Memorandum
To Our Friends and Clients

EU Market Abuse Rules

Introduction
To harmonize existing European legal frameworks and improve investor confidence, the European Parliament, Council and Commission enacted, from January 28, 2003 to April 29, 2004, four directives and a regulation on insider trading and market manipulation (collectively, the “Directive”).

Prior to its enactment, no common provisions against market manipulation existed at the European level, except for a directive that confined itself to the misuse of privileged information. At Member State level, legal requirements differed greatly across jurisdictions. The Directive achieves a high degree of harmonization in defining targeted behaviors and preventive measures.

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All Member States of the European Union were required to have implemented the Directive by October 12, 2004. At present, only Germany and Austria have transposed the Directive into national law. Nonetheless, certain provisions of the Directive may be granted “direct effect” as of October 12, 2004 under case law developed by the European Court of Justice.3

Scope of the Market Abuse Rules

As a general rule, the Directive applies to any securities admitted to trading on a regulated market in at least one Member State, regardless of whether the transaction itself actually takes place on that market.4 This effectively extends the scope of the Directive to market abuse occurring on unregulated markets, trading platforms or off-market transactions, as long as the abuse involves a security admitted to trading on a regulated market.5

In addition, each Member State must apply the Directive’s prohibitions and requirements to “actions carried out in its territory or abroad concerning financial instruments admitted to trading on a regulated market situated or operating within its territory”6 (emphasis added). The European Commission stated in its commentaries to the draft Directive that Member States should be allowed to apply the Directive extraterritorially where “only elements” of the market abuse occur within their territory.7

In effect, this allows Member States to apply the market abuse rules to securities transactions taking place outside the European Union so long as the market abuse concerns securities admitted to trading on a regulated market in their state. This would mean, for example, that Belgium could apply the Directive to the actions of a US person trading in shares of a company listed on the New York Stock Exchange, if the company’s securities are also admitted to trading on EuroNext Brussels.

In its public commentaries to the draft Directive, the International Swaps and Derivatives Association suggested that the Directive be amended so as to apply extraterritorially only with respect to insider dealings that have some more “extensive and foreseeable nexus” with the territory of the Member State concerned and, similarly, that market manipulation...

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3 See ECJ Case 41/74, Van Duyn v. Home Office, ECR 1337, 1 CMLR 1, and its progeny.
4 Article 9 of the Market Abuse Directive.
5 Pursuant to Article 9 of the Market Abuse Directive, “securities for which a request for admission to trading has been made” are also covered by the Directive.
6 Article 10 of the Market Abuse Directive.
laws should have a “foreseeable material adverse effect on a domestic market which is a significant trading market for the financial instrument concerned.” As the Directive remains to be implemented in any Member State, it is still too early to tell whether the Member States will transpose such a broad jurisdictional mandate into national law.

Market Manipulation

The prohibition in the Directive against market manipulation is deceptively brief and simple: “Member States shall prohibit any person from engaging in market manipulation.” In defining what constitutes market abuse, the Directive identifies three broad categories of behavior: manipulation of securities prices, deceptive behavior, and dissemination of false or misleading information. The Directive also provides a non-exhaustive list of examples derived from the core definition. The definition is intended to be flexible enough to adapt to new market developments as they arise while being sufficiently specific to provide adequate guidance to market participants.

The first category of prohibited behavior concerns transactions or orders to trade (a) which give, or are likely to give, false or misleading signals as to the supply of, demand for or price of securities; or (b) for the purpose of pegging the price of securities at an abnormal or artificial level. The Directive provides an affirmative defense if the defendant can show that his reasons were legitimate and that the transactions or orders to trade conformed to accepted market practices on the regulated market concerned. The breadth of this first definition seems to encompass the various acts proscribed by Section 9(a)(1) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

The Directive's second definition prohibits “transactions or orders to trade which employ fictitious devices or any other form of deception or contrivance.” While similar in language to Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, the Directive’s definition focuses on tangible acts of the defendant, whereas the US rule

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9 Article 5 of the Market Abuse Directive.
10 Article 1(2) of the Market Abuse Directive.
11 Id.
12 Section 9(a)(1) of the Exchange Act prohibits “any person” from engaging in certain specified manipulative activities with respect to securities registered on national securities exchange for the purpose of creating a false or misleading appearance of active trading.
13 Article 1(2) of the Market Abuse Directive.
14 Exchange Act Rule 10b-5 provides that it shall be unlawful to “employ any device, scheme, or artifice to defraud, in connection with the purchase or sale of any security.”
includes a *scienter* requirement, under which the defendant’s intent to defraud is an element of the offense.

The third targeted category of behavior prohibits the dissemination of information through the media, including the Internet, or by any other means, that gives, or is likely to give, false or misleading signals concerning financial instruments, including the dissemination of rumors and false or misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading. Unlike Rule 10b-5 in the US, which provides that it is unlawful “to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,” the concept of materiality does not appear in the Directive. Instead, the Directive narrows the scope of the prohibited communication definition to include only information “likely to give false or misleading signals.”

**Insider Trading**

The Directive bars insiders from using inside information and from tipping third parties, unless in the normal course of employment or duties. The prohibition applies not only to persons who possess inside information as a result of their directorship, management function, shareholding or employment, or by way of criminal activities (“primary insiders”), but also to any other person who knows, or ought to have known, that information is inside information (“constructive insiders”).

In defining “inside information,” the Directive sets out a four-part test. The information must be: (i) precise, (ii) non-public, (iii) price-sensitive and (iv) directly or indirectly related to an issuer or to securities.

**(i) Determining whether information is of a precise nature**

Information is deemed of a “precise nature” if it (a) “indicates a set of circumstances which exists or may reasonably be expected to come into existence or an event which has occurred or may reasonably be expected to do so” and (b) “is specific enough to enable a

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15 Article 1(2) of the Market Abuse Directive.
16 Id.
17 Articles 2-4 of the Market Abuse Directive.
18 Article 1(1) of the Market Abuse Directive.
conclusion to be drawn as to the possible effect of that set of circumstances or event on the prices of financial instruments or related derivative financial instruments.”19

Key to this definition is whether the underlying event to which the information relates can reasonably be expected to occur. The Directive seeks to distinguish rumors and other unfounded suggestions from objective, even if tentative, information that can be proven to have happened or existed.20

(ii) Determining whether a piece of information is price-sensitive

Under the Directive, information is deemed to have a significant effect on price if a reasonable investor would likely use it as part of an investment decision, based on what is foreseeable at the time the information is disclosed. Under this foreseeability standard, investors are assumed to take into account all market variables likely to affect securities’ prices, such as “returns, volatilities, liquidity, price relationships among financial instruments, volume, supply, demand, order book, timing of prices and news disclosure, rules governing the exchange and market microstructure.”21

According to the CESR,22 it is not relevant whether or to what degree the price actually changes when the information eventually becomes publicly known. Nonetheless, the actual impact on prices may serve as an “indicator” for the investigation of a potential violation of the Directive.23

(iii) Inside information that relates indirectly to the issuer or financial instrument

An important aspect of the Directive’s definition of “inside information” is its extension of the insider trading and market manipulation prohibitions to inside information that relates only indirectly to an issuer or to securities.24

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19 Article 1(1) of the First Implementing Directive.
20 To illustrate, the Committee of European Securities Regulators (the “CESR”) states that the fact that an expected merger does not occur at the end of a negotiation process does not preclude the classification of such negotiations as precise information (CESR’s Advice on Level 2 Implementing Measures for the Proposed Market Abuse Directive, dated December 2002, CESR/02.089d (“CESR Advice”), p. 9, paragraph 20.
21 CESR Advice, p. 11, paragraph 25.
22 The CESR provided technical advice to the European Commission on the implementation of the Directive.
23 CESR Advice, p. 11, paragraph 26.
24 Article 1(1) of the Market Abuse Directive. This is in contrast to the prompt disclosure requirements of Article 6 of the Market Abuse Directive, which apply only to issuers and to information that directly concern them. Nevertheless, the prompt disclosure requirements of the Directive may apply to the disclosure of consequences directly concerning the issuer and resulting from information that relates indirectly to the issuer, if these consequences constitute inside information.
According to the CESR, “any information generally relevant to the market position of an issuer can be regarded as relating to that issuer.” This includes information on events that impact an issuer’s assets and liabilities, financial position, general business operations, or organizational and labor matters, as well as general information about its industry, such as political, economic or regulatory developments.

The Directive does not give any further guidance on what will constitute relevant “indirect information.” However, in its advice to the Commission, the CESR drafted the following list of examples of information that would usually concern the issuer only indirectly: “(a) data and statistics published by public institutions disseminating statistics; (b) upcoming publication of rating agencies’ reports, research, recommendations or suggestions concerning the value of listed securities; (c) central bank decisions concerning interest rates; (d) governmental decisions concerning taxation, industry regulation, debt management; (e) decisions concerning changes in the governance rules of market indices, and especially as regards their composition; (f) regulated and unregulated markets’ decisions; (g) competition and market authorities’ decisions concerning listed companies; (e) relevant orders by government bodies, regional or local authorities or other public organizations; (f) relevant orders to trade financial instruments; (g) a change in trading mode; or (h) a change of market maker or dealing conditions.”

(iv) Absence of a scienter element or breach of fiduciary duty by the insider

Under the Directive, scienter is no longer an element of the definition of insider trading. The European Commission modified the Former Insider Trading Directive’s definition of insider trading by omitting the qualifier “with full knowledge of the facts.” The European Commission stated that “by nature these insiders may have access to inside information on a daily basis and are aware of the confidential nature of the information that they receive.” Consequently, primary insiders may be found liable for the misuse of inside information, without any further evidence of their intent to misuse the information.
Furthermore, in contrast to the SEC’s insider trading provisions under Section 10b and Rule 10b-5, the Directive does not require that the insider have breached a fiduciary duty to the source of the information for liability to attach.30 In this respect, the Directive mirrors the US prohibition under Section 14(e) of the Exchange Act and Rule 14e-3 against trading on the basis of non-public information in the context of a tender offer.31

(v) Absence of a distinction between transactions effected through a “professional intermediary” and those effected directly by an investor

The Directive does not distinguish between transactions effected through a “professional intermediary” and those effected directly by an investor.32 The Former Insider Trading Directive made this distinction by barring insiders from taking advantage of inside information only when acquiring or disposing of securities through a professional intermediary, not in the case of transactions directly made by the investor. Each Member State could also provide specifically that the insider trading prohibition would not apply to acquisitions or disposals of securities effected without the involvement of a professional intermediary outside a regulated market.33

By eliminating this distinction altogether, the Directive applies to transactions effected through a “professional intermediary” and also to those effected directly between parties, so long as the securities concerned are admitted to trading on a regulated market.

Issuers’ Prompt Disclosure Duties

To reduce the window of time during which insider trading might occur, the Directive imposes on issuers a duty to disclose “inside information” to the public “as soon as possible.”34 To comply with this requirement, issuers must “promptly” inform the public of the occurrence of an event or set of circumstances that relates directly to them even if the event is not yet “formalized.”35

30 See United States v. O’Hagan, 117 S. Ct. 2199 (1997) (The “misappropriation theory” holds that a person commits fraud “in connection with” a securities transaction, and thereby violates 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information.)
31 Exchange Act, 17 CFR Part 240, Rule 14e-3 (Rule 14e-3 forbids trading while in possession of material non-public information relating to a tender offer when that information is acquired from the offeror, the target or any person acting on behalf of either, and is not used for the offeror’s benefit.
32 Article 9 of the Market Abuse Directive.
33 Article 2(3) of the Former Insider Trading Directive.
34 Article 6(1) of the Market Abuse Directive.
35 Article 2(2) of the First Implementing Directive.
In suggesting this requirement, the CESR explained that it viewed the time period between the negotiation of a contract and its completion as prone to a high risk of market abuse.\textsuperscript{36} The CESR acknowledges that, “in some cases, it is not in the company’s best interest to disclose information at an early stage of a negotiation process. However, CESR believes that these situations should be included under the exception [for delayed disclosures], because the company will then have to ensure confidentiality of the matters not disclosed.”\textsuperscript{37} As explained below, the exception in the Directive for delayed disclosure does allow issuers to delay the public disclosure of inside information if such delay is necessary to protect legitimate interests.\textsuperscript{38} Nonetheless, in order to come under the exception, the outcome or normal pattern of ongoing negotiations must be likely to be affected by public disclosure.

Any significant changes concerning inside information already disclosed must also be publicly disclosed promptly after these changes occur, through the same channel as the one used for public disclosure of the original information.\textsuperscript{39}

The Transparency Directive determines the acceptable means of making public disclosures; for example, by publishing in newspapers widely distributed throughout the Member State concerned or by other equivalent means approved by national regulators.\textsuperscript{40} The information must be drafted in a language accepted by the national regulators of the Member State concerned.\textsuperscript{41} In addition, inside information is to be made public by the issuer in a manner that allows “fast access and complete, correct and timely assessment of the information by the public.”\textsuperscript{42} To that end, the Directive mandates that issuers post on their website, for a reasonable time, all inside information that they are required to disclose publicly.\textsuperscript{43}

Issuers must time their disclosures so as to “synchronize” disclosures among all categories of investors as closely as possible in all Member States in which the issuer has requested or received approval for trading its securities on a regulated market. The issuer

\textsuperscript{36} CESR Advice, p. 25, paragraph 66.
\textsuperscript{37} CESR Advice, p. 25, paragraph 67.
\textsuperscript{38} Article 6(2) of the Market Abuse Directive.
\textsuperscript{39} Article 2(3) of the First Implementing Directive.
\textsuperscript{40} Articles 102(1) and 103 of Directive 2001/34/EC of the European Parliament and of the Council (the “Transparency Directive”).
\textsuperscript{41} Articles 102(1) and 103 of the Transparency Directive.
\textsuperscript{42} Article 2(1) of the First Implementing Directive.
\textsuperscript{43} Article 6(1) of the Market Abuse Directive.
must also ensure that the required disclosures are not combined with marketing activities in a misleading manner.44

Delayed Disclosure

Issuers may delay the public disclosure of inside information if necessary to protect “legitimate interests.”45 The issuer may do so only if a delay would not be likely to mislead the public, and the issuer is able to keep the information confidential.46 Any delayed disclosure is made under the issuer’s “own responsibility,” which means that the issuer can be held liable for failing to keep the inside information confidential or for misleading the public as a result of the delayed disclosure.

The nondisclosure of ongoing negotiations may be justified to protect a legitimate interest if the outcome or normal pattern of those negotiations would likely be affected by public disclosure. Public disclosure of information may also be delayed for a limited period if the financial viability of the issuer is in “grave and imminent danger” and “such a public disclosure would seriously jeopardize the interest of existing and potential shareholders by undermining the conclusion of specific negotiations designed to ensure the long-term financial recovery of the issuer.”47 Once the issuer is actually in bankruptcy proceedings, however, disclosures may no longer be delayed.48

To ensure the confidentiality of inside information, an issuer must control access to the information and put in place procedures so as to: (a) deny access to the information to persons other than those who require it for the exercise of their functions (e.g., through the implementation of Chinese walls); (b) ensure that any person with access to the information acknowledges the legal and regulatory duties entailed and is aware of the sanctions attaching to the misuse or improper circulation of inside information; and (c) provide immediate public disclosure in the event the issuer is no longer able to keep the information confidential.49

44 Article 2(4) of the First Implementing Directive.
45 Article 6(2) of the Market Abuse Directive.
46 Id.
47 Article 3(1)(a) of the First Implementing Directive.
48 Id.
49 Article 3(2) of the First Implementing Directive.
Selective Disclosure

Largely inspired by Regulation FD (Fair Disclosure) under the Exchange Act, the selective disclosure rules are designed to prevent issuers from disclosing inside information, such as advance warnings of earnings results, to securities analysts or selected institutional investors, before making full disclosure of the same information to the general public.

To that end, the Directive provides that whenever an issuer, or a person acting on his behalf or for his account, discloses any inside information to any third party in the normal exercise of his duties, it must make full and effective public disclosure of such information, simultaneously in the case of an intentional disclosure and promptly in the case of a non-intentional disclosure.\textsuperscript{50}

As illustrated in Table 1 below, the Directive’s selective disclosure provisions largely mirror Regulation FD, although the Directive’s scope is broader, and it provides for fewer exceptions and exclusions than Regulation FD.

Table 1: Selective Disclosure Comparative Chart

<table>
<thead>
<tr>
<th></th>
<th>EU Directive</th>
<th>US Regulation FD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Categories of issuer</td>
<td>Person acting on behalf or for the account of the issuer.</td>
<td>Person acting on behalf of the issuer (limited to senior officials and those persons who regularly communicate with securities market professionals or with security holders).</td>
</tr>
<tr>
<td>personnel covered</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information recipients</td>
<td>Any third party</td>
<td>(i) Securities market professionals such as broker/dealers, investment advisers and investment companies, and (ii) holders of the issuer’s securities likely to trade on the basis of the information.</td>
</tr>
<tr>
<td>covered</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exclusions from coverage</td>
<td>Disclosures made to a person who owes a duty of confidentiality (whether based on laws, regulations, articles of</td>
<td>Disclosures made (i) to a person who owes a duty of trust or confidence to the issuer, (ii) to any person who expressly agrees to</td>
</tr>
<tr>
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<td></td>
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</tbody>
</table>
Type of information covered

<table>
<thead>
<tr>
<th>EU Directive</th>
<th>US Regulation FD</th>
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</thead>
<tbody>
<tr>
<td>association or contracts).</td>
<td>maintain the information in confidence, (iii) to credit rating agencies, and (iv) in connection with most offerings of securities registered under the Securities Act of 1933, as amended (the “Securities Act”).</td>
</tr>
</tbody>
</table>

Timing of disclosure

<table>
<thead>
<tr>
<th>EU Directive</th>
<th>US Regulation FD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Precise nonpublic information likely to have a significant effect on the price of the issuer’s securities if made public.</td>
<td>Material nonpublic information.</td>
</tr>
<tr>
<td>For an intentional disclosure, simultaneously; for a non-intentional disclosure, promptly.</td>
<td>For an intentional disclosure, simultaneously; for a non-intentional disclosure, promptly.</td>
</tr>
</tbody>
</table>

Insiders Lists

One of the most controversial aspects of the Directive is its requirement that issuers prepare and regularly update lists of employees who have access to inside information relating, directly or indirectly, to the issuer.\(^{51}\) The list must cover individuals working for the issuer, whether on a “regular or occasional basis.”\(^{52}\) This measure seeks to assist issuers in monitoring the flow of inside information so as to comply with their obligations under the Directive.

The insiders list must contain, at a minimum: (a) the identity of each person having access to inside information; (b) the reason why such person is on the list; and (c) the date at which the list of insiders was created and updated. Additionally, lists of insiders must be promptly updated (a) whenever there is a change in the reason why any person is already on the list; (b) whenever any new person needs to be added to the list; or (c) to state when any person on the list ceases to have access to inside information. The insiders list must be retained for at least five years after the date it is drawn up or updated.\(^{53}\)

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\(^{51}\) Article 6(3) of the Market Abuse Directive.

\(^{52}\) Article 5(1) of the Third Implementing Directive.

\(^{53}\) Article 5(2) and (3) of the Third Implementing Directive.
Following controversy regarding the substantial burden this measure would entail, the CESR recommended that the European Commission give additional flexibility to issuers by enabling them to create and update insiders lists “in a way that best reflects their internal arrangements.” As an example, the CESR states that “issuers, within which the only persons who have access to inside information are those who habitually have such access, would be required to draw up and update a list containing only those individuals (emphasis added).” Issuers should probably not rely on this recommendation in light of the apparent contradiction with the Directive, which not only covers individuals working for the issuer on a regular basis but also those working on an occasional basis.

Disclosure of Certain Management Transactions

The Directive imposes a duty on certain insiders within an issuer to disclose all transactions conducted for their own account related to shares (or derivatives relating to those shares) of the issuer. Insiders covered by the Directive are “persons discharging managerial responsibilities,” such as directors and senior executives with regular access to inside information and the power to make managerial decisions affecting the future developments and business prospects of the issuer as well as “persons closely associated with them,” such as spouses, dependent children and other relatives sharing the same house with them.

Management dealing notifications must contain at least the following information: (i) name of the manager or, where applicable, name of a person closely associated with the manager, (ii) reason for notification, (iii) name of the relevant issuer, (iv) description of the financial instrument, (v) nature of the transaction (e.g., acquisition or disposal), (vi) date and place of the transaction, and (vii) price and volume of the transaction.

Unlike Section 16(a) of the Exchange Act, the Directive does not require beneficial owners of more than 10% of any class of any equity security to file reports disclosing changes in beneficial ownership. Further, the Directive’s five-business-day filing deadline is longer.
than the two business days imposed by Section 16(a). Finally, the Directive does not compel insiders to disgorge profits resulting from short-swing trading.

Unlike Rule 3a12-3 under the Exchange Act, which provides that securities registered by a foreign private issuer are exempt from Section 16, the Directive does not exempt securities registered by a non-EU issuer from its reporting requirements. In practice, however, the impact on US issuers with securities trading on an EU-regulated market will be minimal, as Section 16 requirements remain more stringent than the Directive’s equivalent insider reporting obligations.

Stock Repurchase Safe Harbor

The Directive provides issuers with a safe harbor under which they may repurchase their common stock without violating the Directive’s market abuse provisions as long as they meet specified conditions. Pursuant to the Regulation, this safe harbor, along with the stabilization safe harbor discussed below, became binding in its entirety, and directly applicable in all Member States, on October 12, 2004.

Under the Second Company Law Directive, EU Member States may allow issuers to repurchase their common stock. Satisfaction of the conditions of the Second Company Law Directive, however, does not in itself constitute compliance with the conditions for the market abuse safe harbor. Although not presumptively abusive, repurchases outside the scope of the safe harbor must be consistent with the rest of the Directive.

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60 The Sarbanes-Oxley Act of 2002 amended Section 16(a) to accelerate filing deadlines from 10 business days to 2 business days following transactions in an issuer’s stock.

61 Under Section 16(b) of the Exchange Act, any profit realized by a beneficial owner, director, or officer from any purchase and sale, or any sale and purchase, of any equity security of the issuer within any period of less than 6 months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding 6 months. By contrast, the Directive does not specify sanctions to be imposed for infringement of its measures.

62 17 CFR 240.3a12-3

63 As defined in Rule 3b-4 (17 CFR 240.3b-4).

64 See Article 8 of the Market Abuse Directive.

65 Council Directive 77/91/EEC on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty establishing the European Economic Community, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (the “Second Company Law Directive”).
As discussed above, under the Directive, a Member State may regulate trading activities outside the Member State’s territory, so long as the issuer’s securities are admitted to trading on a regulated market situated or operating within its territory. Consequently, EU issuers intending to repurchase securities on a US market will need to comply with both the Directive’s safe harbor provisions and Rule 10b-18 under the Exchange Act. The reverse is not true, however. The SEC has expressly indicated that issuers may not claim the safe harbor under Rule 10b-18 for repurchases made outside the United States even if the primary market for such issuer’s common stock is in the United States. As illustrated in Table 2 below, EU issuers seeking to repurchase securities on a US market will face more rigorous requirements to benefit from both safe harbor provisions.

Table 2: Stock Repurchase Safe Harbor Comparative Chart

<table>
<thead>
<tr>
<th>Coverage of the safe harbor</th>
<th>EU Directive</th>
<th>US SEC Rule 10b-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Protection from liability under the market abuse provisions of the Directive.</td>
<td>Protection from liability for manipulation of security prices and the use of manipulative and deceptive devices under Sections 9(a)(2) and 10(b) and Rule 10b-5 of the Exchange Act.</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Scope of the safe harbor</th>
<th>EU Directive</th>
<th>US SEC Rule 10b-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applies to repurchases (a) reducing an issuer’s capital (in value or in number of shares), or (b) intended to meet obligations arising from debt instruments exchangeable into equity instruments; or from employee stock option programs or other allocations of shares to employees of the issuer or of an associate</td>
<td>Applies to any bids for and purchases of an issuer’s common stock by or for an issuer.</td>
<td></td>
</tr>
</tbody>
</table>

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66 Rule 10b-18 under the Exchange Act [17 CFR 240.10b-18] provides a safe harbor from certain US federal securities laws for stock repurchases on a given day. To come within the Rule 10b-18 safe harbor for that day, an issuer must satisfy the Rule’s manner, timing, price and volume conditions when purchasing its own common stock in the market. Failure to meet any one of the four conditions disqualifies the issuer’s purchases from the safe harbor for that day.

<table>
<thead>
<tr>
<th>EU Directive</th>
<th>US SEC Rule 10b-18</th>
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<tr>
<td>company.</td>
<td>The safe harbor excludes stock repurchases made (a) during certain corporate events, such as, during stock offerings that involve the issuer or when the issuer is intentionally delaying public disclosure of inside information, and (b) during a closed market period.68</td>
</tr>
<tr>
<td>Timing Restrictions</td>
<td>The safe harbor excludes stock repurchases made (a) during certain corporate events, such as during mergers, tender offers, and distributions that involve the issuer69 and (b) at the opening and during the last 10 or 30 minutes of trading. However, under certain conditions, purchases may be made following the close of the primary trading session until the termination of the period in which the last sale prices are reported in the consolidated system.70</td>
</tr>
<tr>
<td>Means of Purchase</td>
<td>N/A</td>
</tr>
<tr>
<td>Price</td>
<td>Price may not exceed the highest current independent bid or the last independent trade, whichever is higher.72</td>
</tr>
<tr>
<td>Volume</td>
<td>On any single day, issuers may not purchase more than 25% of average daily trading volume reported for the security during the month preceding the month of public disclosure of</td>
</tr>
</tbody>
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68 Article 6(1) of the Regulation.  
70 17 CFR 240.10b-18(b)(2).  
71 17 CFR 240.10b-18(b)(1).  
72 Article 5(1) of the Regulation.  
<table>
<thead>
<tr>
<th>EU Directive</th>
<th>US SEC Rule 10b-18</th>
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<tr>
<td>the stock repurchase program.(^{74})</td>
<td>(Exception available for certain block purchases).(^{75})</td>
</tr>
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</table>

**Disclosure requirements**

- Full details of the program must be disclosed to the public prior to the start of trading,\(^{76}\) and details of all executed repurchases must be disclosed no later than the end of the seventh daily market session following the date of execution.\(^{77}\)
- Disclosure of all issuer repurchases (both open market and private transactions) of all equity securities, regardless of whether the repurchases are effected in accordance with Rule 10b-18.\(^{78}\)

**Stabilizing Transactions Safe Harbor**

The Directive establishes a second safe harbor for stabilizing transactions.\(^{79}\) Stabilization is defined as any purchase or offer to purchase securities by an investment firm that is undertaken in the context of a significant distribution of such securities exclusively for supporting the market price of these securities for a predetermined period of time, due to selling pressure on such securities.\(^{80}\)

The purpose of the stabilization safe harbor is to permit underwriters and syndicate members to facilitate an offering by preventing or slowing a decline in the market price of

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\(^{74}\) Article 5(2) of the Regulation. (Where the program makes no reference to that volume, the average daily volume figure must be based on the average daily volume traded in the 20 trading days preceding the date of purchase. Further, in cases of extremely low liquidity on the relevant market, the issuer may exceed the 25% limit, provided that the following conditions are met: (a) the issuer informs the competent authority of the relevant market, in advance, of its intention to deviate from the 25% limit; (b) the issuer discloses adequately to the public the fact that it may deviate from the 25% limit; (c) the issuer does not exceed 50% of the average daily volume.)

\(^{75}\) CFR 240.10b-18(b)(4). However, under CFR 240.10b-18(c), the volume limitation may be increased to 100% during the trading session immediately following a market-wide trading suspension.

\(^{76}\) Article 4(2) of the Regulation. (Those details must include one of the three aforementioned objectives, the maximum consideration, the maximum number of shares to be acquired and the duration of the period for which authorization for the program has been given. Subsequent changes to the program must be subject to adequate public disclosure in Member States.)

\(^{77}\) Article 4(4) of the Regulation.

\(^{78}\) Preliminary Note 2 to § 240.10b-18.

\(^{79}\) Article 8 of the Market Abuse Directive.

\(^{80}\) Article 2(7) of the Regulation. (Under Article 2(b), the safe harbor encompasses securities admitted to trading on a regulated market, as well as “(a) contracts or rights to subscribe for, acquire or dispose of relevant securities; (b) financial derivatives on relevant securities; (c) securities into which convertible or exchangeable debt instruments may be converted or exchanged; (d) instruments which are issued or guaranteed by the issuer or guarantor of the relevant securities and whose market price is likely to materially influence the price of the relevant securities, or vice versa; (e) where the relevant securities are securities equivalent to shares, the shares represented by those securities (and any other securities equivalent to those shares).”)
the security. The safe harbor addresses the risk that stabilization might create a false or misleading appearance with respect to trading in the offered security.

Stabilization raises similar issues for issuers with securities admitted in both an EU Member State and the US. Stabilization efforts must comply with both the Directive’s safe harbor and Rule 104 of Regulation M under the Exchange Act (“Rule 104”).\textsuperscript{81} This is even more significant as Rule 104 does not provide a safe harbor from US federal securities violations, but rather imposes additional conditions with respect to stabilizing and other activities in connection with an offering.\textsuperscript{82}

Nonetheless, if the SEC deems the Directive’s regulation of stabilization to be “comparable” to Rule 104, EU issuers may be exempt from complying with Rule 104 for stabilization undertaken outside the US during an offering in the US so long as the stabilization is not conducted above the US offering price.\textsuperscript{83} Rule 104 provides that the SEC may deem foreign statutes or regulations as comparable to Rule 104 by considering, among other things, “whether such foreign statute or regulation: specifies appropriate purposes for which stabilizing is permitted; provides for disclosure and control of stabilizing activities; places limitations on stabilizing levels; requires appropriate recordkeeping; provides other protections comparable to the provisions of this section; and whether procedures exist to enable the SEC to obtain information concerning any foreign stabilizing transactions.”\textsuperscript{84}

The SEC has not yet indicated whether it considers the Directive’s regulation of stabilization to be comparable to Rule 104. However, as illustrated in Table 3 below, except for the “control” requirement, the enumerated conditions for complying with Rule 104 seem to be met for the most part.

\textsuperscript{81} 17 CFR 242.104. (Rule 104 governs stabilizing and certain aftermarket syndicate activities in connection with an offering and makes it unlawful for any person to stabilize in contravention of the Rule’s provisions).

\textsuperscript{82} Under Rule 100(a) of Regulation M under the Exchange Act, “any transaction, whether or not effected pursuant to the provisions of Regulation M, remains subject to the antifraud and anti-manipulation provisions of the US federal securities laws.”

\textsuperscript{83} 17 CFR 242.104(g).

\textsuperscript{84} For these purposes, the SEC has recognized the stabilization regulations of Chapter III, Part 10 of the Rules of the United Kingdom Securities and Investments Board (SEC Release Nos. 33-7375, 34-38067; IC-22412; International Series Release No. 1039; File No. S7-11-96, Section E.4).
Table 3: Exchange Act Rule 104 Reciprocity Requirements

|---------------------------------------------|-----------------------------------------------|
| Appropriate purposes for which stabilizing is permitted | Exclusively for supporting the market price of securities for a predetermined period of time, due to a selling pressure in such securities.  
85 Article 2(7) of the Regulation. |
| Disclosure of stabilizing activities | Issuers must comply with strict disclosure requirements before the opening of the offer period of the relevant securities and within one week of the end of the stabilization period.  
86 Under Article 9(1) of the Regulation, entities undertaking stabilization must adequately publicly disclose: “(a) the fact that stabilization may be undertaken, that there is no assurance that it will be undertaken and that it may be stopped at any time; (b) the fact that stabilization transactions are aimed to support the market price of the relevant securities; (c) the beginning and end of the period during which stabilization may occur; (d) the identity of the stabilization manager, unless this is not known at the time of publication in which case it must be publicly disclosed before any stabilization activity begins; (e) the existence and maximum size of any over-allotment facility or greenshoe option, the exercise period of the greenshoe option and any conditions for the use of the over-allotment facility or exercise of the greenshoe option.”  
87 Under Article 9(3) of the Regulation, “within one week of the end of the stabilization period, the following information must be adequately disclosed to the entities undertaking the stabilization: (a) whether or not stabilization was undertaken; (b) the date at which stabilization started; (c) the date at which stabilization last occurred; (d) the price range within which stabilization was carried out, for each of the dates during which stabilization transactions were carried out.”  
88 17 CFR 242.104(d). |
| Control of stabilizing activities | Unlike Rule 104, the Directive does not prohibit maintaining more than one stabilizing bid in any one market at the same price at the same time.  
88 |
| Limitations on stabilizing levels | Stabilization must meet specific price conditions and be carried out only at certain limited times, which vary according to the type of financial instrument being stabilized.  
90 |
| Appropriate recordkeeping | Entities undertaking the stabilization must record each stabilization order or transaction, including at least the names and numbers of the instruments bought or sold, the dates and times of the transactions, the transaction prices and means of identifying the entity undertaking the  
91 Article 8 of the Regulation.  
91 Article 9(4) of the Regulation. |

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85 Article 2(7) of the Regulation.  
86 Under Article 9(1) of the Regulation, entities undertaking stabilization must adequately publicly disclose: “(a) the fact that stabilization may be undertaken, that there is no assurance that it will be undertaken and that it may be stopped at any time; (b) the fact that stabilization transactions are aimed to support the market price of the relevant securities; (c) the beginning and end of the period during which stabilization may occur; (d) the identity of the stabilization manager, unless this is not known at the time of publication in which case it must be publicly disclosed before any stabilization activity begins; (e) the existence and maximum size of any over-allotment facility or greenshoe option, the exercise period of the greenshoe option and any conditions for the use of the over-allotment facility or exercise of the greenshoe option.”  
87 Under Article 9(3) of the Regulation, “within one week of the end of the stabilization period, the following information must be adequately disclosed to the entities undertaking the stabilization: (a) whether or not stabilization was undertaken; (b) the date at which stabilization started; (c) the date at which stabilization last occurred; (d) the price range within which stabilization was carried out, for each of the dates during which stabilization transactions were carried out.”  
88 17 CFR 242.104(d).  
89 Under Article 10(1) of the Regulation, “an offer of shares or other securities equivalent to shares, stabilization of the relevant securities must not in any circumstances be executed above the offering price.” Under Article 10(2) of the Regulation, “an offer of securitized debt convertible or exchangeable into shares, stabilization of such instruments must not be executed above the market price of those instruments at the time of the public disclosure of the final terms of the new offer.”  
90 Article 8 of the Regulation.  
91 Article 9(4) of the Regulation.
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<tr>
<td>stabilization.91</td>
<td>The Directive does not require entities undertaking stabilization to grant priority to any independent bid at the same price at the time that it is entered.92</td>
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<tr>
<td>Other protections comparable to the provisions of Rule 104</td>
<td>Where several investment firms or credit institutions undertake the stabilization, one of those persons must act as the central point of inquiry for any request from the competent authority of the regulated market on which the relevant securities have been admitted to trading.93 Further, the details of all stabilization transactions must be disclosed to the competent authority of the relevant market no later than the end of the seventh trading day following the date of execution of such transactions.94</td>
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<td>Existence of procedures to enable the SEC to obtain information concerning any foreign stabilizing transactions</td>
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Exercise of an Overallotment Facility or of a Greenshoe Option

Closely related to stabilizing transactions, the exercise of over-allotment facilities or of greenshoe options by investment firms or credit institutions may also fall under the Directive’s safe harbor if exercised in the context of a significant distribution of securities (initial or secondary offer of securities, publicly announced and distinct from ordinary trading both in terms of the amount in value of the securities offered and the selling methods employed) and carried out exclusively for facilitating stabilization activities.95

The Directive distinguishes an over-allotment facility from a greenshoe option. An “overallotment facility” is defined as a clause in the underwriting agreement or lead management agreement that permits acceptance of subscriptions or offers to purchase a greater number of relevant securities than originally offered. A “greenshoe option” is an option granted by the offeror in favor of the investment firm involved in the offer for the purpose of covering over-allotments, allowing such firm to purchase up to a certain

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92 17 CFR 242.104(c).  
93 Article 9(5) of the Regulation.  
94 Article 9(2) of the Regulation.  
95 Articles 2(12) and 11 of the Regulation.
amount of securities at the offer price for a certain period of time after the close of the offer.96

To benefit from the safe harbor, the exercise of an over-allotment facility or of a greenshoe option must be made in accordance with the aforementioned disclosure and reporting conditions for stabilization. In addition, (a) securities may be overallotted only during the subscription period and at the offer price; (b) a position resulting from the exercise of an over-allotment facility by an investment firm or credit institution that is not covered by the greenshoe option may not exceed 5% of the original offer; (c) the greenshoe option may be exercised by the beneficiaries of such an option only where relevant securities have been overallotted; (d) the greenshoe option may not amount to more than 15% of the original offer; (e) the exercise period of the greenshoe option must be the same as the Directive’s time requirements with respect to stabilizing transactions; and (f) the exercise of the greenshoe option must be disclosed to the public promptly, together with all appropriate details, including in particular the date of exercise and the number and nature of relevant securities involved.97

Conclusion

Pursuant to the Financial Services Action Plan, the European Commission decided in 1999 to make a single market in financial services the core of economic reform in the European Union. The Directive is one of the first major building blocks in the reform. By standardizing the regulatory framework throughout the EU, the Directive should reduce trading risks for all market participants.

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96 Article 2(12) and (13) of the Regulation.
97 Article 11 of the Regulation.
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