

September 22, 2008

Emergency SEC Orders Concerning Short Sales

SEC Takes Temporary Action to Prohibit Most Short Sales in Publicly Traded Shares of Certain Financial Firms and to Require Certain Institutional Investment Managers to Report Information Concerning Daily Short Sales

SUMMARY

On September 18, 2008, the Securities and Exchange Commission ("SEC") issued three emergency orders responding to recent market developments. One prohibits most short sales in the publicly traded shares of certain financial firms. The second requires certain institutional investment managers to report information concerning daily short sales. Each of these orders was amended on September 21, 2008. The third order, which we have discussed in a separate publication, eases the timing and volume conditions of the safe harbor provisions of Exchange Act Rule 10b-18 to allow publicly traded companies greater flexibility to repurchase their own securities.

BACKGROUND

In the two short sale orders issued on September 18, the SEC explained that it was aware of the continued potential of sudden and excessive fluctuations of securities prices and disruption in the functioning of the securities markets that could threaten fair and orderly markets. The SEC stated that it was concerned about the possible unnecessary or artificial price movements based on unfounded rumors regarding the stability of financial institutions and other issuers exacerbated by short selling. These two orders were issued to address those concerns.

SHORT SALE PROHIBITION

The first emergency order relating to short sales¹ (the “Prohibition Order”) prohibits all persons (with limited exceptions) from short selling any publicly traded securities of approximately 800 financial firms specified in an appendix to the order. For purposes of the order, “short sale” has the same meaning as in Rule 200(a) of Regulation SHO, and the requirements for marking orders “long” or “short” are the same as provided in Regulation SHO. It should be noted that the order prohibits all short selling, and not merely naked short selling.

On September 21, 2008, the SEC issued an amendment to the order which, among other things, delegated to the national securities exchanges authority to determine which of their listed financial firms should be covered by the prohibition (the “Amended Prohibition Order”).² The SEC stated that it expects each national securities exchange to immediately publish a list, on its internet Website, of individual listed financial institutions that will be covered by the order’s prohibition on short sales. The common equity securities of covered financial firms are referred to in the Amended Prohibition Order as “Covered Securities.” The SEC expects the exchanges’ lists to cover banks, savings associations, broker-dealers, investment advisers and insurance companies, whether domestic or foreign, and the owners of any of those entities. To the extent an issuer chooses not to be covered by the order’s prohibition on short sales, the applicable national securities exchange may exclude that issuer from its list of Covered Securities. The New York Stock Exchange, Nasdaq and The American Stock Exchange have published their lists of Covered Securities, which include additions to the SEC’s original list. Those lists may be found at the following internet locations:

- http://www.nyse.com/about/listed/1222078675703.html?sa_campaign=/internal_ads/callouts/09222008seclist
- <http://www.nasdaqtrader.com/TraderNews.aspx?id=RA2008-021>
- <http://www.amex.com/amextrader/?href=/amextrader/tdrInfo/data/axNotices/2008/reg08040.html>

The Prohibition Order, which was effective immediately upon issuance, provides three exceptions from the prohibition. The first is for registered market makers, block positioners or other market makers obligated to quote in the over-the-counter market, in each case that are selling short a Covered Security as part of bona fide market making in such security.

The second exception (as amended by the Amended Prohibition Order) is for any person that effects a short sale in any Covered Security as a result of automatic exercise or assignment of an equity option, or

¹ SEC Release No. 34-58592 (Sept. 18, 2008).

² SEC Release No. 34-58611 (Sept. 21, 2008).

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in connection with settlement of a futures contract, that is held prior to effectiveness of the Prohibition Order due to expiration of the option or futures contract.

The third exception was originally intended to facilitate the expiration of options on September 20th and was due to terminate on September 19th. As amended, this exception now applies to all market makers, including over-the-counter market makers, that effect a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in (i) derivative securities based on Covered Securities and (ii) exchange traded funds and exchange traded notes of which Covered Securities are a component. This accommodation is intended to permit market makers to continue to provide liquidity to the markets. However, to help ensure that this hedging exception does not result in increased short exposure in Covered Securities, the exception is not available in connection with a customer or counterparty position in a derivative security based on a Covered Security established after 12:01 a.m. EDT on September 22, 2008 if the market maker knows that the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing an economic net short position (i.e., through actual positions, derivatives, or otherwise) in the issued share capital of a firm covered by the order. The Amended Prohibition Order further requires any market maker relying on this exception to publish, as soon as operationally practicable, a notice on its internet Website that, pursuant to the order, the market maker may not knowingly effect a short sale as part of bona fide market making and hedging activity related directly to bona fide market making in a derivative security based on a Covered Security, if the customer's or counterparty's transaction will result in the customer or counterparty establishing or increasing an economic net short position (through actual positions, derivatives or otherwise) in the issued share capital of a firm covered by the order.

The Amended Prohibition Order adds a clarification that the order does not apply to persons that effect sales of Covered Securities pursuant to the exemption from registration in Rule 144 under the Securities Act of 1933. The SEC considers this accommodation necessary because, in its words, "sales of Rule 144 Securities are sales of owned securities."

The order is scheduled to terminate at 11:59 p.m. EDT on October 2, 2008, unless further extended by the SEC. By law, the SEC may extend an emergency order upon a showing that the emergency still exists, up to 30 calendar days.

SHORT SALE REPORTING

The second emergency order relating to short sales (the "Reporting Order"), requires certain institutional investment managers to report information concerning daily short sales of securities.³ The Reporting Order adopts terms and definitions from section 13(f) of the Exchange Act and Rule 13f-1 as the basis for

³ SEC Release No. 34-58591 (Sept. 18, 2008).

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the new disclosure requirements. The Reporting Order requires that an institutional investment manager that exercises investment discretion with respect to accounts holding section 13(f) securities,⁴ and that filed or was required to file a Form 13F for the calendar quarter ended June 30, 2008,⁵ must file new Form SH with the SEC on the first business day of every calendar week immediately following a week in which it effected any short sales with respect to a section 13(f) security that is not an option. The forms must be filed electronically on the EDGAR system but the September 21 amendment to the order provides that the filings will not be public for a period of two weeks following filing.

With respect to each section 13(f) security that is not an option, the Form SH filing must report the following information for each calendar day of the prior week in which the institutional investment manager effected short sales of that security:

- The number and value of the securities sold short during the day;
- The opening short position;
- The closing short position;
- The largest intraday short position; and
- The time of the largest intraday short position.

An institutional investment manager is not required to report short positions otherwise reportable if both of the following conditions apply: (i) the short position constitutes less than 0.25% of the class of the issuer's section 13(f) securities issued and outstanding as reported on the issuer's most recent annual or quarterly report, and any subsequent current report filed with the SEC, unless the manager knows or has reason to believe the information contained in such report is inaccurate; and (ii) the fair market value of the short position in the section 13(f) securities is less than \$1,000,000.

The Reporting Order was amended by the SEC on September 21, 2008.⁶ The amendment provides that the information electronically filed on Form SH will not be made public for a period of two weeks following filing. At the end of the two-week period the information will be made public. The SEC stated in the September 21 release that the reasons for maintaining the information as non-public, which included avoiding market disruption, will have diminished by the end of the two-week period.

⁴ Defined in Rule 13f-1(c) as equity securities of a class described in section 13(d)(1) of the Exchange Act that are admitted to trading on a national securities exchange or quoted on the automated quotation system of a registered securities association. The SEC maintains a list of section 13(f) securities; the current list may be found on the SEC Website at: <http://www.sec.gov/divisions/investment/13f/13f1ist2008q2.pdf>.

⁵ The section 13(f) quarterly filing requirement applies to every institutional manager which exercises investment discretion with respect to accounts holding section 13(f) securities having an aggregate fair market value on the last trading day of any month of any calendar year of at least \$100,000,000, beginning in the following calendar year.

⁶ SEC Release No. 34-58591A (Sept. 21, 2008).

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The Reporting Order is effective at 12:01 a.m. EDT on September 22, 2008, the first Form SH is required to be filed on September 29, 2008, and the order is scheduled to terminate at 11:59 p.m. on October 2, 2008, unless further extended by the SEC. As discussed above, the order may be extended up to 30 calendar days. Form SH and instructions to Form SH are available on the SEC Website.⁷

For a discussion of the SEC emergency order on issuer repurchases, please ask for our publication entitled "Temporary Emergency Order Eases Timing and Volume Conditions of Exchange Act Rule 10b-18".

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⁷ www.sec.gov/about/forms/formsh.pdf and www.sec.gov/about/forms/formsh_instructions.pdf.

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