

A PRIMER ON SHARE REPURCHASES IN CONNECTION WITH MERGERS AND ACQUISITIONS

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In November 2003 the SEC adopted a series of amendments to Rule 10b-18 under the Securities Exchange Act of 1934, substantially overhauling the safe-harbor for open market repurchases by issuers of their own shares.¹ As part of these amendments, the SEC dramatically limited the safe-harbor for share repurchases during the pendency of most non-cash business combinations. The SEC acted out of concern (heightened in part by reports of significant share repurchases by Wachovia and SunTrust in their 2001 takeover battle) that a party to such a transaction has a “considerable incentive to support or raise the market price of its stock in order to facilitate the merger or acquisition.”²

These amendments had an immediate and significant chilling effect on the practice of share repurchases during business combinations because most companies have historically tried to repurchase their shares only in compliance with the Rule 10b-18 safe-harbor in order to avoid the risk of market manipulation charges. Rule 10b-18 is, however, a safe-harbor and not a substantive prohibition on share repurchases,³ and companies that have announced a business combination may well have legitimate business reasons for desiring to engage in repurchase activities following the announcement of the transaction. In fact, during 2004 and 2005, the participants in several major merger transactions announced their intention to embark on substantial repurchase programs. These repurchases were announced despite the SEC’s action

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- ¹ Rule 10b-18 provides issuers and related parties with a qualified safe-harbor from liability for market manipulation when they repurchase their common stock in accordance with the rule’s timing, price, manner of purchase and volume conditions. These conditions are summarized in Annex A to this memorandum. The SEC revised Rule 10b-18 in the 2003 amendments to provide that the safe-harbor does not apply to transactions done with the intent to manipulate share prices.
- ² 68 Fed. Reg. 64956 and text accompanying note 29 (November 17, 2003) (“Rule 10b-18 is not intended to apply in contexts where the issuer has a heightened incentive to manipulate the market price of its securities.”).
- ³ Paragraph (d) of Rule 10b-18 expressly states that failure to comply with Rule 10b-18 does not create a presumption of market manipulation. The SEC, in its release adopting the Rule 10b-18 amendments, emphasized that the merger exclusion did not unduly restrict issuer repurchase activity because issuers will retain the “flexibility to purchase outside the safe harbor if they choose to do so,” without creating any presumption of market manipulation. 68 Fed. Reg. 64956 and note 30 (November 17, 2003). On the other hand, given the SEC’s evident concern with the potential for market manipulation in connection with business combinations, the parties to a business combination need to weigh the benefits of post-announcement share repurchases against the potential risk of heightened regulatory scrutiny.

to limit the Rule 10b-18 safe-harbor, although to date such repurchases have generally been quite limited during the period that the Rule 10b-18 safe-harbor is unavailable. This memorandum outlines some of the key legal considerations an issuer should evaluate in determining whether and to what extent it can purchase its own shares or shares of its business combination partner following an announcement of a business combination transaction.

First, this memorandum reviews the restrictions on share repurchases during the pendency of a business combination under both Rule 10b-18 (in light of the 2003 amendments to the rule and the SEC staff's November 2004 Q&A on the rule⁴) and Regulation M, which is the SEC's principal rule restricting share repurchases and similar activities during a distribution of securities. Because there is some overlap, as well as a number of inconsistencies, between Rule 10b-18 and Regulation M, the restrictions governing share repurchases in connection with a business combination are somewhat complicated. A chart summarizing the key restrictions on share repurchases at each stage during a business combination is attached to this memorandum as Annex B. This memorandum also provides some suggested guidelines for those who wish to repurchase shares outside the Rule 10b-18 safe-harbor. Finally, this memorandum briefly outlines some other general legal considerations that may affect the permissibility and magnitude of share repurchases during a business combination in addition to those arising under Rule 10b-18 and Regulation M, including the requirements of Rule 10b-5.

Considerations Under the Rule 10b-18 Merger Exclusion and Regulation M

Transactions Covered

The 2003 amendments to Rule 10b-18 added a specific "merger exclusion" (paragraph (a)(13)(iv)) stating that the rule's safe-harbor is not available commencing with the first public announcement of a merger or similar transaction. The Rule 10b-18 merger exclusion applies to all mergers, acquisitions or "similar transactions involving a recapitalization,"⁵ other than those in which the consideration consists solely of cash and there is no valuation period (e.g., the amount of consideration is not based in whole or in part on market trading prices of either party's shares during any period following announcement of the transaction). The merger exclusion applies regardless of the comparative size of the merging parties or the amount of stock being issued as a percentage of the acquiror's capitalization or as a percentage of the transaction consideration. It also applies regardless of the method being used to effect the acquisition (e.g., statutory merger subject to a shareholder vote, exchange offer).

Rule 10b-18 only applies, however, to purchases of common stock. Purchases by either of the combining parties of common stock-related securities (including convertible preferred

⁴ Division of Market Regulation: Answers to Frequently Asked Questions Concerning Rule 10b-18, revised as of November 17, 2004 (the "2004 FAQs"), available at <http://sec.gov/divisions/marketreg/r10b18faq0504.htm>.

⁵ The phrase "similar transactions involving a recapitalization" is not defined in the rule nor explained in the proposing or adopting releases, and is a source of potential ambiguity in the rule's application.

stock or debt or other derivative instruments such as options, warrants or single stock futures) are not entitled to the Rule 10b-18 safe-harbor at any time. (Question 2 of the 2004 FAQs.) The SEC staff takes the position that neither accelerated share repurchase programs (ASRPs) and forward contracts, nor the covering transactions by the counterparty to such agreements, are eligible for the Rule 10b-18 safe-harbor at any time, whether or not executed during a merger exclusion period. (Question 13 of the 2004 FAQs.)

Regulation M applies to any “distribution”⁶ of securities. A merger, exchange offer or other business combination in which all or part of the acquisition consideration consists of the acquiror’s securities would typically be considered a “distribution” of securities and therefore subject to Regulation M.

Time Periods Covered

The Rule 10b-18 safe-harbor is not available during the period beginning with the first public announcement of the transaction and ending on the earlier of the completion of the transaction or the completion of the shareholder votes on the transaction. For these purposes:

- A “public announcement” of the transaction, as set forth in Rule 165(f) under the Securities Act, includes any oral or written communication by a participant in a business combination transaction that informs the public or security holders in general about the business combination transaction. Accordingly, depending upon the circumstances, a press release confirming that a company is in negotiations regarding a business combination transaction might be sufficient to trigger the merger exclusion, thereby depriving the parties to the business combination transaction of the Rule 10b-18 safe-harbor for share repurchases.⁷

⁶ Rule 100 of Regulation M defines a distribution as an “offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.”

⁷ The SEC staff has indicated that a statement need not describe all the terms of an agreed-upon transaction in order to constitute a “public announcement” for purposes of Rule 165: “If the parties to the transaction are announced, that should be enough to constitute a public announcement. For example, if X Co publicly states its intention to acquire Y Co, even though it does not give a time frame, price or form of transaction, this should constitute a public announcement In contrast, a public statement that does not identify the parties, for example, a statement that a company is looking for a buyer or is looking for acquisition targets, should not constitute a ‘public announcement.’” Question A2, Manual of Publicly Available Telephone Interpretations (Third Supplement, July 2000), available at <http://www.sec.gov/offices/corpfin/phoneits3.htm>.

Regardless of whether the Rule 10b-18 safe-harbor is available, the parties to a potential business combination may not be in a position to repurchase shares due to their inability to make adequate public disclosures regarding the terms and financial consequences of the potential business combination or because they have received material nonpublic information about each other’s business, operations or prospects. See discussion of Rule 10b-5 below.

- “Completion of the vote” by shareholders does not occur until the end of the last period during which the market price of either merging company’s shares will be a factor in determining the consideration to be paid pursuant to the business combination. For example, in a transaction in which:
- the exchange ratio is set based on market trading prices during a pre-closing valuation period, or
- there is a period during which the target shareholders may elect to receive cash or stock merger consideration,

the Rule 10b-18 merger exclusion period will run to the end of the last such period to occur.

The SEC has not publicly addressed how a walkaway right in a business combination agreement (that is, where one or both of the parties has the right to terminate the transaction agreement based on the acquiror’s stock price) should be treated for purposes of determining whether “completion of the vote” has occurred. The SEC would, however, likely take the view that any measuring period used to determine the acquiror’s stock price for purposes of a walkaway right is the equivalent of a valuation period for purposes of both Rule 10b-18 and Regulation M.

In regulated industries, those valuation and other measurement periods often occur months after the date on which the shareholders vote to approve the business combination. Under Rule 10b-18 (unlike Regulation M) the merger exclusion is not lifted during any gap of time that may occur between the date of the shareholder vote and any subsequent valuation or similar period. In addition, as noted below, the SEC staff’s position is that the merger exclusion from Rule 10b-18 applies to the shares of both combining companies through the end of any subsequent valuation or similar period, even if the stock price of only one of these companies is relevant during such subsequent period (e.g., a valuation period based on the average trading price of the acquiror’s shares prior to the merger closing).

- Although Rule 10b-18 itself refers to the merger exclusion ending on the date that the target shareholders vote on the business combination, the SEC staff takes the position that if the acquiror’s shareholders must also vote on the transaction, the merger exclusion period does not end until both shareholder votes have occurred. (Question 19 of the 2004 FAQs.)

In contrast, Regulation M does not restrict share purchases until the commencement of the “restricted period,” at which time open market purchases and most other purchases of the security to be issued in the business combination must stop. In the case of a merger subject to a shareholder vote, the Regulation M restricted period begins when the proxy statement for the transaction is first mailed to the shareholders of the merging companies and ends on the date the target shareholders have voted on the proposed business combination. In the case of an exchange offer, the restricted period begins when offering materials are first disseminated to

shareholders and ends when the tender period expires. In contrast to Rule 10b-18, the SEC staff takes the position that the Regulation M restricted period is based solely on the target company's shareholder vote, regardless of whether the acquiror's shareholders will also vote on the transaction. As a result, there may be effectively no Regulation M restricted period in the acquisition of a non-public company. In Staff Legal Bulletin No. 9,⁸ the Staff notes that for the acquisition of a privately held company when the shareholders will not be solicited through proxies:

The day most comparable to the day of mailing the proxy solicitation materials is the day the target security holders are first asked to commit to the transaction, which would be the day the acquiror sends a definitive acquisition agreement to the target security holders for their execution. The restricted period would commence on the earlier of one (or five) business day(s) prior to ... the time the acquiror furnishes the definitive acquisition agreement for execution to the security holders of the privately held target company ... [and] would continue until the ... execution of the definitive acquisition agreement.

The Regulation M restricted period would resume either one or five business days (depending upon the average daily trading volume of the acquiror's stock) prior to any subsequent post-vote valuation or similar period when the market price of the offered security will be a factor in determining the consideration to be paid in the business combination, or prior to any period when shareholders have the right to elect among different forms of consideration, and would terminate at the end of that period.⁹ Note, however, that Regulation M only applies to repurchases by the acquiror and by the target company of shares of the acquiror's stock being issued in the business combination. Under Regulation M, the target's stock would not be considered the security being distributed or a reference security for the distributed security and therefore Regulation M would not prohibit repurchases of target company stock by either the acquiror or the target.¹⁰ If the business combination were being effected by means of an exchange offer, however, open market repurchases of target company stock by the bidder (and in many cases also by the target) would be prohibited by Rule 14e-5 during the pendency of the exchange offer.

Companies and Securities Covered

The SEC staff has interpreted the scope of the merger exclusion broadly and takes the position that neither the target company nor the acquiror is entitled to the Rule 10b-18 safe-harbor for purchases of either its own stock or the other party's stock. In other words, the

⁸ See Staff Legal Bulletin No. 9 (revised April 12, 2002) available at <http://www.sec.gov/interp/leg/mrslb9.htm> ("SLB No. 9").

⁹ This has been a long-standing interpretation by the SEC, which it has recently proposed be expressly stated in Regulation M. See SEC Release Nos. 33-8511; 34-50831; IC-26691 (December 9, 2004).

¹⁰ See SLB No. 9.

merger exclusion will apply to both the acquiror (repurchasing its own shares or the target's shares) and the target company (repurchasing its own shares or the acquiror's shares). Similarly, the SEC staff takes the position under Rule 10b-18 that the acquiror and target company are considered "affiliated purchasers" for purposes of complying with the rule and its procedures (e.g., procedures requiring the use of a single broker by all covered parties during any single trading day). (Questions 18 and 20 of the 2004 FAQs.)

In contrast, Regulation M only restricts purchases of the acquiror's securities, as noted above.¹¹ The SEC staff, however, considers both the acquiror and the target company to be "affiliated purchasers" for Regulation M purposes, just as it does for purposes of Rule 10b-18. Accordingly, during the Regulation M restricted period neither the acquiror nor the target company may make open market purchases of the security being issued in the business combination. Note that Regulation M restricts only purchases of the security being distributed and not derivative securities (such as warrants or convertible debt or preferred stock) that are exercisable for or convertible into the security being distributed.

One consequence of the SEC staff's positions on Rule 10b-18 and Regulation M is that a hostile bidder seeking to derail a pending merger between two other parties may also become subject to the merger exclusion under Rule 10b-18. The SEC staff has taken the position in at least one deal-jumping contest that Regulation M's restricted period applied to the hostile bidder (SunTrust) repurchasing its own shares while the shareholders of the target company (Wachovia) were voting on the proposed merger with the first bidder (First Union). The logic of this position was that the hostile bidder's stock price was highly relevant to the decision of the target shareholders whether to vote against the first bidder's bid, which was in turn a condition to the hostile bidder's completing its own competing all-stock bid for the target company. Accordingly, the hostile bidder's restricted period under Regulation M began when it disseminated its proxy soliciting materials to the target company shareholders soliciting their vote against the proposed merger with the first bidder, and ended when the target shareholders voted on that proposed merger.¹²

Following this reasoning and the plain language of amended Rule 10b-18,¹³ a hostile bidder in a deal-jumping situation should also become subject to the Rule 10b-18 merger exclusion with respect to repurchases of its own shares, and possibly also shares of the target

¹¹ Although there does not appear to be definitive guidance under Regulation M as to the treatment of the securities of the participants in a top hat structure (that is, a merger in which both participant companies effectively merge into a newly-formed holding company), we believe that the SEC would treat the stock of the company which is, in substance, the acquiror, but not that of the target, as a reference security of the holding company issuer.

¹² See SLB No. 9.

¹³ Rule 10b-18, as amended, excludes from the safe-harbor any purchase "effected during the period from the time of public announcement (as defined in [Securities Act Rule] 165(f)) of a merger, acquisition, or similar transaction . . ."

company, as soon as it announces its competing bid, if that announcement constitutes a “public announcement” of a business combination for purposes of Rule 165 (as was the case with SunTrust’s hostile bid for Wachovia).

Permitted Repurchases

Rule 10b-18 permits safe-harbor share repurchases during the pendency of a business combination if they are consistent with historic share repurchase patterns during the three calendar months preceding the month in which the business combination is announced, which the SEC refers to as the “look-back” period. For this purpose:

- Open market repurchases are permitted if they do not exceed the lesser of (i) 25% of the average daily trading volume of those shares during the prior four calendar weeks or (ii) the issuer’s average daily Rule 10b-18 purchases during the three full calendar months preceding the announcement date of the business combination.
- Block purchases are permitted if they do not exceed the average size and frequency of the issuer’s block purchases during the three full calendar months preceding the announcement date of the business combination. This limit is determined by calculating an aggregate volume limit per block purchase (the arithmetic average of total number of shares repurchased in block purchases during the three calendar months preceding the month in which the business combination was announced, divided by the number of block purchases) and a frequency limit per month (total number of block purchases during that three month period, divided by three). In addition, any such block purchases must also comply with Rule 10b-18’s general restrictions on block purchases. These generally limit the size of block purchases to 25% of the average daily trading volume in the shares during the four prior calendar weeks (except that an issuer may, not more than once each week, purchase a block of its shares in lieu of open market purchases under the 25% volume limitation for that day, but, in the case of block purchases during a merger exclusion period, only to the extent it did so during the three month look-back period).

The share buyback volume during the three month look-back period may often be artificially reduced compared to historic practice because the parties to a potential business combination will typically suspend their share repurchase programs when the merger negotiations become serious (for example, because they have exchanged material non-public information about each other). The extent of this reduction in buyback volume during the look-back period will depend upon how long the merger negotiations went on and whether the business combination was announced early or late in the month.

As discussed above, most repurchases of the acquiror's shares are completely prohibited during the Regulation M restricted period, regardless of whether they would otherwise qualify for the Rule 10b-18 safe-harbor under the look-back provisions described above.

Repurchases Outside the Safe-Harbor

Rule 10b-18 is a safe-harbor rather than a substantive prohibition on share repurchases. Accordingly, there may be circumstances in which the parties to a business combination decide, for valid business reasons, to repurchase shares of either or both of the merging companies during the Rule 10b-18 merger exclusion period.

As a general matter, companies wishing to make open market share repurchases during the Rule 10b-18 merger exclusion period (in addition to any repurchases permitted by the look-back rules) might consider the following guidelines:

- The intention to make such repurchases should be publicly announced either at the time the business combination is announced or before the buyback program is commenced. In addition, a prudent practice would be to make regular public announcements, via press releases, disclosing the number of shares repurchased and the average repurchase price or range of repurchase prices. For example, in connection with purchases made by Manulife Financial Corporation following the announcement of its merger with John Hancock, Manulife reported on its open market purchase activities through press releases issued on a daily basis after the market close.
- The proxy statement (or in the case of an exchange offer, the offer to purchase) sent to shareholders should disclose aggregate price and volume information with respect to open market share purchases that were made after public announcement of the proposed business combination and prior to mailing of the proxy statement or offer to purchase.¹⁴

¹⁴ On November 4, 2004, Wachovia Corporation settled, without admitting or denying the allegations, a civil action brought by the SEC with respect to Wachovia's open market purchases of First Union stock during the 2001 SunTrust takeover battle. The SEC's complaint alleged that the failure by Wachovia and First Union to disclose in their Securities Exchange Act filings and joint merger proxy statement material information regarding the share purchases made after announcement of the proposed Wachovia/First Union merger violated Sections 13(a) and 14(a) of the Securities Exchange Act. The disclosure omissions alleged by the SEC included: failure to disclose that Wachovia had received internal approval to purchase First Union shares (although Wachovia did state in its Form 10-Q report that it intended to buy more First Union shares); the size of the proposed repurchase program; and the total number of First Union shares that Wachovia actually purchased prior to the mailing of the merger proxy statement.

Effective in 2004, the SEC added Item 703 to Regulation S-K, which requires disclosure in Form 10-Q and Form 10-K reports of certain information regarding share repurchases and repurchase programs by an issuer and its "affiliated purchasers," as defined in Rule 10b-18. The registration statement form for

Footnote continued

- Even though the repurchases will not be eligible for the Rule 10b-18 safe-harbor, to the extent feasible, the repurchases should be made in accordance with the procedural requirements of Rule 10b-18 (timing, price and volume limits, use of single broker, etc.) in order to minimize the market effect of the repurchases.
- The business purpose for the repurchases (e.g., providing additional market liquidity to counterbalance flowback pressures in a cross-border acquisition) should be documented in accordance with proper corporate procedures.

Public Disclosure of Future Share Repurchases

In some recent transactions, including Bank of America's 2003 acquisition of Fleet, JPMorgan Chase's 2004 merger with Bank One and Procter & Gamble's recently announced proposed merger with Gillette, the merging companies announced significant share buyback plans that would extend beyond completion of the merger. Announcement of such plans should not be considered a bid for or solicitation of offers to sell the shares of the merging companies for purposes of either Rule 10b-18 or Regulation M.¹⁵

Additional Legal Considerations

Rule 10b-5

Regardless of whether a particular transaction falls within the Rule 10b-18 safe-harbor, any company engaging in repurchase activities must comply with the other applicable provisions of the federal securities laws, including Rule 10b-5. Rule 10b-5 prohibits purchases of stock by a person in possession of material non-public information. Accordingly, no party engaged in a business combination transaction should commence any share repurchase program until there is adequate public information available regarding the terms of the proposed business combination and its effect on the financial condition and operations of the issuer of the stock to be purchased and the combined company, to the extent material.

Some issuers have expanded their press releases and other disclosure materials issued in connection with their merger announcement in order to accelerate the dissemination of non-public information necessary to permit market purchases of their common stock. In light of the extent of the disclosures required by the SEC in connection with stock merger transactions, however, other issuers have found it impractical to accelerate those disclosures and have

business combinations (Form S-4) does not, however, specify that Item 703 disclosure must be included in the disclosure document sent to shareholders.

¹⁵ For example, in Question 25 of the 2004 FAQs, the SEC noted that "disclosure and announcement of a repurchase program would not necessarily cause subsequent purchases to be considered solicited" for purposes of the one-broker rule.

instead continued to defer those disclosures until the filing of the proxy statement for the transaction.

The assessment of whether a party is in possession of material non-public information is dependent on the facts and circumstances of the particular case. However, in the context of purchases made during a pending business combination, the following cautionary principles should be kept in mind:

- In light of the heightened investor and regulatory scrutiny and fluid circumstances that often accompany such a transaction (including the possibility of unexpected developments), materiality judgments made by a party to the transaction may be subject to a greater than normal risk of criticism or challenge by third parties;
- Any materiality assessment that is ultimately challenged will be done so by those with the benefit of hindsight; and
- Given the cooperative relationship between the parties to such a transaction, knowledge of information possessed by one party might be attributed to the other party.

Hart-Scott-Rodino/Other Regulatory Considerations

Depending on the facts and circumstances of the particular transaction, a party's purchases of stock of its business combination partner would likely be limited to \$50 million until the Hart-Scott-Rodino waiting period has terminated or expired.¹⁶ Similarly, in the case of purchases of shares of a company subject to a regulatory scheme requiring prior regulatory approval for share acquisitions in excess of specified limits (e.g., banking, insurance and utility companies), any purchases must also comply with the limits imposed by those regulations.

State Antitakeover Laws

Many antitakeover statutes, including, most notably, Section 203 of the Delaware General Corporation Law, impose a variety of restrictions and conditions on business combinations and other specified transactions with significant shareholders. Although approval by the board of directors of the company whose stock is to be purchased is often sufficient to exempt the purchaser from the restrictions of those statutes, such approval must generally be given in advance of the purchaser reaching the relevant statutory ownership threshold. Because board resolutions approving a business combination transaction typically

¹⁶ We are aware of at least one instance in which a merger partner was permitted to rely on Hart-Scott-Rodino's ordinary course investment exception to make purchases in excess of \$50 million prior to expiration of the waiting period. However, in light of subsequent antitrust guidance making that exemption unavailable for investments in competitor companies, it is unlikely that such an approach would be feasible in most future transactions.

would not cover open market share purchases by the other party, before commencing a substantial purchase of stock of a business combination partner, the purchaser should obtain any additional board approvals necessary to neutralize applicable antitakeover statutes.

Contractual Restrictions

Finally, various common contractual restrictions may prohibit a party to a business combination from purchasing its own shares or shares of its business combination partner absent consent of the other party. For instance, interim operating covenants in merger or similar transaction agreements often prohibit parties from repurchasing their own stock or making investments in other entities beyond specified amounts. Standstill provisions routinely contained in confidentiality agreements between the parties may also prohibit them from purchasing each other's shares without consent. Shareholders' rights plans may also contain provisions prohibiting substantial acquisitions of stock absent amendment of the plan. Accordingly, prior to making any purchases, a party should review all relevant contracts and obtain any necessary consents or amendments required by those contracts.

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This memorandum is for general information purposes only and should not be regarded as legal advice. Any questions concerning this memorandum may be directed to Lee Meyerson (212-455-3675, lmeyerson@stblaw.com), John Finley (212-455-2583, jfinley@stblaw.com) or Maripat Alpuche (212-455-3971, malpuche@stblaw.com). If you did not receive this memorandum by e-mail and would like to receive this or future memoranda by e-mail, please provide your e-mail address to Sue Bussy (sbussy@stblaw.com).

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Rule 10b-18 Safe Harbor

Rule 10b-18 under the Securities Exchange Act of 1934 provides a safe harbor from certain claims of market manipulation in connection with issuer repurchases of stock (including purchases by an issuer's "affiliated purchasers")¹⁷. Following is a summary of the volume, price and timing limitations and manner of purchase restrictions specified in Rule 10b-18. These limitations and restrictions should be followed by any broker or dealer making purchases on behalf of a company of its stock regardless of whether such purchases are solicited or unsolicited or whether they are effected on or off a securities exchange. We would recommend entering into a short letter agreement with any dealer retained for this purpose expressly requiring the dealer to comply with Rule 10b-18 since the SEC takes the position that failure by the dealer to comply with any of the Rule 10b-18 conditions deprives the issuer of the Rule 10b-18 safe-harbor.

A. Price Limitations

The price paid by the company (and its affiliated purchasers) cannot exceed the highest independent bid or the last independent transaction price, whichever is higher, quoted or reported in the consolidated transaction reporting system. Most stocks listed on the New York Stock Exchange or the Nasdaq Stock Market are reported in a consolidated system and therefore the rest of this Annex discusses only the rules for stocks that are reported in a consolidated system.

B. Time Limits

No bids or purchases may be made (i) until after the opening purchase reported in the consolidated system, and (ii) within the last ten minutes of trading in the principal market for the securities or on the exchange on which the purchases are to be made.

Purchases during after-hours trading are also permitted. Purchases may be effected after the close of the primary trading session until the termination of the period in which last sale prices are reported in the consolidated system so long as:

- the purchases are effected at prices that do not exceed the lower of the closing price of the primary trading session in the principal market and any lower bids or sale prices subsequently reported in the consolidated system;
- the company (and an affiliated purchaser) complies with the other conditions of the safe harbor: price; the use of only one broker or dealer (although the one broker or dealer used for after-hours trading may be different from the

¹⁷ An "affiliated purchaser" is (1) a person acting, directly or indirectly, in concert with the issuer for the purpose of acquiring the issuer's securities, or (2) an affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer, or whose purchases are under common control with those of the issuer.

one used during the primary trading session); and volume (which would include all the shares purchased during the regular trading session); and

- the company's (or an affiliated purchaser's) purchase is not the opening transaction of the session following the close of the primary trading session.

C. One Broker Rule

Bids and purchases, including block bids or purchases, on any one day must be handled by only one broker or, if no broker is used, by one dealer. If a company (and its affiliated purchasers) retain more than one dealer to effect the stock repurchases, the company should coordinate with them to ensure that only one broker acts on any one day. A company can also effect repurchases through an electronic communications network ("ECN") or other alternate trading systems ("ATS"). The company, however, cannot use both an ECN or other ATS directly and a non-ECN or other non-ATS broker-dealer on any single day. Additionally, if a company chooses to use a non-ECN or other non-ATS broker-dealer to conduct all of its repurchases on a particular day, that broker-dealer can access an ECN or other ATS on behalf of the company on that day.

D. Volume Limitations

The number of shares of stock purchased on any single day by the company (and its affiliated purchasers) in reliance upon the Rule 10b-18 safe harbor cannot exceed 25% of the average daily trading volume ("ADTV") in such shares for the four calendar weeks preceding the week in which the 10b-18 purchases take place. A company (or an affiliated purchaser) is allowed, however, to make one "block" purchase (see definition of "block" below) per week in excess of the 25% volume limitation, provided that the company (or its affiliated purchaser) does not make any other Rule 10b-18 purchases on that day and provided that such purchase is not included in calculating the stock's ADTV.

To the extent that the merger exclusion is applicable, the total amount of the company's (or affiliated purchaser's) repurchases effected on any single day may not exceed the lesser of 25% of the security's four-week ADTV or the company's average daily purchases during the three full calendar months preceding the date of the announcement of the merger or acquisition. The company (or affiliated purchaser) may effect one block purchase per week as described in the preceding paragraph provided that the company (and affiliated purchaser) does not exceed the average size and frequency of block purchases effected during the three full calendar months preceding the date of the announcement of the merger or acquisition.

E. Definition of "Block"

A "block" is defined as a quantity of stock that meets one of the following tests:

- has a purchase price (exclusive of commissions, mark-ups or similar items) of \$200,000 or more;
- is at least 5,000 shares and has a purchase price (exclusive of commissions, mark-ups or similar items) of at least \$50,000; or

- is at least 20 round lots and totals 150% or more of the average daily trading volume (excluding a company's block purchases) on the composite tape over the preceding four calendar weeks or, if volume data is not available, is at least 20 round lots and totals at least one tenth of one percent of the outstanding shares exclusive of shares held by affiliates; provided, however, that a block shall not include any shares that (i) a broker or dealer, acting as principal, has accumulated for the purpose of selling to the company (or any affiliate) or (ii) a broker or dealer has sold short to the company (or any affiliate) if, in either case, the company knows or has reason to know of the broker or dealer's purpose in accumulating the shares or that the sale was a short sale. If there is any question with respect to these matters, appropriate written representations should be obtained from the broker or dealer in question.

F. Rule 10b-18 Alternative Conditions

A company (and its affiliated purchasers) may purchase more of its stock within the safe harbor during the trading session following the termination of a market-wide trading suspension. A market-wide trading suspension is defined as a market-wide trading halt of 30 minutes or more that is: (i) imposed pursuant to the rules of a national securities exchange or a national securities association in response to a market-wide decline during a single trading session, or (ii) declared by the SEC pursuant to its authority under Sections 12(k) or 36 of the Securities Exchange Act. In the event that a market-wide trading suspension occurs, the 25% ADTV volume limitation applicable to purchases made in reliance upon Rule 10b-18 increases to 100% of ADTV.

G. Riskless Principal Transactions

Rule 10b-18 clarifies how purchases undertaken by a broker or dealer on behalf of a company can qualify under the safe harbor. This was done in order to address concerns whether both "legs" of these transactions (namely the broker-dealer's purchase in the market for its own account and the company's purchase of the shares from the broker-dealer) could qualify. Both legs can qualify for the safe harbor so long as the trade qualifies as a "riskless principal transaction" in which:

- a broker or dealer, after having received an order from the company to buy the shares, buys the shares as principal in the market at the same price to satisfy the company's buy order;
- the company's purchase is effected at the same price per share at which the broker or dealer bought the shares to satisfy the company's buy order, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee; and
- only the first part of the transaction (the purchase by the broker or dealer in the market as principal) rather than the second part of the transaction (the sale of the shares by the broker or dealer to the issuer) is reported under the rules of a self-regulatory organization or under the Securities Exchange Act.

In addition, to qualify as a “riskless principal transaction”:

- the broker or dealer must have written policies and procedures in place to assure that, at a minimum, the company’s buy order was received prior to the offsetting transaction;
- the offsetting transaction is allocated to a riskless principal account or the company’s account within 60 seconds of the execution; and
- the broker or dealer has supervisory systems in place to produce records that enable the broker or dealer to accurately and readily reconstruct, in a time-sequenced manner, all orders effected on a riskless principal basis.

ANNEX B

SHARE PURCHASES IN CONNECTION WITH A BUSINESS COMBINATION

The chart below reflects a stock acquisition effected by means of a statutory merger. It does not include any Hart-Scott-Rodino or other regulatory limitations on share purchases that may be applicable. Availability of the Rule 10b-18 safe-harbor would also depend upon the volume of share repurchases during the three-month look-back period, which is not included in the chart below.

Time Period	Purchases Permitted?	Rule 10b-18 Safe-Harbor Available?
Prior to announcement	Prudential limitations depending upon status/stage of negotiations and extent of exchanges of nonpublic information	Yes
After announcement and prior to mailing of merger proxy statement	Prudential limitations depending upon adequacy of public information regarding the transaction	No
After mailing of merger proxy statement and prior to shareholder meeting(s)	Regulation M prohibits purchases of acquiror stock Purchases of target stock are generally permitted	No
After shareholder meeting(s)	Yes, after the target shareholder meeting (regardless of whether the acquiror has a meeting)	If there is a subsequent pre-closing valuation or election period – no If there is no subsequent pre-closing valuation or election period – yes, after the later of the two meetings
During pre-closing valuation or election period	Regulation M prohibits purchases of acquiror stock Purchases of target stock are generally permitted	No
After closing	Yes	Yes