



Here's the deal:

- Rule 10b-18 provides a non-exclusive safe harbor for an issuer from liability under certain market manipulation rules and Rule 10b-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), in connection with stock repurchases.
- This safe harbor is available for repurchases of an issuer's securities on any given day. To fall within the safe harbor, the issuer's repurchases must satisfy, daily, each of the rule's manner, timing, price and volume conditions. Failure to meet any one of these conditions disqualify all of the issuer's repurchases from the safe harbor for that day.
- Due to the increased scrutiny surrounding stock repurchase programs, issuers seeking to repurchase their common stock should have a heightened awareness of the regulatory, legal and other considerations discussed here.

What's the Deal?

Rule 10b-18 provides an issuer (and its "affiliated purchasers") with a non-exclusive safe harbor from liability under certain market manipulation rules (i.e., Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act) when repurchases of the issuer's common stock are made in accordance with the rule's manner, timing, price and volume conditions. The safe harbor is available for purchases of the issuer's stock on any given day. To come within the safe harbor, the issuer's repurchases must satisfy, daily, each of the rule's four conditions. Failure to meet any of the four conditions will disqualify all of the issuer's repurchases from the safe harbor for that day.

Purpose and Benefits of a Stock Repurchase Program

An issuer may want to engage in stock repurchases for a variety of reasons, including to send a signal to the market that the stock is undervalued and a good investment, and to reduce its cost of capital.

There are several potential benefits associated with stock repurchase programs depending on the issuer's circumstances. These may include the following:

- The availability of a non-exclusive safe harbor from liability for manipulation of the issuer's stock price (if Rule 10b-18's conditions are met);
- Greater certainty to the issuer and affiliated purchasers in planning purchases of the issuer's common stock;
- Increased liquidity, which should benefit shareholders;
- Minimizing dilution following a stock acquisition;

- A tax efficient alternative to dividends as a way to return money to shareholders; and
- Shares repurchased by an issuer are either canceled or kept as treasury stock, which then reduces the number of the issuer's shares outstanding, which may be beneficial to the issuer's earnings per share calculations.

Conditions for Repurchases under Rule 10b-18

Rule 10b-18's non-exclusive safe harbor is available only when the repurchases of the issuer's common stock in the market are made in accordance with the following conditions:

- *Manner of purchase condition*: requires an issuer to use a single broker or dealer per day to bid for or purchase its common stock;
- *Timing condition*: restricts the periods during which an issuer may bid for or purchase its common stock;
- *Price condition*: specifies the highest price an issuer may bid or pay for its common stock; and
- *Volume condition*: limits the amount of common stock an issuer may repurchase in the market in a single day.

Failure to meet any one of the rule's conditions will disqualify the issuer's purchases for that day from the safe harbor.

Manner of Purchase Condition

On a single day, the purchases and any bids of the issuer or its affiliated purchasers must be made through one broker or dealer. However, this restriction does not bar the issuer or its affiliated purchasers from making purchases if they are deemed not solicited by or on behalf of the issuer, such as purchases not solicited from additional brokers or dealers or when a shareholder approaches the issuer to have it buy shares. An issuer must evaluate whether a transaction is "solicited" based on the facts and circumstances in each case. Additionally, on a daily basis, the issuer may use a different broker or dealer to execute purchases. Furthermore, an issuer may use a different broker or dealer during an after-hours trading session from the one used during regular hours.

An issuer that directly accesses an electronic communication network ("ECN") or an alternative trading system ("ATS") to purchase common stock will be considered to be using one broker or dealer and cannot purchase its common stock through a non-ECN or non-ATS broker or dealer on the same day.

The purpose of this condition is to avoid creating the false appearance of widespread purchasing interest and trading activity in the issuer's common stock through the use of many brokers or dealers on any given trading day.

Timing Condition

A purchase by the issuer may not be the opening transaction reported in the consolidated system, the principal market or the market where the purchase is effected. A consolidated system is a 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.

Additionally, the purchase may also not be effected during the ten minutes before the scheduled close of the primary trading session in the principal market for the security or during the last ten 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”) of \$1 million or more, and a public float of \$150 million or more. The ADTV is the volume reported for the security during the four calendar weeks preceding the week in which the Rule 10b-18 purchase is to be effected. For all other securities, purchases may not be effected during the 30 minutes before the scheduled close of the primary trading session in the principal market for the security or the 30 minutes before the scheduled close of the primary trading session in the market where the purchase is effected.

An issuer purchase may be effected following the close of the primary trading session in the principal market until the termination of the period in which the last sale prices are reported in the consolidated system if: (i) the purchase is effected at a price that does not exceed the lower of the closing price of the primary trading session in the principal market for the security, and any lower bids or sales prices subsequently reported in the consolidated system; (ii) all of the other Rule 10b-18 requirements are met; and (iii) the issuer’s Rule 10b-18 purchase is not the opening transaction of the session following the close of the primary trading session.

The purpose of this condition is to prevent the issuer from establishing the opening or closing price of the stock, both of which are considered to guide the direction of trading.

Price Condition

During trading hours, if the security is reported in the consolidated system, displayed and disseminated on any national securities exchange, or quoted on any inter-dealer quotation system that displays at least two price quotations, issuer purchases must be made at a price not exceeding the highest independent bid or last transaction price, whichever is higher. For all other securities, an issuer will need to look at the highest independent bid obtained from three independent dealers.

For after-hours trading, stock repurchase prices must not exceed the lower of the closing price of the primary trading session in the principal market for the security and any lower bids or sales prices subsequently reported in the consolidated system by other markets. The issuer is permitted to repurchase until the termination of the period in which last sale prices are reported in the consolidated system.

The purpose of the price condition is to prevent an issuer from propping up its stock price through the repurchases, or from supporting the price at a level that would not otherwise be maintained by independent market forces.

Volume Condition

The purchases on a particular day may not exceed 25% of the ADTV in the preceding four weeks. “Block” transactions are included in determining the 25% limit and include trades of not less than \$50,000 with a volume of not less than 5,000 shares if the trade value is less than \$200,000, but excludes any securities the issuer knows or has reason to know were accumulated by a broker-dealer, acting as a principal, for the purpose of resale to the issuer. Alternatively, the issuer may make one “block” purchase per week and not be subject to the 25% limit, provided the “block” purchase is the only Rule 10b-18 purchase made on that same day. Rule 10b-18’s volume calculation carries over from the regular trading session to after-hours trading sessions.

The purpose of the volume condition is to prevent the issuer from dominating the market by purchasing a large amount of its common stock relative to other market transactions.

Severe Market Downturns

The Rule 10b-18 safe harbor conditions are modified following a market-wide trading suspension. The volume condition is modified so that the issuer may purchase up to 100% of the security's ADTV. Additionally, the time of purchase condition does not apply (a) from the reopening of trading until the scheduled close of trading on the day that the market-wide trading suspension is imposed or (b) at the opening of trading on the next trading day until the scheduled close of the trading day, if a market-wide trading suspension was in effect at the close of trading on the preceding day.

Establishing a Stock Repurchase Program

When establishing a stock repurchase program an issuer should consider (i) the impact on the issuer's cash position and capital needs for its continuing operations; (ii) alternative uses for the cash that will be used for repurchases, including repayment of outstanding indebtedness; and (iii) the possible effect on earnings per share and book value per share. The issuer should consult with its accountants regarding the issuer's capital position prior to implementing a stock repurchase program. Additionally, prior to implementing a stock repurchase program, the issuer should conduct a review of its charter, bylaws and the agreements to which it is a party, or by which it is bound, to determine whether there are any restrictions on, or impediments to, the issuer's use of funds to acquire its own securities. Specifically, the issuer's loan agreements and security documents should be reviewed for any such limitations. These restrictions may be direct limitations on repurchases or indirect limitations in the form of financial ratios and covenants.

State Law Restrictions

Certain provisions of the Delaware General Corporation Law ("DGCL") contain restrictions regarding legally available funds that apply to repurchases of shares of capital stock. Under DGCL Section 160, a Delaware corporation cannot purchase shares of its capital stock when the purchase "would cause any impairment of the capital of the corporation." The issuer should consult with its outside counsel regarding any applicable state law restrictions prior to implementing a stock repurchase program.

Additionally, the California Corporations Code requires that a California corporation must follow certain requirements prior to engaging in a distribution which includes issuer repurchases. Accordingly, an issuer repurchase may only be made if either: (a) the amount of retained earnings of the corporation immediately prior to the distribution equals or exceeds the sum of (i) the amount of the proposed distribution plus (ii) the preferential dividends arrears amount, or (b) immediately after the distribution, the value of the corporation's assets would equal or exceed the sum of its total liabilities plus the preferential rights amount.

Board Approval

Any stock repurchase program should be authorized and approved by the issuer's board of directors. As part of this authorization, the board should document the purpose of the share repurchase. It is important that the board concludes that the repurchase program is desirable and in the issuer's and its shareholders'

best interests. When approving a repurchase program, it is advisable that the board establishes a record of discharging its fiduciary duty. The record should include a current review, in consultation with the issuer's accountants, of the issuer's capital position and a thorough discussion of the purpose of the program.

Reporting Requirements

Regulation S-K and Forms 10-Q, 10-K and 20-F (for foreign private issuers) require periodic disclosure for all issuer repurchases of equity securities. This disclosure is required regardless of whether the repurchase is effected in reliance on the Rule 10b-18 safe harbor. An issuer must disclose in tabular form (a) the total number of shares, by month, repurchased during the past quarter; (b) the average price paid per share; (c) the number of shares that were purchased as part of a publicly announced repurchase plan; and (d) the maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs. For publicly announced repurchase plans, the issuer is also required to disclose (by footnotes to the table) the following information: (a) the announcement date; (b) the share or dollar amount approved; (c) the expiration date (if any) of the plans or programs; (d) each plan or program that has expired during the period covered by the table; and (e) each plan or program that the issuer has determined to terminate prior to expiration or under which the issuer does not intend to make further purchases. Additionally, the issuer should consider discussing any repurchase program under the "Liquidity and Capital Resources" section of the MD&A if material. The issuer should also consider whether disclosure of significant repurchases is required in the notes to its financial statements.

Public Announcements

Issuers should publicly announce the adoption of a stock repurchase program before it is implemented. However, an announcement should not be made unless the issuer actually intends to repurchase shares because any termination of the repurchase program without purchases could be deemed manipulative in the absence of a sound business reason.

The specifics of the public announcement depend on the circumstances, but the issuer should include the following:

- The reason for the repurchase;
- The approximate maximum number or aggregate dollar amount of shares to be repurchased;
- The method of purchase to be used;
- Any significant corporate developments which have not been previously disclosed;
- The impact of the repurchase program on the remaining outstanding shares;
- Any arrangement, contractual or otherwise, with any person for the purchase of the shares;
- Whether the purchases are to be made subject to restrictions relating to volume, price and timing in an effort to minimize the impact of the purchases upon the market for the shares; and
- The duration of the program.

The announcement of the stock repurchase program should be made on Form 8-K with any press release included as an exhibit for purposes of Regulation FD. The issuer should also be mindful that any material changes to its stock repurchase program (including program size) should be publicly disclosed as well.

Repurchase Structures

Issuers have significant flexibility with respect to choosing a particular repurchase structure ranging from open market repurchases to repurchases that are subject to tender offer rules. An issuer may structure its repurchase as an accelerated stock repurchase (“ASR”). An ASR may result in faster execution and more price certainty; however, ASR repurchases do not benefit from the Rule 10b-18 safe harbor. An ASR is a privately negotiated transaction, usually documented as a forward contract, in which a repurchase agent agrees to sell a predefined amount of stock to an issuer at a price per share based on the volume weighted average price during the specified period. A repurchase agent acts as the seller of the issuer’s shares in an ASR and the issuer acts as the purchaser buying back its own shares. ASRs provide numerous benefits, including transaction efficiency, an immediate share count reduction, certainty as to the timing and quantity of the repurchase, and possible accounting advantages. Notwithstanding these benefits, ASRs have been the subject of some criticisms. As a result, an issuer should consider its alternatives carefully.

At the beginning of the ASR, the issuer pays a predefined dollar amount to the repurchase agent for a specified number of securities. The repurchase agent generally borrows securities from stock lenders and delivers those securities to the issuer. Over time, the repurchase agent will buy securities in the market to cover its borrow and has the option to complete the ASR at any time within a pre-agreed period. The purchase period will have a fixed starting and end point, though the repurchase agent will have the right, upon notice to the issuer, to shorten the period. An average price is determined for the purchase period, which is typically based on the Rule 10b-18 pricing condition minus an agreed discount or price adjustment. At the ASR’s final settlement, the total number of securities purchased by the issuer generally equals the ASR dollar size divided by the discounted average price. If the repurchase agent did not deliver a sufficient number of securities at inception, it must deliver incremental securities to the issuer at the end of the ASR. Conversely, if the repurchase agent delivered too many securities, the issuer must settle with the repurchase agent in cash or stock on the settlement date.

Purchase Activity Covered by Rule 10b-18

The Rule 10b-18 safe harbor only applies to purchases by an issuer of its common stock (or an equivalent interest, such as a unit of beneficial interest in a trust or limited partnership or a depository share). It does not apply to any other type of security, such as purchases of preferred stock, warrants, convertible debt securities, options or security future products. However, many issuers analogize to the conditions of Rule 10b-18 in connection with repurchases of other equity or equity-linked securities.

Generally, open market purchases by an issuer of its common stock are covered by the safe harbor. However, certain types of purchases of common stock are not covered by Rule 10b-18, due to the greater potential risk of manipulation of the price of the stock by the issuer. Such transactions include: (i) purchases effected by or for an employee plan by an agent independent of the issuer; (ii) purchases of fractional interests; (iii) certain purchases made pursuant to a merger, acquisition or similar transactions

involving a recapitalization (subject to certain exceptions); and (iv) purchases made pursuant to a tender offer governed by the Williams Act.

Purchases by an affiliate will be attributable to the issuer under Rule 10b-18 where, directly or indirectly, (a) the affiliate controls the issuer's Rule 10b-18 purchases, (b) the issuer controls the affiliate's Rule 10b-18 purchases or (c) the Rule 10b-18 purchases by the affiliate and the issuer are under common control. Purchases by persons acting in concert with the issuer for the purposes of acquiring the issuer's common stock will also be attributed to the issuer. If Rule 10b-18 purchases are effected by or on behalf of more than one affiliated purchaser (or the issuer and one or more of its affiliates) on a single day, the issuer and all affiliated purchasers must use the same broker or dealer.

Interaction between Rule 10b-18 and Other Federal Securities Laws

Rule 10b-18 provides an issuer a safe harbor from liability for manipulation in connection with stock repurchases in the open market; however, it does not provide protection from other federal securities laws, such as insider trading and antifraud provisions. An issuer making purchases pursuant to a stock repurchase program must still comply with other regulatory reporting requirements.

Rule 10b-5

An issuer can address concerns regarding Rule 10b-5 liability by structuring its stock repurchase program to comply with the Rule 10b5-1 safe harbor. Compliance with the safe harbor under Rule 10b5-1 generally requires that the issuer, before becoming aware of any material non-public information ("MNPI") do one of the following: (i) enter into a binding contract to purchase the securities; (ii) instruct another person to purchase the securities for the issuer's account; or (iii) adopt a written plan for purchasing or selling the securities and conform its stock repurchases to the requirements of a Rule 10b5-1 plan. For a Rule 10b-18 repurchase program to meet the requirements of the safe harbor under Rule 10b5-1, the program must contain one of the following elements: (i) it must specify the amount, price and date of the transaction(s); (ii) it must include a written formula, algorithm or computer program for determining amounts, prices and dates for the transaction(s); or (iii) it must not permit the issuer to exercise any subsequent influence over how, when or whether to make purchases or sales (and any other person exercising such influence under the stock repurchase program must not be aware of MNPI when doing so). Furthermore, the repurchase program must be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b5-1. The issuer must implement reasonable policies and procedures to ensure that individuals making investment decisions on its behalf would not violate the laws prohibiting trading on the basis of MNPI.

The Securities and Exchange Commission ("SEC") recently announced that it settled charges against an issuer relating to its alleged failure to establish reasonable controls to ensure that the issuer did not conduct a buyback while in possession of MNPI. While the issuer named in the SEC's enforcement action had authorization for the stock repurchase from its board of directors, this was given on the condition that the company is not in possession of MNPI. In its press release, the SEC noted that the issuer in question did not take reasonable steps to ensure that its stock repurchase complied with such policy, which highlights the importance of establishing effective checks and policies for issuers using stock repurchase programs.

Regulation M

Under Rule 102 of Regulation M, with certain exceptions, the issuer cannot repurchase its common stock during certain restricted periods if at the same time the issuer or an affiliate is engaged in a “distribution” of the same class of equity securities or securities convertible into the same class of equity securities. Regulation M requires repurchase activity to be discontinued one business day prior to the determination of the offering price for the securities in distribution until the issuer’s completion of its participation in distribution. The term “distribution” in this context covers more than conventional public offerings and includes any offering which is distinguished from any ordinary trading transaction by the magnitude of the offering and the presence of special selling efforts and methods. This definition may include certain offerings in connection with acquisitions or exchange offers. Such a distribution might also take place if a major stockholder of the issuer that is an affiliate was engaged in significant sales of the issuer’s stock.

An issuer should assume that its officers, directors and controlling shareholders will be deemed to be “insiders;” that the rules as to insiders will apply to purchases as well as sales; that the rules generally require disclosure of material facts concerning the issuer or affecting the market in securities of the issuer not generally known to the public; and that the disclosure or use of non-public information may violate a fiduciary duty owed to the issuer or stockholders to whom it is not disclosed. As a result, an issuer may want to consider:

- Avoiding purchases of stock at any time when an insider is selling equity securities, and insiders should avoid selling the issuer’s stock, when the issuer is purchasing its own stock.
- Encouraging its executive officers, directors and other insiders not to go into the market and purchase or sell, on their own behalf, the issuer’s common stock during the course of any repurchase program, unless they advise a designated officer and secure confirmation that such action will not violate any applicable securities or other laws or fiduciary obligations to the issuer or its stockholders.

Negotiating Repurchase Agreements

Repurchase agreements that document traditional open market purchases are typically short form agreements. Most repurchase agents have a form of repurchase agreement that will serve as a starting point. The form repurchase agreement will incorporate the applicable Rule 10b-18 provisions in setting out the mechanics of the repurchase. The repurchase agreement appoints the repurchase agent and authorizes it to make open market purchases on the issuer’s behalf in accordance with the terms and conditions set forth in the agreement. As part of the agreement, the repurchase agent agrees to use commercially reasonable efforts to purchase the issuer’s outstanding shares and comply with the pricing, timing and volume guidelines that are provided to the repurchase agent by the issuer. The repurchase agent typically disclaims responsibility for complying with Rule 10b-18(b) (4) (volume of purchases) to the extent that the issuer or any affiliated purchaser of the issuer has separately purchased securities without informing the repurchase agent. The agreement will include customary issuer representations and warranties. Unlike the repurchase agreement for traditional open market repurchases, the documentation for ASRs has not become fully standardized. An issuer typically pre-negotiates forms of ASR documents with members of its lending syndicate. Typically, either a master confirmation or agreement is used with supplemental confirmations containing economic terms for individual transactions or stand-alone long-form confirmations that incorporate or reference an ISDA Master Agreement are used. The master

confirmation structure is more prevalent as it allows for multiple transactions to be consummated using the same legal terms.

COVID-19 Pandemic

As a result of the COVID-19 pandemic, the U.S. stock markets have experienced heightened volatility. This volatility may generate incentives for issuers to repurchase their common stock at lower prices in comparison to pre-pandemic trading levels. However, these incentives must be balanced in light of the heightened scrutiny surrounding issuer repurchase programs.

One specific regulatory concern relating to the pandemic for issuers contemplating a stock repurchase program is the Coronavirus Economic Stabilization Act of 2020 under the Coronavirus Aid, Relief, and Economic Stability Act (the "CARES Act"), which was enacted on March 27, 2020, to address the impact of the COVID-19 outbreak in the United States. Under the CARES Act, the federal and state governments offer relief and financing programs to assist businesses; however, there are restrictions on stock buybacks during the period in which an issuer obtains a loan or guarantee and for the 12 months after the loan or guarantee is no longer outstanding. A restriction would not be applicable if an issuer already had a contractual obligation to repurchase its shares prior to the enactment of the CARES Act.

Checklist of Key Questions

- Did the issuer take the recommended steps in connection with establishing its stock repurchase program including obtaining the approval of the board of directors?
- Did the issuer consider the structure of the proposed repurchase program? Will the issuer seek authority for repurchases up to a specified dollar amount in an identified period, or for repurchases of a specified number of shares? Or some combination?
- Has the issuer consulted with its auditors and tax advisers?
- Does the issuer intend to rely on the Rule 10b-18 safe harbor? Or will the issuer undertake an ASR? Will either be paired with a Rule 10b5-1 plan?
- Has the issuer and its board established appropriate controls relating to repurchases and communications with the appointed broker?
- Does the issuer have a process in place to address suspensions of repurchases if it were to undertake a securities offering?
- Has the issuer considered how to address any questions that may arise following the announcement of a repurchase program?
- Has the issuer ensured that there is a process in place to report regularly any repurchases?