WILLKIE FARR & GALLAGHER LLP

CLIENT MEMORANDUM

COMMENT PERIOD FOR PROPOSED AMENDMENTS TO REGULATION SHO RE-OPENED

The U.S. Securities and Exchange Commission has issued a notice[1] re-opening the comment period for its proposal[2] to re-institute price test regulation for short sales of equity securities and seeking comment on a specific price test alternative. The comment period will end 30 days after publication of the Notice in the Federal Register.

Price tests permit short sales to occur only when the sale price equals or exceeds a reference price. In the April Proposal, the SEC sought comment on a "bid test" (the "modified uptick rule") based on the current national best bid (the "NBB") for a security, and a "last sale test" (the "uptick rule") based on the last reported transaction price for the security. The SEC also proposed three versions of "circuit breakers" that would impose short selling restrictions following a significant decline in the market price of a security. The SEC now seeks comment on a new and far more restrictive "alternative uptick rule" that would allow short selling only at a price above the current NBB. Although the SEC previously sought comment on the alternative uptick rule, it was not one of the alternatives set out in the April Proposal.

The alternative uptick rule would be similar to the SEC's proposed modified uptick rule in that both would use the current NBB as a reference in determining the permissibility of executing a short sale order. Unlike the modified uptick rule, the alternative uptick rule would not permit short selling at the current NBB. Rather, the alternative uptick rule would require short sellers to offer price improvement over the best prices available and would permit short sales only at an increment above the NBB, absent an applicable exception. Therefore, as noted by the SEC in the Notice, it would prohibit immediate execution of a short sale, even in an advancing market. The alternative uptick rule, therefore, would restrict short selling to a greater extent than would either the modified uptick rule or the uptick rule.

Based on comments it received on the April Proposal, the SEC has now noted that its new alternative uptick rule could be easier to monitor and implement than the modified uptick rule and the uptick rule. The alternative uptick rule would not require bid or last sale price sequencing, meaning that there would be no need to determine whether the current NBB or last sale price is above or below the previous NBB or last sale price. As a result, the alternative

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1 Amendments to Regulation SHO, Securities Exchange Act Release No. 60509 (Aug. 17, 2009), available at http://www.sec.gov/rules/proposed/2009/34-60509.pdf (the "Notice").

2 Amendments to Regulation SHO, Securities Exchange Act Release No. 59748, 74 FR 18042 (Apr. 20, 2009) (the "April Proposal"). More information on the April Proposal is available at http://www.willkie.com/files/tbl_s29Publications/FileUpload5686/2948/SEC_Requests_Comment_On_New_Short_Selling_Price_Test.pdf.

uptick rule could be easier to program into trading and surveillance systems than the proposed modified uptick rule or the uptick rule.

The SEC acknowledges certain shortcomings of the alternative uptick rule. By restricting short selling to a greater extent than would either the modified uptick rule or the uptick rule, the alternative uptick rule could limit market liquidity and pricing efficiency more than would the other two tests. According to the SEC:

> [T]here may be potential costs associated with the alternative uptick rule in terms of potential impact of such a price test on quote depths, spread widths, market liquidity, execution and pricing inefficiencies.

The alternative uptick rule could be implemented using either a policies and procedures approach or a straight prohibition approach. The policies and procedures approach would require trading centers, which would include exchanges, alternative trading systems, market makers and other execution venues, to have policies and procedures to prevent short sales at prices that are not above the current NBB. In the alternative, the rule could prohibit any person from effecting a short sale at a price that is not above the current NBB. A combination of the two approaches also could be adopted.

Like the modified uptick rule and the uptick rule, the alternative uptick rule could be implemented in conjunction with a circuit breaker rule. Under this approach, an intraday decline in the price of a stock of more than a specified percentage from its previous close would trigger the alternative uptick rule.

The SEC states in the Notice that the alternative uptick rule could be subject to the same exceptions that were proposed for the modified uptick rule. Exceptions could include (i) a seller's delay in delivery, (ii) odd lots, (iii) domestic arbitrage, (iv) international arbitrage, (v) over-allotments and lay-off sales, (vi) transactions executed on a VWAP basis, and (vii) riskless principal transactions. Exceptions adopted could apply to either a permanent alternative uptick rule or an alternative uptick rule triggered by a circuit breaker.

The SEC invites comment on all aspects of the alternative uptick rule. The SEC also requests comment on a number of specific issues relating to the alternative uptick rule, including whether it is more likely to prevent abusive short selling intended to drive down the market price of a stock than are other alternatives; its potential effect on price efficiency and liquidity; ease and cost of implementation relative to other alternatives; whether it should be adopted under a policies and procedures or a prohibition approach; whether exceptions to the rule should be adopted, including a market maker exception; and whether it is likely to help restore investor confidence. Commenters are also invited to comment on any other aspects of the April Proposal.

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If you have any questions regarding this memorandum, please contact Roger D. Blanc (212-728-8206, rblanc@willkie.com), Martin R. Miller (212-728-8690, mmiller@willkie.com), Matthew B. Comstock (202-303-1257, mcomstock@willkie.com) or the Willkie attorney with whom you regularly work.

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