

Nasdaq and NYSE Provide Temporary Relief From Shareholder Approval Requirements Applicable to Certain Issuances

I. Overview

On May 1, 2020¹ and May 13, 2020², The Nasdaq Stock Market LLC (“Nasdaq”) and the New York Stock Exchange (the “NYSE”), respectively, filed with the Securities and Exchange Commission (the “SEC”) proposals to adopt new rules providing temporary exceptions to the shareholder approval requirements applicable to (1) certain issuances of common stock constituting 20% or more of the number or voting power of the outstanding common stock prior to such issuance (“20% Offerings”) and (2) certain sales to officers, directors, employees, or consultants that could be considered a form of “equity compensation,” where unaffiliated investors require an affiliate of a company to participate in a capital raising transaction (“Equity Compensation Issuances”). The proposed rules became effective immediately upon filing with the SEC and will remain in effect through June 30, 2020—although the SEC may suspend the rule changes within 60 days from the date of the filing if it determines that such suspension is appropriate in the public interest or for the protection of investors.

II. Current Rules Requiring Shareholder Approval

a. 20% Offerings

i. Nasdaq Listing Rule 5635(d)

Nasdaq Listing Rule (“Nasdaq Rule”) 5635(d) provides that shareholder approval is required for a transaction that involves the sale, issuance or potential issuance by a company of its common stock or securities convertible into or exercisable for common stock, which alone or together with sales by shareholders who hold 5% of the number of shares of common stock and voting power outstanding of the company³, officers, or directors, would be for 20% or more of the common stock or voting power outstanding before such issuance.⁴ However, shareholder approval is not required for (1) public offerings and (2) issuances at a price (or with a conversion or exercise price, in the case of convertible securities) equal to or greater than the lower of (i) the official closing price immediately before the signing of the binding agreement or (ii) the average official closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement (the “Minimum Price”).⁵

¹ For full text of the proposal and the related SEC release, *see* Securities and Exchange Commission, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Provide Listed Companies With a Temporary Limited Exception From Certain Shareholder Approval Requirements in Nasdaq Rules 5635(c) and (d), SEC Release No. 34-88805; File No. SR-NASDAQ-2020-025, available at <https://www.sec.gov/rules/sro/nasdaq/2020/34-88805.pdf> (May 4, 2020) [hereinafter, the “Nasdaq Release”].

² For full text of the proposal and the related SEC release, *see* Securities and Exchange Commission, Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt New Section 312.03T of the NYSE Listed Company Manual to Provide a Temporary Exception Through June 30, 2020 From the Application of Certain Shareholder Approval Requirements Set Forth in Sections 312.03 and 303A.08 of the Manual, SEC Release No. 34-88875; File No. SR-NASDAQ-2020-43, available at <https://www.sec.gov/rules/sro/nyse/2020/34-88875.pdf> (May 14, 2020) [hereinafter, the “NYSE Release”]. Unless otherwise specified, quoted statements in this memorandum are taken from the Nasdaq Release or the NYSE Release, as the context suggests.

³ *See* Nasdaq Rule 5635(e)(3).

⁴ *See* Nasdaq Rule 5635(d).

⁵ *See* Nasdaq Rule 5635(d).

ii. NYSE Listed Company Manual Section 312.03(c)

Section 312.03(c) of the NYSE Listed Company Manual (“NYSE Manual”) provides that shareholder approval is required before issuance of common stock or of securities convertible into or exercisable for common stock in any transaction or related series of transactions if the issuance would be for 20% or more of the common stock or voting power outstanding before such issuance.⁶ However, shareholder approval is not required for (1) public offerings and (2) *bona fide* private financings if they involve a sale of common stock or securities convertible into or exercisable for common stock, for cash, at a price (or the conversion or exercise price, in the case of convertible securities) equal to or greater than the Minimum Price.⁷

b. Equity Compensation Issuances

i. Nasdaq Rule 5635(c)

Nasdaq Rule 5635(c) provides that, subject to certain exceptions, shareholder approval is required before the issuance of securities when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended, pursuant to which stock may be acquired by officers, directors, employees, or consultants.⁸ Nasdaq historically has interpreted Nasdaq Rule 5635(c) to require shareholder approval for certain sales to officers, directors, employees, or consultants when such sales could be considered a form of equity compensation, such as when common stock or securities convertible into or exercisable for common stock are issued at a price less than the fair market value of the stock.⁹

ii. NYSE Manual Sections 312.03(a), 312.03(b), and 303A.08

NYSE Manual Sections 312.03(a) and 303A.08 provide that shareholder approval is generally required for equity compensation plans and any material revisions to such plans.¹⁰ Section 312.03(b) provides that shareholder approval is required before the issuance of common stock, or securities convertible into or exercisable for common stock, in any transaction or series of transactions to (1) a director, officer, or substantial securityholder of a company (“Related Party”), (2) a subsidiary, affiliate, or other closely-related person of a Related Party, or (3) any company or entity in which a Related Party has a substantial direct or indirect interest, if the number of shares of common stock to be issued or into which the securities may be convertible or exercisable, exceeds either 1% of the number of shares of common stock or voting power outstanding before the issuance, subject to certain exceptions.¹¹ The NYSE historically has interpreted Section 303A.08 to require shareholder approval for certain sales to officers, directors, employees, or consultants when such sales could be considered a form of equity compensation.

⁶ See NYSE Manual Section 312.03(c).

⁷ See NYSE Manual Section 312.03(c).

⁸ See Nasdaq Rule 5635(c).

⁹ See Nasdaq Reference Library, FAQs – Listings, Identification Number 275, available at https://listingcenter.nasdaq.com/ViewPDF.aspx?Material_Search.aspx?mcd=LQ&cid=71&years=2017,2016,2015,2017,2016,2015,2014,2013,2012,2011,2010,2009,2008,2007,2006,2005,2004,2003,2002&sub_cid=114&searchkeywords=&exactsearchddvalue=1&Print=N&materials=0&popularfl= (October 10, 2018).

¹⁰ See NYSE Manual Sections 312.03(a) and 303A.08.

¹¹ See NYSE Manual Section 312.03(b).

III. New Nasdaq and NYSE Rules Temporarily Waiving Shareholder Approval

a. General

New Nasdaq Rule 5636T and NYSE Manual Section 312.03T are substantially similar (other than as indicated below) and grant limited temporary exceptions to the shareholder approval requirements for 20% Offerings and Equity Compensation Issuances until and including June 30, 2020, although the issuance itself may occur after June 30, 2020 if it occurs within 30 calendar days from the date of the binding agreement. A company must meet these requirements to rely on the exceptions:

- Nexus to COVID-19:
 - Demonstrate the following to Nasdaq or the NYSE, as applicable: (1) the need for the transaction is due to circumstances related to COVID-19 and (2) the delay in securing shareholder approval would: (a) have a material adverse impact on the company's ability to maintain operations under its pre-COVID-19 business plan, (b) result in workforce reductions, (c) adversely impact the company's ability to undertake new initiatives in response to COVID-19, or (d) seriously jeopardize the financial viability of the enterprise.¹²
- Procedural Requirements:
 - *Nasdaq Notification and Approval*: Although a company relying on the exception is not subject to Nasdaq Rule 5250(e)(2), which requires a company to notify Nasdaq at least 15 calendar days before certain events, a company must still submit a supplement to the Listing of Additional Shares notification form as promptly as possible, no later than at the time of public announcement and in no event later than June 30, 2020, certifying that the company complies with all requirements of Nasdaq Rule 5636T(b) or Rule 5636T(c), as applicable, and describing with specificity how it complies.¹³

Although prior approval of the exception by Nasdaq is not required if (1) the maximum issuance of common stock or securities convertible into common stock is for less than 25% of the total shares outstanding and voting power outstanding before the transaction and (2) the maximum discount to the Minimum Price at which shares could be issued is 15% (the "Safe Harbor Provision"), the Nasdaq Listing Qualifications Department must approve transactions that do not fall within the Safe Harbor Provision prior to the issuance, which approval will be based upon whether the company has established that it complies with the requirements of Nasdaq Rule 5636T(b) or Nasdaq Rule 5636T(c), as applicable.¹⁴
 - *NYSE Notification and Approval*: Before executing a binding agreement, a company must obtain NYSE's approval by submitting (1) a supplemental listing application in accordance with Section 703.01 (part 1) and (2) certification to the NYSE that the company complies with all requirements of Section 312.03T(b) (and Section 312.03T(c), if applicable) and describing with specificity how it complies. The NYSE advises companies to commence discussions and

¹² See Nasdaq Rule 5636T(b); See NYSE Manual Section 312.03T(b).

¹³ See Nasdaq Rules 5636T(a), 5636T(b)(5)(A), and 5636T(e).

¹⁴ See Nasdaq Rule 5636T(b)(5)(B).

provide the required documentation as far in advance of the transaction as possible.¹⁵

- *Binding Agreement*: Execute a binding agreement governing the issuance of securities.¹⁶
- *Public Announcement*: To provide shareholders with advance notice of the transaction, make a public announcement by filing a Current Report on Form 8-K, where required by the SEC rules, or issue a press release, as promptly as possible, but no later than two business days before issuing securities, disclosing: (1) the terms of the transaction, (2) that shareholder approval would ordinarily be required under the Nasdaq or NYSE rules, and (3) that the audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors expressly approved reliance on the exception and determined that the transaction is in the best interest of shareholders.¹⁷
- *Governance Requirements*: (1) The company must have undertaken a process designed to ensure that the proposed transaction represents the best terms available to the company and (2) the company's audit committee, or a comparable body of the board of directors comprised solely of independent, disinterested directors must have (a) expressly approved reliance on the exception and (b) determined that the transaction is in the best interest of shareholders.¹⁸ NYSE-listed companies must also demonstrate that the proceeds would not be used to fund any acquisition transaction.¹⁹

b. Additional Requirements for Equity Compensation Issuances

Nasdaq Rule 5636T(c) and NYSE Manual Section 312.03T(c) both provide an exception from the shareholder approval requirement for an affiliate's participation in Equity Compensation Issuance if the transaction satisfies the following requirements designed to protect against self-dealing: (1) any affiliate's participation must be for less than 5% of the transaction, (2) all affiliates' participation collectively must be for less than 10% of the transaction, (3) any affiliate's participation must have been specifically required by unaffiliated investors, and (4) the affiliates must not have participated in negotiating the economic terms of the transaction. As previously mentioned, the exception is intended to address situations where unaffiliated investors require an affiliate of a company to put capital at risk and participate in a capital raising transaction.

c. Subsequent Issuances

Securities issued in reliance on the exceptions will be aggregated with any subsequent issuance by a company at a discount to the Minimum Price (other than in a public offering for cash), if the binding agreement for the subsequent issuance is executed within 90 days of the initial issuance.²⁰ If following the subsequent issuance, the aggregate issuance would be equal to 20% or more of the total shares or the voting power outstanding before

¹⁵ See NYSE Manual Section 312.03T(b).

¹⁶ See Nasdaq Rule 5636T(a); See NYSE Manual Section 312.03T(a).

¹⁷ See Nasdaq Rule 5636T(d); See NYSE Manual Section 312.03T(d).

¹⁸ See Nasdaq Rule 5636T(b); See NYSE Manual Section 312.03T(b).

¹⁹ See NYSE Manual Section 312.03T(b).

²⁰ See Nasdaq Rule 5636T(f); See NYSE Manual Section 312.03T(f).

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the initial issuance, shareholder approval is required under Nasdaq Rule 5635(d) or the NYSE Manual Section 312.03(c), as applicable, before such subsequent issuance.²¹

IV. Conclusion

In proposing these rule changes, both Nasdaq and the NYSE stated that although there currently is an exception available for companies in financial distress, that exception alone does not cover most situations arising from the COVID-19 pandemic. The new rules should allow, among other things, companies to more quickly raise capital to continue running their businesses, compensate their workforces, and undertake new initiatives in response to COVID-19.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; or Joseph E. Cho at 212.701.3589 or jcho@cahill.com; or email publications@cahill.com.

²¹ See Nasdaq Rule 5636T(f); See NYSE Manual Section 312.03T(f).