? Should the current ADTV and public float value qualifying thresholds be raised to adjust for inflation? Are there alternative tests we should consider? For example, should the 10 minutes before the scheduled close of trading limitation be based on the securities offering reform standard?⁵⁰ Further, does the 10 minute limitation adequately protect against an issuer affecting the closing price of its security? Please explain. Is a shorter or longer period warranted for an issuer whose security meets the applicable ADTV and public float thresholds? If so, please identify what time limitation would be appropriate and provide data and a detailed rationale supporting the suggested alternative, including how it will promote securities prices based on independent market forces without undue issuer influence.

Q. Currently, repurchases of OTC Bulletin Board ("OTCBB") and Pink Sheet securities do not have an opening purchase timing restriction under the safe harbor. Should Rule 10b-18's timing condition be amended to apply to repurchases effected in markets where there is no official opening of trading, such as on the OTCBB and Pink Sheets? If so, what opening timing limitation should be applied to such securities? Should such a limitation be based on normal market hours or such market's regular hours of operation rather than the opening of trading? Should the current end of the day timing limitation be modified in any way with respect to OTCBB and Pink Sheets securities? If so, how? If not, why not? Please explain. In what way

⁴⁹ 17 CFR 240.10b-18(b)(2)(ii).

⁵⁰ See Securities Offering Reform, Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722, 44731 at n. 88 (Aug. 3, 2005) (setting a public float threshold of \$700 million and noting that those issuers had \$52 million ADTV).

could market activity at the end of the trading day be considered a significant indicator of the direction of trading, the strength of demand, and the current market value of an OTCBB or a Pink Sheets security?

2. Price of Purchases

a. VWAP Transactions

Rule 10b-18 limits an issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the purchase is effected.⁵¹ We understand that issuers would like to be able to repurchase their securities on a VWAP basis knowing that such purchases are within the safe harbor. However, because VWAP transactions are priced on the basis of individual trades that are executed and reported throughout the trading day, there may be instances where the execution price of an issuer's VWAP purchase effected at the end of that trading day (after the security's VWAP has been calculated and assigned to the transaction) exceeds the highest independent bid or last independent transaction price quoted or reported in the consolidated system for that security and, therefore, will be outside of the safe harbor's current price condition.

In order to provide issuers with additional flexibility to conduct repurchase programs using VWAP within the safe harbor, we propose to except from the Rule 10b-18's price condition Rule 10b-18 purchases effected on a VWAP basis, provided certain criteria are met. Specifically,

⁵¹ 17 CFR 240.10b-18(b)(3).

the proposal would amend paragraph (b)(3) of the Rule to except those Rule 10b-18 VWAP purchases that satisfy the criteria set forth in proposed paragraph (a)(14) of the Rule.⁵²

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 101(c)(1) of Regulation M).⁵³ Similar to the Rule 10b-18's timing condition, the proposed exception would incorporate Regulation M's standards and methods of calculating ADTV and public float value. Under Regulation M, issuers with a security that has an ADTV value of \$1 million or more and a public float value of \$150 million or more are excluded from Rule 101 of Regulation M under its "actively-traded securities" exception.⁵⁴ The securities of issuers that have an ADTV value of at least \$1 million and a public float value at or above \$150 million are considered to have a sufficient market presence to make them less likely to be manipulated.⁵⁵ Moreover, the public float value test is intended in part to exclude issuers from the "actively-traded securities" category where a high trading volume level is an aberration.⁵⁶

Additionally, the VWAP purchase must be entered into or matched before the regular trading session opens, and the execution price of the VWAP matched trade must be determined based on a full trading day's volume.⁵⁷ We believe that requiring the VWAP calculation to be

⁵² Proposed Rule 10b-18(b)(3)(i)(a). The proposed amendment would except issuers' VWAP Rule 10b-18 purchases from only the pricing condition of the safe harbor. Issuers would remain responsible for compliance with all other conditions of Rule 10b-18 to secure the protections of the safe harbor.

⁵³ Proposed Rule 10b-18(a)(14)(i). See also 17 CFR 242.101(c)(1).

⁵⁴ See 17 CFR 242.101(c)(1).

⁵⁵ See Securities Exchange Act Release No. 38067 (Dec. 20, 1996), 62 FR 520 (Jan. 3, 1997).

⁵⁶ Id.

⁵⁷ Proposed Rules 10b-18(a)(14)(ii) and (iii). Specifically, under proposed paragraph (a)(14)(iii) of Rule 10b-18 would require the execution price of the VWAP matched trade must be determined based on all regular way

based on a full day of trading would be the method of calculation that is the least susceptible to manipulation, because it would take into account the greatest volume of transactions occurring during regular trading hours.

To qualify for the exception, the issuer's VWAP purchase also must not exceed 10% of the ADTV in the security⁵⁸ and must not be effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security.⁵⁹ These conditions are similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions.⁶⁰ We believe that such conditions would similarly work well

trades effected in accordance with the Rule's timing and price conditions that are reported in the consolidated system during the primary trading session for the security. See Proposed Rule 10b-18(a)(14)(iii).

The proposed criteria are similar to the criteria contained in VWAP exemptive relief from former Rule 10a-1 under the Exchange Act. See, e.g., Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Edith Hallahan, Counsel, Phlx, dated Mar. 24, 1999; letter Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Soo J. Yim, Wilmer, Cutler & Pickering, dated Dec. 7, 2000 ("Wilmer, Cutler & Pickering"); letter from James Brigagliano, Assistant Director, Division of Market Regulation, SEC, to William W. Uchimoto, Esq., Vie Institutional Services, dated Feb. 12, 2003.

⁵⁸ The VWAP exemptive relief from former Rule 10a-1 VWAP included the condition that a broker or dealer will act as principal on the contra-side to fill customer short sale orders only if the broker-dealer's position in the subject security, as committed by the broker-dealer during the pre-opening period of a trading day and aggregated across all of its customers who propose to sell short the same security on a VWAP basis, does not exceed 10% of the covered security's relevant average daily trading volume, as defined in Regulation M. See, e.g., Wilmer, Cutler & Pickering, id.

⁵⁹ Proposed Rule 10b-18(a)(14)(iv) and (v).

⁶⁰ See text accompanying supra note 57.

in restricting the exemptive relief to situations that generally would not raise the harms that Rule 10b-18 is designed to prevent. Additionally, the VWAP must be calculated by first calculating the values for every regular way trade reported in the consolidated system (except those trades that are expressly excluded under proposed paragraph (a)(14)(iii) of the Rule, as described below), by multiplying each such price by the total number of shares traded at that price; then compiling an aggregate sum of all values; and then dividing this aggregate sum by the total number of trade reported shares for that day in the security that represent regular way trades effected in accordance with the conditions of paragraphs (b)(2) and (b)(3) of Rule 10b-18 that are reported in the consolidated system during the primary trading session for the security.⁶¹ This method of calculating VWAP is consistent with the method of calculation contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions, and it is consistent with industry practices for calculating VWAP for purposes of the Rule 10b-18 safe harbor. In addition, the VWAP assigned to the purchase must be based on trades effected in accordance with the Rule's timing and price conditions and, therefore, must not include trades effected as the opening purchase reported in the consolidated system (including the opening purchase in the principal market for the security and in the market where the purchase is effected) or during the last 10 minutes before the scheduled close of the primary trading session in the principal market for the security, and in the market where the purchase is effected. Moreover, the VWAP assigned to the purchase must not include trades effected at a price that exceeds the highest independent bid or the last independent transaction price, whichever is higher, quoted or

⁶¹ Proposed Rule 10b-18(a)(14)(vi).

reported in the consolidated system at the time such trade is effected.⁶²

In addition, the VWAP purchase also must be reported using a special VWAP (e.g., a “.W”) trade modifier⁶³ in order to indicate to the market that such purchases are unrelated to the current or closing price of the security. The special trade modifier requirement is intended to prevent the issuer’s Rule 10b-18 VWAP purchase from providing any price discovery information or influencing the pricing direction of the security.

The proposed VWAP exception from the Rule’s price condition is intended to provide issuers and their brokers with greater certainty and flexibility in effecting qualifying VWAP transactions within the safe harbor. We believe that VWAP transactions meeting the above criteria would present little potential for manipulative abuse and, therefore, should be exempt from the Rule’s price condition.⁶⁴ In using VWAP as a pricing mechanism to effect repurchases, issuers relinquish control over the pricing of their executions, thereby reducing the risk of potential manipulation. In addition, the nature of the pricing is objective since VWAP is a commonly used benchmark that is based on independent market forces and is identifiable to all market participants.

⁶² Proposed Rule 10b-18(a)(14)(iii).

⁶³ Proposed Rule 10b-18(a)(14)(vii). For example, FINRA rules require VWAP transaction reports to be identified with a special modifier to indicate to the market that such transaction reports are unrelated to the current or closing price of the security. See FINRA Rule 6380A(a)(5)(E).

⁶⁴ The staff has previously recognized the limited potential to influence the price of transactions effected pursuant to passive pricing mechanisms, such as the VWAP, by exempting such transactions from the former Rule 10a-1 under the Exchange Act. See, e.g., supra note 57.

Q. Should the proposed VWAP exception be modified in any way? If so, please explain. Are all of the proposed criteria for the VWAP exception appropriate, or should any be eliminated or modified? What, if any, additional or alternative criteria should the Commission consider including in the proposed definition of a VWAP Rule 10b-18 purchases in order to prevent any potential manipulative abuse?

Q. Should a “full day” of trading be defined to permit VWAP purchases to be entered into or matched between 9:30 a.m. EST and 10:00 a.m. EST (rather than requiring the VWAP purchase to be entered into or matched before the regular trading session opens)? Please explain.

Q. Should we consider excepting VWAP purchases that are based on an intra-day VWAP (or a time-weighted average price, or “TWAP”), such as a particular time interval from 9:30 a.m. EST through 1:00 p.m. EST, rather than on a full-day’s trading volume? If so, please describe, in light of the objectives of the safe harbor, which time intervals would be appropriate.

Q. Similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions, the proposed definition of a VWAP Rule 10b-18 purchase uses an “actively-traded” standard. Should the proposed definition also include securities that also comprise the S&P Index, similar to the conditions contained in the exemptive relief from former Rule 10a-1 granted for VWAP short sale transactions? Should we consider requiring the securities offering reform thresholds,⁶⁵ instead of the proposed “actively traded” standard? Should a different standard be used?

Q. The proposed definition of a VWAP Rule 10b-18 purchase is based on all regular way trades reported in the consolidated system. Should the proposed definition also permit an issuer in listed securities to calculate the VWAP based only on trades occurring in the principal

⁶⁵ See *supra* note 50.

market for the security? Please explain. Would permitting issuers to use either a consolidated or a principal market calculation for their VWAP purchases be consistent with securities information vendor standards used in the dissemination of VWAP calculations to market participants?

Q. Should the proposed exception distinguish between manually executed VWAP purchases and VWAP purchases executed through automated trading systems? If so, how?

Q. Should we require an issuer to establish and maintain written policies and procedures reasonably designed to assure that the issuer's VWAP purchase was effected in accordance with the proposed criteria and that it has supervisory systems in place to produce records that enable the issuer to accurately and readily reconstruct, in a time-sequenced manner, all orders effected in reliance on the exception? If no, why not? Please explain. How long would it take to update systems and procedures in a manner that ensured compliance with the proposed exception? Please explain. What technological challenges, if any, would be encountered?

Q. What types of costs, if any, would be associated with implementing the proposed exception? We seek specific comment as to what length of implementation period, if any, would be necessary and appropriate and, why, such that issuers would be able to meet the conditions of the proposed exception.

Q. Do VWAP transactions create improper incentives for broker-dealers, such that an exception should not be granted? If the proposed exception is adopted, are there ways to detect and limit the effects of such incentives?

Q. How would trading systems and strategies used in today's marketplace be impacted by the proposed exception? How might market participants alter their trading systems and

strategies in response to the proposed amendments? Please provide an estimate of costs if possible.

b. Other Alternative Passive Pricing Systems

We are considering whether to except other passive pricing mechanisms from the Rule's price condition. We understand that some issuers may effect repurchases through electronic trading systems that use passive or independently-derived pricing mechanisms, such as the mid-point of the national best bid and offer ("NBBO") or "mid-peg" orders. Under Rule 10b-18, matches to a mid-peg order involving an issuer repurchase will necessarily be above the highest bid and may also occur at a price above the last sale price and, therefore, would fall outside of the Rule's price condition, absent an exception. Thus, we seek comment regarding the appropriateness of expanding the proposed exception to include issuer repurchases effected through certain electronic trading systems that match and execute trades at various times and at independently-derived prices, such as at the mid-point of the NBBO. We believe it may be appropriate to expand the safe harbor to permit an issuer to submit a buy order that is "pegged" to the mid-point of the NBBO at the time of execution (a "mid-peg" order) where the issuer's mid-peg order is matched and executed against a sell order that also is pegged to the mid-point of the NBBO at the time of execution, provided certain criteria are met, as discussed below. In the past, the Commission has granted limited exemptive relief in connection with these systems under former Rule 10a-1 under the Exchange Act because matches could potentially occur at a price below the last sale price.⁶⁶

⁶⁶ See, e.g., Letter from Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, SEC, to Andre E. Owens, Schiff Hardin & Waite, dated Apr. 23, 2003 (granting exemptive relief from former Rule 10a-1 for trades executed through an alternative trading system that matches buying and selling interest among institutional investors and broker-dealers at various set times during the day).

Thus we are considering whether to except from Rule 10b-18's price condition purchases that are effected in an electronic trading system that matches buying and selling interest at various times throughout the day if, for example: (i) matches occur at an externally derived price within the existing market and above the current national best bid; (ii) sellers and purchasers are not assured of receiving a matching order; (iii) sellers and purchasers do not know when a match will occur; (iv) persons relying on the exception are not represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction; (v) transactions in the electronic trading system are not made for the purpose of creating actual, or apparent, active trading in, or depressing or otherwise manipulating the price of, any security; (vi) the covered security qualifies as an "actively-traded security" (as defined in Rule 101(c)(1) of Regulation M); and (vii) during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any communication with customers that the match has not yet occurred.

These conditions parallel the conditions provided in the exemptive relief granted under former Rule 10a-1.⁶⁷ Consistent with the relief granted under former Rule 10a-1 and the rationales provided in granting such relief, we believe it may be appropriate to expand the proposed VWAP exception to Rule 10b-18's price condition for purchases effected through these electronic trading systems due to the passive nature of pricing and the lack of price discovery. As such, we believe issuer repurchases effected through these passive pricing systems generally do not appear to involve the types of abuses that the Rule 10b-18 is designed to prevent.

Although purchases effected using mid-point NBBO pricing algorithms may be passively priced, such purchases are not reported using any special trade modifier to indicate to the market

⁶⁷ See, e.g., *id.*

that they are priced according to a special formula and, therefore, may be away from the quoted price of the stock at the time of execution. We, therefore, are concerned that a sizable purchase or series of purchases effected at the mid-point of the NBBO may result in the issuer leading the market for its security through its repurchases, which could undermine the purpose of the price condition. Thus, we seek comment below on what additional safeguards could be imposed to address the concern that such orders are not reported using any special trade modifier to indicate to the market that such transactions are priced at the mid-point of the NBBO.

Q. Should the safe harbor's price condition be modified to except electronic trading systems that effect issuer repurchases at the mid-point of the NBBO? For example, should the safe harbor permit an issuer to submit a buy mid-peg order that is "pegged" to the mid-point of the NBBO at the time of execution where the issuer's mid-peg order can only be matched and executed against a sell order that also is pegged to the mid-point of the NBBO at the time of execution? If so, should the exception be limited to repurchases of actively-traded securities effected through an electronic trading system that automatically matches and executes trades at random times, within specific time intervals, at an independently-derived mid-point of the NBBO price?

Q. If such an exception were adopted, what other conditions should apply? For instance, should we require that sellers and purchasers must not be assured of receiving a matching order or know when a match will occur? Should we require that persons relying on the exception not be represented in the primary market offer or otherwise influence the primary market bid or offer at the time of the transaction, and that during the period of time in which the electronic trading system may match buying and selling interest, there is no solicitation of customer orders, or any

communication with customers that the match has not yet occurred? What, if any, other criteria would be appropriate?

Q. What, if any, additional safeguards could be imposed to address the concern that such orders are not reported using any special trade modifier to indicate to the market that such transactions are priced at the mid-point of the NBBO? Should we require mid-point priced trades to be reported with a special trade modifier? What technological challenges would be encountered as a result? How long would it take to update systems and procedures in order to mark such trades with a special trade modifier? Please explain.

Q. What types of costs, if any, would be associated with requiring mid-point priced trades to be reported to the market with a special trade modifier? Please explain what length of implementation period, if any, would be necessary and appropriate to comply with such a requirement and why.

Q. Are there other benchmark/derivatively priced transactions that should be excepted from Rule 10b-18's price condition? For example, should we consider excepting benchmark/derivatively priced purchases that qualify for the trade through exception in Rule 611(b)(7) of Regulation NMS? If so, please provide specific examples of transactions (and specific supporting criteria) where modifying the Rule's price condition would be appropriate. We also seek comment concerning the potential for manipulative abuse that permitting such transactions may present.

3. Volume of Purchases

Under the current volume condition, an issuer may effect daily purchases in an amount up to 25 percent of the ADTV in its shares, as calculated under the Rule.⁶⁸ Alternatively, once each

⁶⁸ 17 CFR 240.10b-18(b)(4). See 17 CFR 240.10b-18(a)(1) (defining ADTV for purposes of the safe harbor).

week an issuer may purchase one block of its common stock in lieu of purchasing under the 25% volume limitation for that day (the “one block per week” exception).⁶⁹ Rule 10b-18(a)(5) currently 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.⁷⁰ When we adopted the “one block per week” exception in connection with the 2003 amendments to Rule 10b-18, we had retained the former Rule’s “block” definition, including paragraph (iii) which references “trading volume” rather than “ADTV.” However, Rule 10b-18, as amended in 2003, uses the term “ADTV” instead of the former term “trading volume.” We therefore propose a non-substantive conforming change to Rule 10b-18 that would amend paragraph (a)(5)(iii) of the “block” definition to reference “ADTV” instead of “trading volume” in order to make the definition consistent with the current Rule. We also request and encourage comment on the following:

Q. We seek specific comment concerning the proposal to amend the definition of a “block” to reference “ADTV” instead of “trading volume” in paragraph (a)(5)(iii) of Rule 10b-18.

⁶⁹ 17 CFR 240.10b-18(b)(4). See text accompanying supra note 38 (regarding “block” purchases under Rule 10b-18).

⁷⁰ See 17 CFR 240.10b-18(a)(5).

Q. Is a volume limitation based on an ADTV calculation feasible with respect to Rule 10b-18 purchases of thinly traded securities? Should we raise (or lower) the volume limit for these securities? Would this increase the potential for manipulative activity in such securities?

Q. Should we retain the current 25% volume limitation? Is the 25% a reasonable limitation that furthers the objectives of the Rule or should the volume limitation be reduced?

Q. Should we retain the current “one block per week” exception? What, if any, modifications should be made to the definition of a “block” purchase for purposes of this exception? For example, should we retain the current “one block per week exception” but increase the amount of shares constituting a block (for instance, should the amount of shares constituting a block conform to the markets’ definition of a block trade,⁷¹ that is, typically at least 10,000 shares)?

Q. Does the current “one block per week” exception enable issuers of thinly or moderately traded securities to avail themselves of the Rule 10b-18 safe harbor? If not, why not?

Q. Should we modify the volume condition to allow issuers, for example, once a week to purchase up to a daily aggregate amount of 500 shares, as an alternative to the 25% volume limitation? Would this allow issuers of thinly traded securities to carry out their repurchase programs more effectively? Please provide specific examples of where modifying the Rule’s current volume condition with respect to thinly traded securities would be appropriate. We also seek comment concerning the potential for manipulative abuse that such transactions may present.

⁷¹ See, e.g., NYSE Rule 97.10 (defining a “block” as consisting of at least 10,000 shares, or a quantity of securities that has a current market value of at least \$200,000).

Q. We encourage commenters to submit data regarding what percentage of individual issuer repurchase trading volume over the past three years has been effected in reliance on the current “one block per week” exception. The Commission requests data and analysis on what effect limiting the former block exception has had on such issuer’s repurchasing activity.

B. Amendments Concerning Scope of the Safe Harbor

1. “Flickering Quotes”

Rule 10b-18 provides a safe harbor for purchases on a given day. To come within the safe harbor on a particular day, an issuer must satisfy the Rule’s manner, timing, price, and volume conditions when purchasing its own common stock in the market.⁷² Moreover, the Rule provides 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 (the “disqualification provision”).⁷³ However, as noted above, we understand that the increased speed of today’s markets, as evidenced by flickering quotes,⁷⁴ has made it 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. Accordingly, even if an issuer inadvertently effects a Rule 10b-18 purchase outside of the Rule’s price condition⁷⁵ due to flickering bid quotes in a market, the

⁷² 17 CFR 240.10b-18(b)(1) - (4).

⁷³ See Preliminary Note 1 to 17 CFR 240.10b-18.

⁷⁴ “Flickering quotes” occur when there are rapid and repeated changes in the current national best bid during the period between identification of the current national best bid and the execution or display of the Rule 10b-18 bid or purchase. In many active NMS stocks, the price of a trading center’s best displayed quotations can change multiple times in a single second. See, e.g., Securities Exchange Act Release No. 51808 (June 9, 2005), 71 FR 37496, 37522-23 (June 29, 2005) (providing an exception in Rule 611 of Regulation NMS for flickering quotations).

⁷⁵ As discussed above, Rule 10b-18(b)(3) limits an issuer to bidding for or buying its security at a purchase price that is no higher than the highest independent bid or last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the purchase is effected. 17 CFR 240.10b-18(b)(3).

Rule's general disqualification provision would cause the issuer to forfeit the safe harbor for all of its Rule 10b-18 compliant purchases that day.

In order to accommodate the increasing occurrence of flickering price quotations in today's markets, we propose to limit the general disqualification provision in Rule 10b-18. Specifically, we propose to amend Preliminary Note 1 to Rule 10b-18 and paragraph (d) of the Rule 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.⁷⁶ In these instances, only the non-compliant purchase, rather than all of the issuer's other Rule 10b-18 purchases for that day, would be disqualified from the safe harbor.⁷⁷ In this way, if an issuer's repurchase fails to meet the price condition due to flickering quotes, the issuer would not forfeit the safe harbor for all of its compliant purchases that day. This proposed limitation to the general disqualification provision 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.

While we recognize that today's fast moving markets may still present challenges to issuers attempting to repurchase their securities within the safe harbor, Rule 10b-18(b)(3) would also continue to retain the "last independent transaction price" alternative (in addition to the highest

See also 17 CFR 240.10b-18(b)(3)(iii) (price limits for securities for which bids and transaction prices not reported in the consolidated system).

⁷⁶ See Proposed Preliminary Note No. 1 to Rule 10b-18.

⁷⁷ The disqualified non-compliant purchase would still count toward an issuer's daily volume limitation and would still have to satisfy the Rule's "single broker or dealer" and timing conditions, in order for the issuer's remaining purchases during that day to still qualify for the safe harbor.

independent bid), which should provide issuers with additional flexibility and a reliable mechanism in which to comply with the safe harbor's price condition in the event of flickering bid quotes.⁷⁸

Q. Do flickering bid quotes make the Rule's "highest independent bid" alternative difficult to satisfy? Does the "last independent transaction price" alternative help issuers comply with Rule's price condition when there are flickering bid quotes? If not, why not? Please provide specific examples concerning the impact of quote flickering with respect to the Rule's price condition, including specific alternatives to address these concerns.

Q. Should we condition reliance on the disqualification limitation on issuers executing their otherwise compliant purchase within a certain period of time (i.e., a second) after being entered? If so, how much time would be appropriate? Please explain.

Q. Should we require issuers wishing to rely on the disqualification limitation to have specific data management strategies to retain and recall order and trade history to demonstrate compliance with the safe harbor's price condition at the time of order entry? We understand that most broker-dealers already retain the appropriate market data, order status, and execution report elements to provide a "snap shot" of the market conditions at time of order entry versus execution. In order to rely on the safe harbor, what, if any, specific procedures should be established and enforced that would help issuers develop the necessary protocols to deal with the various market centers when flickering quotes appear or fast-moving markets occur in order to help reduce any unnecessary or undue reliance on the proposed limitation? How long would it take to develop these protocols, including updating systems and procedures in a manner that would help reduce any unnecessary or undue reliance on the proposed limitation? Please explain. What

⁷⁸ We note, however, that trade prices also may flicker quickly, which can complicate compliance with Rule 10b-18's price condition because the last trade price printed to the Tape may not necessarily be the last trade price in terms of the actual order of trades.

technological challenges, if any, would be encountered? What types of costs, if any, would be associated with implementing the necessary protocols?

Q. We seek specific comment as to what length of implementation period, if any, would be necessary and appropriate and, why, such that issuers would be able to reduce any unnecessary or undue reliance on the proposed limitation.

Q. Should we limit the number of times that an issuer may rely on the disqualification limitation, for example, once per day?

Q. Should we specify the volume of purchases that are eligible to rely on the disqualification limitation to, for example, 1%, 2%, or 5% of ADTV?

Q. Should we restrict use of the disqualification limitation during certain times of the day in order to maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer? For example, should the limitation not be available for purchases effected immediately after the opening or just before the last half hour of trading?

Q. What effect, if any, would the proposed disqualification limitation have on Rule 10b-18 purchases effected in reliance on the proposed VWAP exception? Similarly, what effect, if any, would the proposed VWAP exception have on issuers' ability to effect Rule 10b-18 purchases in instances where there may be flickering quotes? Please explain.

2. "Merger Exclusion" Provision

The proposed amendments also would add a provision that extends the time in which the safe harbor is unavailable in connection with a SPAC⁷⁹ acquisition until the completion of the vote by the SPAC shareholders. Rule 10b-18 assumes normal market conditions.⁸⁰ Accordingly, the definition of a “Rule 10b-18 purchase” excludes issuer bids and purchases made during certain corporate events because of the heightened incentive of an issuer to facilitate a corporate action, such as a merger. We do not believe that it is appropriate to make the safe harbor available when an issuer is under pressure to complete a merger or similar corporate action and may attempt to bring about a successful conclusion to the corporate action with issuer repurchases. Currently, paragraph (a)(13)(iv) of Rule 10b-18, which defines a Rule 10b-18 purchase, 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”).⁸¹ Thus, ordinarily, it is the target shareholder vote that determines the completion of the merger exclusion period for purposes of Rule 10b-18.

Paragraph (a)(13)(iv) illustrates the modernization of the safe harbor in 2003. The Commission adopted the amended merger exclusion in recognition of issuers’ incentives to facilitate corporate actions with issuer purchases. The Commission adopted this modified provision of Rule 10b-18 out of concern for issuer activity designed to facilitate a merger, which

⁷⁹ SPACs are shell, developmental stage, or blank-check companies that raise capital in initial public offerings (“IPOs”) generally for the purpose of acquiring or merging with an unidentified company or companies, or other entity, that will be identified at a future date (a “target”). See generally 17 CFR 230.419 (defining blank-check companies).

⁸⁰ 2002 Proposing Release, 67 FR at 77595.

⁸¹ 17 CFR 240.10b-18(a)(13)(iv). This would include any period where the market price of a security will be a factor in determining the consideration to be paid pursuant to a merger, acquisition, or similar transaction. See 2008 Adopting Release, 68 FR at 64955.

had been highlighted by news articles suggesting that banks repurchased their respective securities in order to boost their stock price to enhance the value of their competing merger proposals.⁸² At that time, the concern about issuers facilitating corporate actions was on raising the market price of an issuer's stock in order to facilitate the merger or acquisition in a contested takeover. The exclusion advanced the goal of making the safe harbor available to an issuer only during those times when there is no special event that may impact an issuer's purchasing activity. Since 2003, securities markets and capital raising have evolved significantly, and we once again believe it is appropriate to modify the merger exclusion with respect to issuer purchases aimed at facilitating corporate actions. This proposal is triggered by the rapid growth of SPAC capital raising, and its objective is to maintain the integrity of the safe harbor by narrowing its use during corporate actions that can impact an issuer's purchasing activity.⁸³

SPAC acquisitions can present unique conflicts of interest and significant financial incentives for SPAC management. For instance, a SPAC generally must complete its acquisition within 18 to 24 months,⁸⁴ which can put SPAC management under severe time pressure to identify an appropriate target and complete the acquisition. Typically, if an acquisition target is identified during this timeframe, both the SPAC shareholders and target shareholders are given the opportunity to vote on whether or not to approve the proposed acquisition. However,

⁸² See 2003 Adopting Release, 68 FR at 64955 n. 29.

⁸³ See FINRA Regulatory Notice 08-54: Guidance on Special Purpose Acquisition Companies, (stating that 22% of all IPOs in 2007 were SPAC IPOs totaling \$12 billion in raised capital).

⁸⁴ This 18- to 24-month deadline is designed to help investors by forcing a timely return of most of their capital (previously held in an escrow or trust account) if an acquisition is not completed within this timeframe and the SPAC must liquidate. See id.

because of the special incentives and deferred compensation involved with a SPAC,⁸⁵ if SPAC management believes that SPAC holders will vote against an acquisition, or to otherwise ensure that the acquisition will be approved, they may attempt to rely on Rule 10b-18 to repurchase a substantial percentage of shares of the SPAC's common stock in the open market,⁸⁶ thereby reducing the possibility that the acquisition will be disapproved.⁸⁷ These open market repurchases can also have the effect of supporting and/or raising the market price of the SPAC shares, and cause other investors to buy up shares in the SPAC in the open market when they might not otherwise have done so.⁸⁸ Moreover, because the SPAC shareholder vote typically occurs much later than the vote by the target shareholders, this allows the SPAC management an

⁸⁵ SPAC managers, as well as underwriters, often have significant financial incentives that may conflict with their investors' interests and may cause them to effect an acquisition regardless of the merit of the target or the potential for future success of the entity as a public company. For instances, the SPAC underwriters may be paid a portion of their fee, usually half, following the IPO, but the remainder is only paid upon the closing of an acquisition. In addition, SPAC managers may not be paid a salary but will receive an equity stake, roughly 20%, in the company post-acquisition.

⁸⁶ See, e.g., Douglas S. Ellenoff, "Facilitating a Business Combination: The Valuation and Economics of a Proposed SPAC Don't Determine a Successful Outcome," Equities Magazine (Sept. 2009) (stating that SPAC sponsors and affiliates consider additional purchases of open market shares in order to implement a favorable approval process); Frederick D. Lipman, "International and US IPO Planning: A Business Strategy Guide," at p. 218 and 223 (2008) ("Lipman") (stating that business combinations that trade below the Trust's per share amount after announcement require the SPAC's sponsors or the target's owners to enter into agreements to incentivize the SPAC's public stockholders or potential investors to support the transaction" and that "SPAC sponsors may commit to spend funds to buy stock in the open market that can be targeted during the proxy process").

⁸⁷ See, e.g., Lipman, id. at p. 217 (noting that getting the SPAC's stockholder vote and limiting exercises of conversions is by far the most difficult and uncertain part of the process and that this uncertainty affects the extent to which concessions will be made by the SPAC sponsors to complete the transaction – the greater the percentage of arbitrageurs holding the SPAC's stock and the less favorable the transaction is perceived, the greater the concessions that will have to be made). "In most [SPAC] transactions, negotiations and deals need to occur during the proxy process because at the time of the IPO, it is not possible to foresee all the variables involved in the business combination that will affect how much stock will need to be turned over from no votes to yes votes." Id. at p. 218 (emphasis added)

⁸⁸ See, e.g., id. (stating that SPAC sponsors may enter into Rule 10b5-1 trading plans which require them to purchase up to a specified number of shares or dollar amount of shares at the prevailing market prices, and that these purchases are intended to support the market price of the stock during the proxy process and provide potential sellers the ability to dispose of their shares and achieve the same or greater return than if they were to vote against the transaction and exercise their conversion rights).

even longer period of time in which to engage in substantial open market repurchases of the SPAC's stock in order to secure "yes" votes in favor of the proposed merger or acquisition. In view of this heightened incentive, we do not believe it is appropriate to provide a safe harbor for purchases made in connection with an acquisition by a SPAC during this period and, therefore, believe a longer exclusionary period is warranted.

Thus, we propose to add a provision that would increase the time in which the safe harbor is unavailable in connection with an acquisition by a SPAC until the completion of the vote by the SPAC's shareholders. Specifically, the proposal would amend the language of paragraph (a)(13)(iv) to provide that, in connection with a SPAC, Rule 10b-18's "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.⁸⁹ By extending the "merger exclusion" to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would 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. The benefit of a safe harbor is only appropriate during "normal" market conditions.⁹⁰

We note, however, that SPACs would still have the ability to make safe harbor repurchases following an announcement of a merger or covered transaction (subject to Regulation M's restricted period and any other applicable restriction) so long as the total amount of the issuer's Rule 10b-18 purchases effected on any single day does not exceed the lesser of

⁸⁹ Proposed Rule 10b-18(a)(13)(iv).

⁹⁰ See supra note 80. See infra note 106.

25% of the security's four-week ADTV or the issuer's average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.⁹¹ Moreover, the issuer may effect block purchases pursuant to paragraph (b)(4) of the Rule (subject to Regulation M's restricted period and any other applicable restrictions) provided that the issuer does not exceed the average size and frequency of block purchases effected pursuant to paragraph (b)(4) of the Rule during the three full calendar months preceding the date of the announcement of such transaction.⁹²

Q. Given the significant financial incentives on the part of SPAC managers and underwriters to engage in repurchase activity solely to facilitate an acquisition, should the safe harbor in general continue to apply to issuer repurchases of SPAC securities? If so, should the Commission consider other modifications, either in addition to or instead of, the safe harbor conditions proposed here in the case of issuer repurchases of SPAC securities? If not, what specific types of costs or burdens, if any, would be associated with making the safe harbor in general unavailable to issuer repurchases of SPAC securities? Please explain. Please provide detailed comment regarding excepting all issuer repurchases of SPAC securities from the definition of a Rule 10b-18 purchase. Are there other types of securities for which the safe harbor should not apply? We also seek specific comment concerning the potential for manipulative abuse that transactions in such securities may present.

3. Preliminary Note to Rule 10b-18

⁹¹ See 17 CFR 240.10b-18(a)(13)(iv)(B)(1).

⁹² See 17 CFR 240.10b-18(a)(13)(iv)(B)(2).

We also propose a non-substantive amendment that would update Preliminary Note No. 2 to Rule 10b-18 to reference “Item 16E” (instead of “Item 15(e)”) of Form 20-F. Preliminary Note No. 2 currently states, “[r]egardless of whether the repurchases are effected in accordance with § 240.10b-18, reporting issuers must report their repurchasing activity as required by Item 703 of Regulations S-K and S-B (17 CFR 229.703 and 228.703) and Item 15(e) of Form 20-F (17 CFR 249.220f) (regarding foreign private issuers), and closed-end management investment companies that are registered under the Investment Company Act of 1940 must report their repurchasing activity as required by Item 8 of Form N-CSR (17 CFR 249.331; 17 CFR 274.128).”⁹³ The proposed amendment would update this note by changing “Item 15(e)” to “Item 16E” consistent with the current Form 20-F.

4. Additional Request for Comments regarding Scope of Safe Harbor

Q. Should the safe harbor in general continue to apply to less liquid, less transparent securities, such as OTCBB and Pink Sheet securities? If so, should these securities be subject to more restrictive limitations in order to minimize the risk of manipulation by an issuer making market repurchases in these less liquid, less transparent securities?

Q. Should the Rule 10b-18 safe harbor be available for issuer repurchases during periods when an issuer’s insiders are selling their own shares of the issuer’s stock? If not, please provide specific suggestions regarding what, if any, limitations should be placed on the availability of the safe harbor during such periods.

Q. Should the Rule require that an issuer have current financial disclosures as a prerequisite to receiving the protection of the safe harbor? For example, should it be available to companies that do not make public filings of financial information, or are not current in required

⁹³ 17 CFR 240.10b-18.

filings? If so, how should we require the issuer to demonstrate such compliance? Should such information be required to be made available on the issuer's website for the investing public? What, if any, other requirements should be a prerequisite to receiving the protection of the safe harbor?

Q. Item 703 of Regulation S-K requires disclosure of repurchases of all shares of a company's equity securities of a class registered under Section 12 of the Exchange Act regardless of whether an issuer relies on the safe harbor. Should compliance with the disclosure requirements of Item 703 be made a condition of using the safe harbor? Should Rule 10b-18 contain a specific disclosure requirement as a condition of the safe harbor, similar to other Commission regulations that link a safe harbor with disclosure (e.g., Regulation D with Form D and Rule 144 with Form 144)? What specific types of information would be useful to investors regarding an issuer's repurchase activity?

Q. Would requiring specific disclosure as a condition of the safe harbor provide a useful way to monitor the operation of (or verify compliance with) the safe harbor? Would it provide useful information in assessing the level and market impact of issuer repurchases? If so, should the safe harbor require disclosure on a daily basis, or would more frequent disclosure (e.g., on a "real time" basis) be more meaningful to investors? If so, how should the disclosure be made (e.g., issuing daily press releases, posting daily notices on the issuer's website, or reporting such purchases to the tape using a special trade indicator)? Please provide specific suggestions.

Q. Should the safe harbor require issuers to maintain (and provide to the Commission, upon request) separately retrievable written records concerning the trade details (trade-by-trade information) about the manner, timing, price, and volume of their Rule 10b-18 repurchases?

Q. Should the safe harbor be made available to securities other than common equity, such as preferred stock, warrants, rights, convertible debt securities, or other products? If the safe harbor

were to include such securities, what price, volume, and time of purchase conditions should apply? We seek specific comment concerning the potential for manipulative abuse that transactions in such securities may present.

Q. Should the safe harbor be available for issuer repurchases involving security futures or option contracts (including the receipt or purchase for delivery of securities underlying such contracts)? Should the number of shares underlying an option or security futures contract (or other derivative security) entered into by an issuer count against an issuer's 25% daily volume limitation? What effect, if any, should taking delivery of common stock pursuant to a security futures contract or upon exercise of an option have regarding the Rule's other conditions (e.g., price, timing, and manner of purchase) with respect to the availability of the safe harbor for purchases effected in accordance with Rule 10b-18?

Q. Currently, the Rule 10b-18 safe harbor is not available for an issuer and the broker-dealer who engage in an accelerated share repurchase plan or use a forward contract to repurchase the issuer's stock, or for the broker's covering transactions. What, if any, manipulative concerns are raised by alternative or novel methods of repurchasing securities (e.g., use of derivatives or share accumulation programs)? Please provide specific comment as to what limitations should apply to such repurchases to address these concerns.

Q. Should the safe harbor apply to an issuer's repurchases of its common stock effected outside of the United States (e.g., on foreign exchanges)? If so, how should the safe harbor conditions apply to such purchases (e.g., should a security's ADTV include worldwide trading volume)?

Q. Should the safe harbor only be available outside of the United States to foreign private issuers, or to foreign companies whose principal market is outside the United States? If

so, are there certain conditions of Rule 10b-18 that should be modified or that should not apply at all with respect to purchases outside the United States and, if so, why?

Q. Are there different conditions under Rule 10b-18 that should apply with respect to purchases outside the United States and, if so, why are those conditions more appropriate than the conditions currently proposed for Rule 10b-18?

IV. General Request for Comment

We request and encourage any interested person to comment generally on these proposals. In addition to the specific requests for comment, the Commission invites interested persons to submit written comments on all aspects of the proposed amendments. The Commission also requests commenters to address whether the proposed Rule 10b-18 amendments provide appropriate safe harbor conditions in light of recent market developments. The Commission seeks comment on whether the safe harbor proposals raise any manipulation risks. Commenters may also discuss whether there are legal or policy reasons why the Commission should consider a different approach.

The Commission encourages commenters to provide information regarding the advantages and disadvantages of each proposed amendment. The Commission invites commenters to provide views and data as to the costs and benefits associated with the proposed amendments. We also seek comment regarding other matters that may have an effect on the proposed amendments.

V. Paperwork Reduction Act

A. Background

One provision of the proposed amendments to Rule 10b-18 would result in new “collection of information” requirements within the meaning of the Paperwork Reduction Act of

1995 (“PRA”).⁹⁴ The Commission is therefore submitting this proposal to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for the collection of information requirements is “Purchases of Certain Equity Securities by the Issuer and Others.” If adopted, this collection would not be mandatory, but would be necessary for issuers that wish to avail themselves of the proposed VWAP exception to Rule 10b-18’s price condition. Responses to the collection of information requirements of the proposed VWAP exception to Rule 10b-18’s price condition would not be kept confidential. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. OMB has not yet assigned a control number to the new collection for the proposed VWAP exception to the Rule’s price condition.

B. Summary

In order to provide issuers with additional flexibility to conduct repurchase programs using VWAP within the safe harbor, we are proposing to except from the Rule 10b-18’s price condition Rule 10b-18 purchases effected on a VWAP basis, provided certain criteria are met. Proposed Rule 10b-18(a)(14)’s definition of a “Rule 10b-18 VWAP Purchase” would require a new collection of information in that one of the requirements for qualifying for the exception is that the VWAP purchase must be reported using a special VWAP (e.g., a “.W”) trade modifier⁹⁵ in order to indicate to the market that such purchases are unrelated to the current or closing price of the security.

C. Proposed Use of Information

⁹⁴ 44 U.S.C. 3501 et seq.

⁹⁵ Proposed Rule 10b-18(a)(14)(vii).

The information that would be collected under the special trade modifier requirement would help prevent the issuer's Rule 10b-18 VWAP purchase from providing any price discovery information or influencing the pricing direction of the security. The information collected also would aid the Commission in monitoring compliance with the proposed VWAP exception.

D. Respondents

The collection of information that would be required by the proposed special trade modifier requirement of the proposed VWAP exception to Rule 10b-18 would apply to all 5,561 registered broker-dealers effecting Rule 10b-18 VWAP on behalf of issuers in reliance on the proposed VWAP exception to Rule 10b-18's price condition. As discussed below, the Commission has considered the above respondents for the purposes of calculating the reporting burdens under the proposed amendments to Rule 10b-18. The Commission requests comment on the accuracy of these figures.

E. Total Annual Reporting and Recordkeeping Burdens

Proposed Rule 10b-18(a)(14)'s definition of a "Rule 10b-18 VWAP Purchase" would require that the VWAP purchase must be reported using a special VWAP trade modifier.⁹⁶ VWAP trade reports are already required to be identified with a special trade indicator or modifier to indicate that such transaction reports are unrelated to the current or closing price of the security.⁹⁷ Thus, this identification is usual and customary in the conduct of this activity and

⁹⁶ Id.

⁹⁷ For example, FINRA rules require VWAP transaction reports to be identified with a special modifier to indicate to the market that such transaction reports are unrelated to the current or closing price of the security. See FINRA Rule 6380A(a)(5)(E) (requiring members to append the applicable trade report modifier, as specified by FINRA, to all last sale report that occur at a price based on an average weighting or another special pricing formula).

no new burden would be imposed.⁹⁸

F. Record Retention Period

The proposed VWAP exception's special modifier requirement does not contain any new record retention requirements. All registered broker-dealers that would be subject to the proposed special trade modifier requirement are currently required to retain records in accordance with Rule 17a-4(e)(7) under the Exchange Act.

G. Request for Comment

We invite comment on these estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to: (i) evaluate whether the collection of information is necessary for the proper performance of our functions, including whether the information will have practical utility; (ii) evaluate the accuracy of our estimate of the burden of the collection of information; (iii) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (iv) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. **S7-04-10**. Requests for materials submitted to OMB by the Commission with regard to

⁹⁸ 5 CFR 1320.3(b)(2).

this collection of information should be in writing, with reference to File No. **S7-04-10**, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Costs and Benefits of the Proposed Amendments

The Commission is considering the costs and the benefits of the proposed amendments. The Commission encourages commenters to discuss any additional costs or benefits. In particular, the Commission requests comment on the potential costs for any modifications to information gathering, management, and recordkeeping systems or procedures, as well as any potential benefits resulting from the proposals for issuers, investors, broker-dealers, other securities industry professionals, regulators, and others. Commenters should provide analysis and data to support their views on the costs and benefits associated with the proposed amendments.

A. Costs

As an aid in evaluating costs and reductions in costs associated with the proposed amendments, the Commission requests the public's views and any supporting information. The Commission believes that the proposed amendments would impose negligible costs, if any, on issuers and would not compromise investor protection. The Commission notes that any costs related to complying with the proposed amendments to Rule 10b-18 are assumed voluntarily because the Rule provides an optional safe harbor.⁹⁹ The Commission, however, notes that

⁹⁹ See discussion in Section VII, *infra*, noting that, even with the proposed modification to the “merger exclusion,” all issuers, including SPACs, still have the ability to make safe harbor repurchase following an announcement of a merger or covered transaction (subject to Regulation M’s restricted period and any other applicable

issuer repurchases effected under the proposed VWAP exception, or other passive pricing mechanisms, may create costs to both issuers and market participants to update systems and enhance recordkeeping in order to comply with the proposed exception. Also, to qualify as a “Rule 10b-18 VWAP Purchase” under the proposed Rule 10b-18(a)(14), the VWAP purchase be reported using a special VWAP trade modifier.¹⁰⁰ VWAP trade reports are already required to be identified with a special trade indicator or modifier to indicate that such transaction reports are unrelated to the current or closing price of the security.¹⁰¹ Thus, this identification is usual and customary and no new burden would be imposed. In addition, if adopted, an issuer may need to establish specific procedures that would help them develop the necessary protocols to deal with the various market centers when flickering quotes appear or fast-moving markets occur in order to help reduce any unnecessary or undue reliance on the proposed disqualification limitation. The Commission seeks estimates of such costs. The Commission also solicits comments as to whether the proposed amendments would impose greater costs on issuers than the current Rule.

The Commission also notes that the proposed modification to the “merger exclusion” in connection with SPAC acquisitions may create costs to issuers in terms of not being able to effect all of their issuer repurchases within the safe harbor. We understand that this, in turn, could affect some SPACs’ ability to complete an acquisition or other covered transaction.

restriction) so long as the total amount of the issuer’s Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security’s four-week ADTV or the issuer’s average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction. See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰⁰ Id.

¹⁰¹ See, e.g., text accompanying supra note 97.

However, we preliminary do not believe that the proposed modification to the “merger exclusion” would significantly hinder a SPAC’s ability to complete an acquisition or other covered transaction. The proposed modification is designed to maintain reasonable limits on the availability of the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer. Moreover, even with the proposed modification to the “merger exclusion,” SPAC issuers, similar to other issuers, would still be able to effect other repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or covered transaction (subject to Regulation M’s restricted period and any other applicable restriction) so long as the total amount of the issuer’s Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security’s four-week ADTV or the issuer’s average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.¹⁰² As such, we do not believe that the proposed modification to the “merger exclusion” would unfairly hinder a SPAC’s ability to complete an acquisition or other covered transaction. In fact, by extending the “merger exclusion” to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would simply make the safe harbor unavailable to SPAC issuers during the period when the incentive to engage in substantial repurchases to facilitate a corporate action is greatest.¹⁰³ We also note that some SPAC issuers may conduct privately

¹⁰² See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰³ Proposed Rule 10b-18(a)(13)(iv).

negotiated repurchases for which the safe harbor is already unavailable. As such, this proposal would not trigger new costs for that purchasing activity. Nevertheless, the Commission seeks estimates of any potential costs associated with the proposed modification to the “merger exclusion,” including the extent to which, if at all, the proposed modification would affect a SPAC’s ability to effect issuer repurchases within the safe harbor or otherwise complete an acquisition or other covered transaction.

B. Benefits

The proposed amendments would update the safe harbor in light of market developments since the 2003 Adopting Release, as well as provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor without sacrificing investor protection or market integrity. The proposed amendments would allow issuer repurchases under conditions designed to reduce the potential for manipulative abuse without either imposing undue restrictions on the operation of issuer repurchases or undermining the economic benefit such purchases provide investors, issuers, and the marketplace. In addition, the proposed amendments would provide clarity as to the scope of permissible market activity for issuers and the broker-dealers that assist them in their repurchasing. Many issuers may be reluctant to repurchase without the certainty that their activity comes within the safe harbor. If an issuer effects repurchases in compliance with Rule 10b-18, it may avoid what might otherwise be substantial and unpredictable risks of liability under the anti-manipulative provisions of the Exchange Act. Therefore, the safe harbor may provide increased liquidity to the marketplace from issuers that would not repurchase but for the safe harbor.

The proposed modification to the timing condition would maintain reasonable limits on the safe harbor consistent with the objectives of the Rule to minimize the market impact of the

issuer's repurchases, thereby allowing the market to establish a security's price based on independent market forces without undue influence by the issuer. As such, the proposed condition would establish additional reasonable limits on issuer activity that may influence market prices at or near the open. In addition, the amendment would allow issuers to carry out their repurchase programs more effectively by providing issuers with guidance in complying with Rule 10b-18's opening purchase limitation, particularly when, for example, the principal market has a delayed opening in a stock and another exchange's smaller opening transaction is reported in the consolidated system first.

The proposed VWAP exception from the Rule's price condition would provide issuers and their brokers with flexibility and greater certainty in effecting qualifying VWAP transactions within the safe harbor. The proposed VWAP exception to the Rule's price condition also may increase the likelihood that firms would engage in open market repurchases since the price condition would be less restrictive for such transactions. As such, the proposed VWAP exception may further provide increased liquidity to the marketplace.

In addition, if an issuer's repurchase meets all of the conditions under Rule 10b-18 but fails to meet the Rule's price condition due solely to flickering quotes, the proposed limitation to the general disqualification provision would disqualify only this otherwise compliant Rule 10b-18 purchase, rather than disqualifying all of the issuer's other purchases from the safe harbor for that day. The proposed amendments to the disqualification provision under the Rule also may increase the likelihood that firms would engage in open market repurchases since the execution of an otherwise compliant Rule 10b-18 purchase in a fast moving market would no longer jeopardize the availability of the safe harbor for all of an issuer's other Rule 10b-18 purchases

that day. As such, the proposed limitations to the general disqualification provision may further provide increased liquidity to the marketplace.

The proposal to modify the “merger exclusion” under the Rule in connection with a SPAC acquisition, merger, or similar transaction is designed to maintain the integrity of the safe harbor by narrowing its use where an issuer is under considerable pressure to complete an acquisition, merger, or similar transaction and effects a substantial amount of open market repurchases solely to facilitate the intended merger or other covered transaction. Additionally, as discussed above, these open market repurchases can have the effect of supporting and/or raising the market price of the SPAC shares, and cause other investors to buy up shares in the SPAC in the open market when they might not otherwise have done so. Thus, the proposed modification would maintain reasonable limits on the availability of the safe harbor consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer and, therefore, help to promote price efficiency in the marketplace.

The Commission encourages commenters to provide empirical data or other facts to support their views concerning these and any other benefits not mentioned here.

VII. Consideration of Burden on Competition and Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.¹⁰⁴ In addition, Section 23(a)(2) of the Exchange Act requires

¹⁰⁴ 15 U.S.C. 78c(f).

the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.¹⁰⁵ Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

We believe the proposed amendments would have minimal impact on the promotion of price efficiency and capital formation and preliminarily believe that these proposals would promote efficiency, competition and capital formation by enhancing market transparency, promoting liquidity in issuer securities and providing clarity to market participants engaging in issuer repurchases.

First, the proposed modification to the timing condition would promote price transparency in issuer securities. The proposed modifications to Rule 10b-18's timing condition are designed to minimize the market impact of an issuer's repurchases during a period (the market open) where market activity is considered to be a significant indicator of the direction of trading, the strength of demand, and the current market value of the security. This additional, reasonable limit on issuer activity, consistent with the objectives of the Rule, would allow the market to establish a security's price based on independent market forces without undue influence by the issuer, thereby further promoting price transparency at the market open. Second, the proposed amendments to the Rule would promote increased liquidity in issuer securities, by providing issuers with additional flexibility to conduct their repurchase programs more effectively and within the safe harbor. For example, the proposed VWAP exception to the safe harbor's existing price condition may increase the likelihood that firms would engage in open market purchases, thereby potentially providing increased liquidity in issuers' securities.

¹⁰⁵ 15 U.S.C. 78c(f).

Finally, the commission preliminarily believes that the proposed amendments should improve market efficiency by providing greater clarity and uniformity of the safe harbor conditions. It is our understanding that significant market changes with respect to trading strategies and developments in automated trading systems that have increased the speed of trading (evidenced by flickering quotes) have made it increasingly difficult for issuer to operate within the Rule. As such, the proposed modifications to the Rule would clarify and modernize the Rule’s provisions in light of market developments since the Rule’s adoption, providing the market with additional comfort while engaging in issuer repurchases.

In addition, we believe that the proposed modification to the “merger exclusion” in connection with SPAC acquisitions would have minimal impact on the promotion of price efficiency and capital formation. While the proposed modification may impact an issuer’s ability to effect all of their issuer repurchases within the safe harbor, the proposed modification is designed to maintain reasonable limits on the availability of the safe harbor¹⁰⁶ consistent with the objectives of the Rule to minimize the market impact of the issuer’s repurchases, thereby allowing the market to establish a security’s price based on independent market forces without undue influence by the issuer. An efficient market generally promotes capital formation. Moreover, even with the proposed modification to the “merger exclusion,” SPAC issuers, similar to other issuers, would still be able to effect other repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or covered transaction (subject to Regulation M’s restricted period and any other

¹⁰⁶ As discussed above, because the benefit of a safe harbor is only appropriate during “normal” market conditions, and not where there is a heightened incentive to engage in substantial repurchase activity solely to facilitate a corporate action, we believe that extending the “merger exclusion” to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders) is warranted. See also supra note 80.

applicable restriction) so long as the total amount of the issuer's Rule 10b-18 purchases effected on any single day does not exceed the lesser of 25% of the security's four-week ADTV or the issuer's average daily Rule 10b-18 purchases during the three full calendar months preceding the date of the announcement of the merger or other covered transaction.¹⁰⁷ As such, we do not believe that the proposed modification to the "merger exclusion" would unfairly hinder a SPAC's ability to complete an acquisition or other covered transaction. In fact, by extending the "merger exclusion" to the time of the vote by the shareholders of the SPAC (and not just the vote by the target shareholders), the proposal would simply make the safe harbor unavailable to SPAC issuers when the incentive to engage in substantial repurchases to facilitate a corporate action is greatest.¹⁰⁸

The Commission has considered the proposed amendments in light of the standards cited in Section 23(a)(2) and believes preliminarily that, if adopted, they would not likely impose any significant burden on competition not necessary or appropriate in furtherance of the Exchange Act. We believe the proposed VWAP exception to the Rule's price condition, the proposed amendments to the Rule's opening purchase condition, and the proposed limitation of the general disqualification provision under the Rule might help to avoid undermining competition by increasing the likelihood that more issuers will be able to effect qualifying Rule 10b-18 repurchases within the safe harbor. In addition, we believe that the proposed modification to the "merger exclusion" in connection with a SPAC acquisition would have a minimal impact on competition as SPAC issuers, similar to other issuers, would still be able to effect other

¹⁰⁷ See 17 CFR 240.10b-18(a)(13)(iv)(B)(1). See also 2003 Adopting Release, 68 FR at 64955.

¹⁰⁸ Proposed Rule 10b-18(a)(13)(iv).

repurchases (i.e., privately negotiated repurchases) and certain ordinary course Rule 10b-18 purchases following the announcement of a merger or other acquisition. Moreover, Rule 10b-18 is a safe harbor rather than a mandatory rule, and as such, issuers choose whether or not to use it. Many issuers might be reluctant to repurchase without the safe harbor. Therefore, the safe harbor may provide increased liquidity to the marketplace from issuers that would not repurchase but for the safe harbor. Issuers also have the option to repurchase securities outside the Rule 10b-18 safe harbor conditions without raising a presumption of manipulation. Moreover, the proposed version of the Rule 10b-18 safe harbor, like the current Rule, would apply to all issuers. Thus, we do not believe the proposed amendments would have a significant effect on competition because all issuers have the option of complying with the manner, volume, time and price conditions.

The Commission requests comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or “SBREFA,”¹⁰⁹ we must advise the Office of Management and Budget as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);

¹⁰⁹ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. and as a note to 5 U.S.C. 601).

- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effect on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of the proposed amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act ("RFA")¹¹⁰ requires the Commission to undertake an initial regulatory flexibility analysis of a proposed rule on small entities, unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.¹¹¹ Pursuant to Section 605(b) of the RFA, the Commission hereby certifies that the proposed amendments to Rule 10b-18, would not, if adopted, have a significant economic impact on a substantial number of small entities.

The proposed amendments are intended to clarify and modernize the safe harbor provisions. In particular, the proposal to modify the price condition is intended to provide issuers with greater flexibility to conduct their issuer repurchase programs within the safe harbor under conditions designed to reduce the potential for abuse. The proposal to limit the general disqualification provision is intended to provide issuers with additional flexibility to conduct their share repurchase programs in fast moving markets. At the same time, the proposals to modify the timing condition and the "merger exclusion" provision are intended to maintain

¹¹⁰ 5 U.S.C. 603(a).

¹¹¹ 5 U.S.C. 605(b).

reasonable limits on the safe harbor while furthering the objectives of Rule 10b-18. The Commission believes that the proposed amendments would impose negligible costs, if any, on issuers and would not, if adopted, have a significant impact on a substantial number of small entities. Based on Exchange Act Rule 0-10, a small issuer is one that on the last day of its most recent fiscal year had total assets of \$5,000,000 or less. The Commission believes that the majority of issuers effecting repurchase programs are not small entities.¹¹² Moreover, any costs related to complying with the proposed amendments to Rule 10b-18 would be assumed voluntarily because the Rule provides an optional safe harbor.

We encourage written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact. In particular, the Commission requests comment on: (i) the number of small entities that would be affected by the proposed amendments to the Rule, (ii) the nature of any impact the proposed amendments would have on small entities and empirical data supporting the extent of the impact, and (iii) how to quantify the number of small entities that would be affected by or how to quantify the impact of the proposed amendments.

X. Statutory Basis and Text of Proposed Amendment

The Rule amendments are being proposed pursuant to Sections 2, 3, 9(a)(6), 10(b), 12, 13(e), 15, 15(c), 23(a) of the Exchange Act, 15 U.S.C. 78b, 78c, 78i(a)(6), 78j(b), 78l, 78m(e), 78o, 78o(c), and 78w(a).

List of Subjects

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¹¹² The Commission's OEA estimates that, of the 2,218 issuers that announced repurchases during the years 2005 through 2008 (and that had total asset figures available), only 25 had assets below \$5 million. Source: Securities Data Company "SDC" database.

Brokers, Dealers, Issuers, Securities.

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 240---GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for Part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 240.10b-18 is amended by:

- a. Revising the next to last sentence of the Preliminary Note 1;
- b. Revising the term “Item 15(e)” to read “Item 16E” in Preliminary Note 2;
- c. Revising paragraph (a)(5)(iii) and the introductory text of paragraph (a)(13)(iv);
- d. Adding paragraph (a)(14); and
- e. Revising paragraphs (b)(2)(i), (b)(3)(i) and (d).

The addition and revisions read as follows:

§ 240.10b-18 Purchases of certain equity securities by the issuer and others.

* * * * *

1. * * * Except as provided in paragraph (d)(2) of this section, failure to meet any one of the four conditions will remove all of the issuer's repurchases from the safe harbor for that day. * * *

* * * * *

(a) * * *

(5) * * *

(iii) Is at least 20 round lots of the security and totals 150 percent or more of the ADTV for that security or, in the event that ADTV 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; Provided, however, That a block under paragraph (a)(5)(i), (ii), and (iii) of this section shall not include any amount a broker or dealer, acting as principal, has accumulated for the purpose of sale or resale to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose, nor shall it include any amount that a broker or dealer has sold short to the issuer or to any affiliated purchaser of the issuer if the issuer or such affiliated purchaser knows or has reason to know that the sale was a short sale.

* * * * *

(13) * * *

(iv) Effected during the period from the time of public announcement (as defined in §230.165(f) of this chapter) of a merger, acquisition, or similar transaction involving a recapitalization, until either the earlier of the completion of such transaction or the completion of the vote by target shareholders or, in the case of an acquisition or other covered transaction by a special purpose acquisition company (“SPAC”), the earlier of the completion of such transaction or the completion of the votes by the target and SPAC shareholders. This exclusion does not apply to Rule 10b–18 purchases:

* * * * *

(14) Rule 10b-18 VWAP purchase means a purchase effected at the volume-weighted average price (“VWAP”) by or on behalf of an issuer or an affiliated purchaser of the issuer that meets the conditions of paragraphs (b)(1), (b)(2), and (b)(4) of this section and the following criteria:

(i) The purchase is for a security that qualifies as an “actively-traded security” (as defined in §242.101(c)(1) of this chapter);

(ii) The purchase is entered into or matched before the opening of the regular trading session;

(iii) The execution price of the VWAP purchase is determined based on all regular way trades effected in accordance with the conditions of paragraphs (b)(2) and (b)(3) of this section that are reported in the consolidated system during the primary trading session for the security;

(iv) The purchase does not exceed 10% of the security’s relevant average daily trading volume;

(v) The purchase is not effected for the purpose of creating actual, or apparent, active trading in or otherwise affecting the price of any security;

(vi) The VWAP assigned to the purchase is calculated by:

(A) Calculating the values for every regular way trade reported in the consolidated system during the regular trading session, except as provided in paragraph (a)(14)(iii) of this section, by multiplying each such price by the total number of shares traded at that price;

(B) Compiling an aggregate sum of all values; and

(C) Dividing the aggregate sum by the total number of trade reported shares for that day in the security that represent regular way trades effected in accordance with the conditions of

paragraphs (b)(2) and (b)(3) of this section that are reported in the consolidated system during the primary trading session for the security; and

(vii) The purchase is reported using a special VWAP trade modifier.

(b) * * *

(2) * * *

(i) The opening regular way purchase reported in the consolidated system, the opening regular way purchase in the principal market for the security, and the opening regular way purchase in the market where the purchase is effected;

* * * * *

(3) * * *

(i) Does not exceed the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated system at the time the Rule 10b-18 purchase is effected; Provided, however, that Rule 10b-18 VWAP purchases, as defined in paragraph (a)(14) of this section, shall be deemed to satisfy paragraph (b)(3)(i) of this section;

* * * * *

(d) Other purchases. (1) No presumption shall arise that an issuer or an affiliated purchaser has violated the anti-manipulation provisions of section 9(a)(2) or 10(b) of the Act (15 U.S.C. 78i(a)(2) or 78j(b)), or §240.10b-5, if the Rule 10b-18 purchases of such issuer or affiliated purchaser do not meet the conditions specified in paragraph (b) or (c) of this section; and

(2) A Rule 10b-18 purchase of an issuer or affiliated purchaser that meets the conditions specified in paragraph (b) or (c) of this section at the time the purchase order is entered but does not meet the price condition specified in paragraph (b)(3)(i) of this section at the time the purchase is effected due to flickering quotes shall remove only such purchase, rather than all of the issuer's other Rule 10b-18 purchases, from the safe harbor for that day.

By the Commission.

Elizabeth M. Murphy
Secretary

Dated: January 25, 2010