

# PAUL, WEISS, RIFKIND, WHARTON & GARRISON

SEPTEMBER 16, 2001

## SEC TAKES EMERGENCY ACTION TO RESPOND TO MARKET DEVELOPMENTS

To our clients and friends: This update is occasioned by the tragic events of last week. We cannot, however, merely resort to business as usual and report on a regulatory response to the terrorist acts against the United States without expressing our deep sorrow for all of the individual victims of these tragic events. We mourn the victims and our thoughts are with all of the members of the families, friends and colleagues of the victims, with those that have been involved in the rescue efforts and with the survivors.

The US capital markets are expected to open tomorrow. The SEC, among others, is concerned about undue market imbalances. The SEC also recognizes that public companies and affiliated insiders can provide an important source of liquidity. To provide relief from some of the regulatory constraints on issuer and affiliate repurchases of stock during the coming week, on Friday, September 14, 2001, the SEC issued an emergency order (the "Order"). Under the Order:

- Public companies may repurchase their stock without meeting the volume and timing restrictions imposed by Rule 10b-18;
- Public companies involved in pooling-of-interest transactions may repurchase stock without adverse accounting consequences; and
- Public company officers, directors and 10% shareholders may repurchase stock of the public company without incurring liability under Section 16 in respect of matching transactions that occurred during the preceding six months.

**The Order is effective for the five business days beginning on the date of the first reopening of trading on the US equities and option markets.**

On the same day, the SEC also issued an interpretive release to the effect that, under the auditor independence rules, an accounting firm's independence will not be deemed to be impaired where a firm provides bookkeeping services to entities directly affected by the

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destruction to the World Trade Center and surrounding buildings. Accounting firms, however, may not undertake managerial actions or decisions for their audit clients.

In a related development, we understand that the FASB's Emerging Issues Task Force will be considering at a meeting on September 20<sup>th</sup> EITF Issue No. 01-10 "Accounting for the Impact of the September 11, 2001 Terrorist Acts," which will address loss recognition, income statement clarification and financial statement disclosure issues. These issues will include what costs should be included in the loss, when the loss should be recognized, how the loss should be classified and what additional financial statement disclosure will be appropriate.

**Rule 10b-18.** Public company issuers may repurchase their stock without incurring liability under the market manipulation rules (Section 9(a)(2) and Rule 10b-5) of the Securities Exchange Act of 1934 if their purchases meet the terms and conditions of the safe harbor available under Rule 10b-18. Our general firm memorandum on Rule 10b-18 purchases is attached as Annex I. Under the Order, issuers and affiliated purchasers will be deemed to have complied with the safe harbor, provided all of its terms and conditions are met, with the exception that, during the period covered by the Order:

- the timing condition may be satisfied without regard to whether the purchase constitutes the opening transaction or whether any such purchase occurs during the last half hour of trading; and
- the volume condition may be satisfied if all Rule 10b-18 purchases, other than block purchases, in an aggregate amount on that day from or through a broker or dealer, effected by or for the issuer or an affiliated purchaser, do not exceed 100% of the trading volume (determined on the basis of the 4 calendar weeks preceding the week beginning September 10, 2001). The limit is normally 25%.

The SEC reminded issuers that under Regulation M, as a technical matter, issuers will need to consider whether there are sales being made by affiliates under shelf registration statements and, if so, whether they amount to distributions.

**APB 16.** Under the pooling-of-interest provisions in Accounting Principles Board Opinion 16, "Business Combinations," share repurchases can have adverse accounting consequences. Repurchases covered by the Order will not affect the availability of pooling-of-interest accounting. This provides relief for those registrants that had transactions pending at the pooling cut-off date (June 30, 2001) or that completed such transactions and are subject to post-closing restrictions on repurchases.

**Section 16.** Section 16 imposes liability for purchases and sales, or sales and purchases, within six months on officers, directors and 10% shareholders of a public company. The Order removes from the scope of liability, for insiders that have matchable sales in the past six months, purchases that are effected during the period covered by the Order. Such purchases will not be matched with sales during the preceding six months. Purchases must nonetheless be reported on Form 4s. The Form 4 should use transaction code "j" and the transaction should be described in a footnote with a specific reference to the Order ("Emergency Order Pursuant to Section 12(k)(2) of the Securities Exchange Act of 1934 Taking Temporary Action to Respond to Market Developments"). Presumably the Order will not exempt insiders that made purchases

under the Order from liability for sales made in the six months following the period covered by the Order.

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Public companies and their affiliates must continue to consider the other constraints, and must comply with all of the other regulatory limitations, on repurchases. These are summarized on Annex I. For example, although the SEC recognized in the preamble to its Order that public companies and their affiliates may find themselves in blackout periods, or outside window periods, under their insider trading policies and stated that failure to comply with the timing policies should not be viewed in and of itself as a violation of antifraud rules, the antifraud provisions nonetheless remain in effect.

The foregoing is a summary of the regulatory steps taken on Friday to ease the burdens on the companies affected by the tragic events of last week and on the global securities markets. This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. Questions concerning this memorandum may be addressed to any members of the Paul Weiss Securities Group, including:

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## Annex I

**STOCK REPURCHASES: REGULATORY AND LEGAL CONSIDERATIONS**

The following memorandum describes certain legal considerations relevant to repurchases by a public company (the “Company”) of its outstanding common stock (the “Common Stock”). The following is only a summary of the material legal issues that the Company should consider when contemplating repurchases of its Common Stock.

**I. Stock Purchases Must Not Be Effected for the Purpose of Manipulating Stock Prices**

Section 9(a)(2) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), makes it unlawful for any person, directly or indirectly, to effect “a series of transactions in any security registered on a national securities exchange creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others.”

Because issuers and their affiliates may wish to purchase shares of their own stock for valid business purposes and not to manipulate the market price of such stock, in 1982 the Securities and Exchange Commission (the “SEC”) adopted Rule 10b-18, which provides a “safe harbor” exemption from the provisions of Section 9(a)(2) under the Exchange Act. Complying with Rule 10b-18 protects issuers from claims based solely upon the time or price at which an issuer or its affiliate bids for or purchases stock of such issuer, the amounts of any such purchases and the number of brokers or dealers used to effect such purchases.

Complying with the requirements of Rule 10b-18, however, does not insulate the Company from the general applicability of Section 9(a)(2) and Rule 10b-5 under the Exchange Act. Therefore, the Company should proceed with a stock repurchase program only if it is not in possession of material non-public information. (See Part II, below)

To take advantage of the safe harbor of Rule 10b-18, all of the following conditions must be met:

**Single Broker-Dealer Limitation.** Solicited purchases of Common Stock must be made, and all bids must be effected, from or through only one broker or dealer on any day. Where Rule 10b-18 purchases or bids are made by or on behalf of the Company and one or more of its affiliated purchasers (or more than one affiliated purchaser of the Company) on a single day, the single broker/dealer condition applies to all such bids and purchases in the aggregate. Unsolicited purchases and bids may be made through any number of broker-dealers.

**Time of Purchases.** Purchases may not be made (i) until after a purchase or sale of the Common Stock has occurred on any given day and (ii) during the last half hour before the scheduled close of trading on the principal market or exchange on which the transaction is to be effected. If the transaction is to be effected over the counter (including on the Nasdaq National Market), it must be made more than one half hour before the termination of the period in which

the last sale prices are reported in the consolidated transaction reporting system. **[Modified by the SEC Order.]**

Price of Purchase. Purchases must be made at a price that does not exceed the higher of (i) the last independent sale price reported in the consolidated transaction reporting system or on a national securities exchange, or (ii) the highest independent published bid, regardless of the market reporting such figure.

Volume of Purchases. The Company or an affiliated purchaser may purchase on any one day an aggregate amount that, when added to the amounts of all other Rule 10b-18 purchases on that date, does not exceed the greater of (i) one round lot (100 shares), or (ii) the number of round lots closest to 25% of the average daily trading volume over the previous four calendar weeks (excluding any purchase of a “block” by or for the Company or any affiliated purchaser under the Rule). In addition to the limitation set forth in the preceding sentence, the Company may purchase an unlimited number of “blocks” of its stock (although the time and price requirements described above continue to apply). For these purposes, a “block” means a quantity of stock that either (i) has an aggregate purchase price of at least \$50,000 and, if the aggregate purchase price is less than \$200,000, is a number of shares that is at least 5,000 or (ii) at least 20 round lots that total 150% or more of the average daily trading volume over the previous four calendar weeks. However, a block does not include any amount that a broker or dealer, acting as principal, has accumulated for the purpose of sale or resale to the Company or to any affiliated purchaser of the Company if the Company or such affiliated purchaser knows or has reason to know that such amount was accumulated for such purpose. **[Modified by the SEC Order.]**

Because Rule 10b-18 is only intended as a “safe harbor,” it is not necessary that all stock repurchases be effected in accordance with its conditions. The Rule makes clear that the mere failure to comply with its conditions will not give rise to a presumption that a violation of either Section 9(a)(2) or Rule 10b-5 has occurred. Nevertheless, the Company should make every effort to comply with all the requirements of the Rule and should weigh carefully the option of not proceeding with a stock repurchase program if these conditions cannot be met.

## **II. The Company Should Proceed With a Stock Repurchase Program Only if it is Not in Possession of Material Non-Public Information**

Notwithstanding compliance with Rule 10b-18, in effecting stock repurchases the Company must always ensure that all material information concerning the Company has been disclosed. Consideration should be given to the timeliness of disclosure of material information, including quarterly earnings information and information concerning any pending extraordinary transaction or corporate development. If the Company has no reason to believe that quarterly results will be outside the range previously disclosed or the range of expectations as indicated by published estimates of the Company or securities analysts (where such estimates exist), then no public disclosure regarding such information is required. If, however, the Company has previously made a projection or estimate of its quarterly earnings that it now has reason to believe is incorrect, corrective disclosure should be made prior to commencing any stock purchases.

Where disclosure is required, time must be allowed for the dissemination of the announcement prior to commencing purchases. The amount of time allowed for dissemination

should be “reasonable,” although what is reasonable will depend upon the circumstances. If there are unsettled conditions in the markets, the Company should anticipate delay in the publication of news releases by Dow Jones and the other wire services.

### **III. Regulation M Considerations**

Regulation M under the Exchange Act, promulgated by the SEC in late 1996, supersedes prior Rules 10b-6, 10b-7 and 10b-8. Among other things, Regulation M generally prohibits those persons who participate in a distribution of securities (including issuers and underwriters and their “affiliated purchasers”) from bidding for or purchasing or inducing others to purchase the security being distributed until they have completed their participation in the distribution, unless the activity is subject to an exception or exemption. For purposes of Regulation M, the term “distribution” means an offering of securities, whether or not subject to registration under the Securities Act of 1933, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.

In order to avoid a violation of Regulation M during a distribution of Common Stock (either in a public offering or a merger or other acquisition), the Company may not make stock repurchases during the “restricted period” except under certain limited circumstances. For the Company, the restricted period means: for companies with an average daily trading volume of \$100,000 or more or a public float of \$25 million or more: the period beginning on the business day prior to the pricing of an offering (or, in the case of a merger or other acquisition, the date the proxy solicitation or offering materials are first disseminated) and ending on the completion of the distribution, and for all others: the period beginning on the later of five business days prior to the pricing of an offering or such time that a person becomes a distribution participant (or, in the case of a merger or other acquisition, the date the proxy solicitation or offering materials are first disseminated) and ending on the completion of the distribution.<sup>1/</sup> In addition, during the restricted period the safe harbor for repurchases under Rule 10b-18 is not available.

### **IV. Accounting Considerations**

Under certain circumstances, repurchases of Common Stock by the Company may limit its ability to use “pooling” accounting for future acquisitions or other business combinations. Before commencing any stock repurchase program, the Company may want to discuss this issue with its accountants. **[Modified by SEC Order.]**

### **V. Stock Purchases Should Be Authorized by Board Action**

Management should have Board authorization prior to effecting any purchases of its stock (draft board resolutions are attached hereto as Appendix A for your reference). This approval may be given by the full Board of Directors or by the duly authorized Executive Committee of the Board of Directors.

### **VI. Public Announcement of a Stock Purchase Program Should Ordinarily Be Made Prior to Commencing Purchases**

A public announcement of the Company's intention to purchase its own stock should be made prior to the purchase of any material amount of stock (a draft of an appropriate press release is attached hereto as Appendix B for your reference). The question of what is a "material amount of stock" for an issuer will depend upon the number of shares it has outstanding, the amount of stock in its public "float" and the average daily trading volume of its stock. An amount of stock exceeding 5% of the outstanding shares of the Company should presumptively be deemed material. No public announcement is required in connection with the purchase of an immaterial amount of stock.

## **VII. Special Considerations Apply in a Situation Where the Company's Stock Repurchases Could Result in it "Going Private"**

In a few cases, stock purchases by the Company could have the effect, directly or indirectly, of causing a class of equity securities to be held of record by fewer than 300 persons or to be delisted from a national securities exchange or removed from quotation on Nasdaq. If there is a reasonable likelihood of this occurring, or if the Company has as one of its objectives in effecting a stock repurchase program one of these effects, stock repurchases may only be effected in compliance with Rule 13e-3 under the Exchange Act. Rule 13e-3 sets forth extensive requirements concerning the disclosure, filing and dissemination of information relating to a proposed "Rule 13e-3 transaction," which, as a practical matter, are likely to make implementation of an ordinary stock repurchase program impracticable.

## **VIII. The Company Must Comply With Applicable Listing Rules**

The rules of the major exchanges have criteria that must be satisfied for the continued listing of the Common Stock. These criteria include minimum numbers of shareholders, minimum average weekly trading volume, minimum numbers of publicly held shares and minimum aggregate market value of publicly held shares. After giving effect to any stock repurchase, the Company must ensure that it is still in compliance with these criteria.

## **IX. The Company Must Comply with Corporate Law on Stock Repurchases**

For example, Section 160(a) of the Delaware General Corporation Law (the "DGCL") prohibits a corporation from purchasing its own stock for cash or other property when doing so would cause "impairment of its capital." Delaware courts have interpreted this Section to mean that a corporation may use only its surplus for the purchase of its own capital stock.

Further, a corporation's purpose pursuant to which it purchases its own stock may be subject to judicial review in Delaware. Delaware courts have held that a corporation cannot purchase its own stock when its only purpose is to perpetuate control by a dominant shareholder or by a director and when there is no showing of any real threat to corporate policy. On the other hand, directors have not been held liable for having a corporation buy blocks of its own shares at premium prices to fend off a purchase by an outsider that they believed posed a threat to the corporation's continued existence.