NYSE Partial Waiver of Shareholder Approval Rules

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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On April 6, 2020, the New York Stock Exchange (NYSE) filed an immediately effective rule change with the Securities and Exchange Commission (SEC) that waives the application of certain shareholder approval requirements through June 30, 2020.[1] This alert briefly summarizes the changes. For a more comprehensive overview of the shareholder approval rules applicable to NYSE- and Nasdaq-listed companies, please see the NYSE and Nasdaq Shareholder Approval Rules chart at the end of this alert.

Shareholder Approval Rules

The NYSE Listed Company Manual requires listed companies to obtain majority shareholder approval of certain transactions, especially those that may dilute existing shareholders' voting power or the value of their equity, those that involve transactions with company insiders, or those that would change significantly the structure and ownership of a company. As a result of the NYSE actions, two shareholder approval rules, known colloquially as the "20% Rule" and the "Related Party Transactions Rule" are subject to partial, temporary waiver.

20% Rule

Pursuant to the 20% Rule, a NYSE-listed company must obtain shareholder approval for issuances of more than 20% of the company's outstanding common stock or voting power. The 20% Rule is subject to exceptions, including bona fide private placements to multiple purchasers, none of whom are acquiring more than 5% of the company's common stock or voting power, provided that the offer meets certain minimum price requirements — namely that the price exceeds the lesser of the official common stock closing price immediately prior to signing the agreement or the average official closing price for the five trading days immediately preceding the signing of the binding agreement.

After observing that the COVID-19 pandemic has created a liquidity crisis for many companies, the NYSE noted that companies in distress often may obtain funding most easily in private transactions with a few key investors, including insiders who are already shareholders of the company. The NYSE further noted that in the 2008-2009 financial

[1] The changes came in the form of an immediately effective proposed rule. A proposed rule change does not ordinarily become operative until at least 30 days after filing. However, the NYSE requested an immediate effectiveness date, and the SEC, finding that waiving the 30-day period was consistent with the protection of investors and the public interest, waived the delay and designated the proposal operative upon filing, pursuant to Securities Exchange Act Rule 19b-4(f)(6)(iii).

crisis, many NYSE-listed companies in need of equity financing were limited by the shareholder approval rules in the size and structure of their capital raising.

The temporary partial waiver of Section 312.03(c) eliminates the 5% ownership/voting power threshold, permitting private placements of securities, regardless of their size, the number of participating investors or the amount of securities purchased by any single investor, provided that minimum pricing requirements are met. Additional requirements apply if the sale is to a related party (as described below). Such transactions must be reviewed and approved by the company's audit committee or a comparable committee comprised solely of independent directors, and must otherwise comply with the related party transactions rule, described below. So long as such requirements are met, the company would not be required to make a public announcement of its reliance on the waiver, inform existing shareholders or take other steps to benefit from this relief of obtaining shareholder approval. The waiver does not apply to transactions that require shareholder approval due to a change of control (described in the following chart). As a result of this proposed waiver, the NYSE's shareholder approval exception for bona fide private financings temporarily will be consistent with Nasdaq's private financing exception (described in the following chart).

Related Party Transactions Rule

The shareholder approval rules view transactions with company insiders — including directors, officers and holders of 5% or more of the company's common stock — with heightened scrutiny. Shareholder approval is required if the number of common shares to be issued to any related party exceeds 1% of either the pre-issuance outstanding common stock or voting power. For related parties who meet the definition solely by virtue of their common stock holdings or voting power and no other insider status, shareholder approval is required for issuances that exceed 5%, provided certain minimum pricing conditions are met.

The waiver significantly broadens the current exceptions and permits sales of securities to related parties, regardless of percentages issued, provided that:

- the sale is for cash at a price no less than the minimum price;
- the transaction is reviewed and approved by the company's audit committee or a comparable committee comprised solely of independent directors; and
- proceeds from the sale of securities to the related party will not be used to fund an acquisition of stock or assets of another company in which the related person has a direct or indirect interest or assets to be acquired or in the consideration to be paid for such acquisition (*i.e.*, a transaction which would require shareholder approval under Nasdaq Marketplace Rule 5635(a)(2)).

As a result of the waiver of Section 312.03(b), the NYSE's shareholder approval rule for related party transactions temporarily will be consistent with Nasdaq's rule. The waiver does not apply to transactions that implicate a change of control and, as a result, shareholder approval would still be required under that rule if the issuance also constitutes a change of control (described in the following chart).

Conclusion

In the notice announcing the changes, NYSE staff observed that "[e]xisting large investors are often the only willing providers of much-needed capital to companies undergoing difficulties and the [NYSE] believes that it is appropriate to increase companies' flexibility to access this source of capital for a limited period." The temporary shareholder approval waivers are a welcome change for companies experiencing a current liquidity crisis, and should remove impediments to raising capital in private offerings, especially those involving significant stakeholders or those who are willing to become significant stakeholders in the company. Provided no change of control is implicated, such investors may increase their ownership positions without the company needing to pursue a costly and time-consuming approval by a majority of shareholders. The changes are consistent with other recent rulemaking initiatives by the NYSE, which also recently proposed relaxing its continued listing requirements by suspending the application of its $50 million market capitalization and $1.00 price requirements.

NYSE Partial Waiver of Shareholder Approval Rules

	NYSE	Nasdaq
20% Issuance of Common Stock	NYSE Listed Company Manual Section 312.03(c) requires shareholder approval for transactions pursuant to which a company issues/sells common stock (or securities convertible into common stock) that will constitute 20% or more of the company's: - outstanding common stock pre-issuance; or - voting power pre-issuance; unless the issuance is either (1) a public offering for cash or (2) a bona fide private financing at no less than the minimum price. **Public Offering for Cash.** To determine whether an offering is a "public offering," the NYSE will consider all relevant factors, which may include: - how widely/publicly the offer is marketed; and - transaction pricing based on marketing efforts. Note that: - SEC registration is not determinative; and - the "for cash" requirement precludes exchange offers. **Bona Fide Private Financing at No Less Than the Minimum Price.** A "bona fide private financing" is defined as sales to either: - a registered broker-dealer that plans only unregistered resales; or - multiple purchasers, none of which has a right to acquire more than 5% of the company's common stock or voting power presale (**see proposed waiver below**); and "minimum price" is defined as the lower of: - the official closing price immediately preceding signing the binding agreement; and - the average official closing price for the five trading days immediately preceding signing the binding agreement.	Nasdaq Rule 5635(d) requires shareholder approval for transactions pursuant to which a company issues/sells common stock (or securities convertible into common stock) that constitute 20% or more of the company's: - outstanding common stock pre-issuance; or - voting power pre-issuance; unless the issuance is either (1) a public offering (regardless of whether or not the offering is for cash) or (2) a private financing at no less than the minimum price. Nasdaq has stated that it will aggregate such issuances together with sales by officers, directors and substantial stockholders for purposes of the 20% calculation. **Public Offering.** To determine whether an offering is a "public offering," Nasdaq will consider all relevant factors, including: - the type of offering; - the manner in which the offering is marketed; - the extent of the offering's distribution; - the offering price; and - the extent to which the company controls the offering and its distribution. Note that: - SEC registration is not determinative; and - "best efforts" underwriting is less likely than "firm commitment" underwriting to be considered a public offering. **Private Financing at No Less Than the Minimum Price.** The offering, if not a public offering, must not be for less than the "minimum price," which is the lower of: - the official closing price immediately preceding signing the binding agreement; and - the average official closing price for the five trading days immediately preceding signing the binding agreement. Nasdaq has published guidance on key terms and calculations in various interpretive materials and FAQ's, including Interpretive Material IM 5635-3 and Nasdaq Staff Interpretive Letter 2009-13.

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NYSE Partial Waiver of Shareholder Approval Rules

<table>
<tr><th></th><th>NYSE</th><th>Nasdaq</th></tr>
<tr><td rowspan="3">20% Issuance of Common Stock (cont'd)</td><td>*Update: NYSE Partial Waiver through June 30, 2020. This waiver eliminates the multiple purchasers/5% limitation for bona fide private financings to permit a sale of securities in a private placement, regardless of its size, the number of participating investors or the amount of securities purchased by any single investor, provided that the sale is for cash at a price no less than the minimum price. As a result of this proposed waiver, the NYSE's shareholder approval exception for bona fide private financings will be consistent with Nasdaq's private financing exception. If the sale is to a related party, the transaction must be reviewed and approved by the company's audit committee or a comparable committee comprised solely of independent directors, and otherwise comply with the related party rule described below. In addition, the waiver does not apply to the change of control rule described below and, as a result, shareholder approval would still be required under that rule if the issuance also constitutes a change of control.</td><td>In addition to the 20% test under Nasdaq Rule 5635(d), Nasdaq Rule 5635(a)(1) provides that issuances of securities in excess of 20% (other than in a public offering for cash) that occur in connection with an acquisition of stock or assets of another company will require shareholder approval even if the offering equals or exceeds the minimum price.</td></tr>
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<tr><td rowspan="2">Calculation of 20%</td><td colspan="2">The percentage of common stock to be issued in a transaction is calculated by dividing the "maximum potential issuance" by the number of common shares issued and outstanding before the transaction.
- The number of shares outstanding before the transaction does not include treasury shares, shares held by a subsidiary or shares reserved for issuance upon conversion or upon exercise of options or warrants.[2]
Convertible/Exchangeable Securities and Warrants. The maximum potential issuance includes all shares of common stock issuable upon conversion of the convertible/exchangeable securities or exercise of the warrants (not taking into account standard anti-dilution adjustments such as stock splits and combinations, but including adjustments for below-market issuances and "make-whole shares").</td></tr>
<tr><td>Aggregation: The NYSE may view multiple transactions related in substance and proximity as a series of related transactions and treat them as a single issuance. Companies considering multiple transactions may wish to contact the NYSE to discuss whether the transactions may be viewed as related.</td><td>Aggregation: Nasdaq may view multiple transactions as a series of related transactions and treat them as a single issuance. Nasdaq typically considers the following factors when determining whether to aggregate the securities:
- timing of the issuances;
- whether subsequent financings were planned or expected at the time of the initial transaction;
- commonality of investors;
- contingencies between the issuances;
- commonality as to the use of proceeds; and
- timing of the board of directors' approval.
If an acquisition occurs around the same time as a private placement, Nasdaq may aggregate shares issued in the private placement with those issued in the acquisition if Nasdaq concludes the private placement financed the acquisition.</td></tr>
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[2] For a company with dual class stock, the number of common shares that may be issued in a transaction is calculated by dividing the "maximum potential issuance" by the total number of common shares issued and outstanding in all classes (not just the specific class of shares being issued) before the transaction.

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	NYSE	Nasdaq
Related Party Transactions	NYSE Listed Company Manual Section 312.03(b) requires shareholder approval for the sale or issuance by a company of its common stock (or securities convertible into or exercisable for its common stock) to: - directors, officers or owners of 5% or more of the company's common stock ("related parties"); - subsidiaries of, affiliates of, or other closely related persons to related parties; or - companies or entities in which a related party has a substantial direct or indirect interest; if the number of common shares to be issued (or underlying the convertible securities to be issued) exceeds either 1% of the number of common shares outstanding before the issuance or 1% of the voting power outstanding before the issuance. However, if the related party involved in the transaction is classified as such solely because of its ownership of 5% or more of the common stock, and the sale is for a price at least as great as the minimum price, shareholder approval will not be required unless the number of shares to be issued (or underlying the convertible securities to be issued) exceeds either 5% of the number of shares of common stock or voting power outstanding before the issuance. ***Update*: NYSE Partial Waiver through June 30, 2020.** This waiver will permit sales of securities to related parties, regardless of percentage issued, that meet all the following requirements: - the sale is for cash at a price no less than the minimum price; - the transaction is reviewed and approved by the company's audit committee or a comparable committee comprised solely of independent directors; and - proceeds from the sale of securities to the related party will not be used to fund an acquisition of stock or assets of another company in which the related person has a direct or indirect interest in the company or assets to be acquired or in the consideration to be paid for such acquisition (*i.e.*, a transaction which would require shareholder approval under Nasdaq Rule 5635(a)(2)).	Generally Nasdaq maintains no explicit restriction on related party transactions. However, Nasdaq Rule 5635(a)(2) provides that issuances of securities in connection with an acquisition will require shareholder approval if any director, officer or substantial stockholder has a 5% or more interest (or collectively, such persons have a 10% or greater interest) in the company or assets to be acquired and the issuance could result in an increase in outstanding common stock or voting power of 5% or more.

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<table>
<tr><th></th><th>NYSE</th><th>Nasdaq</th></tr>
<tr><td>Related Party Transactions (cont'd)</td><td>As a result of this proposed waiver, the NYSE's shareholder approval rule for related party transaction will be consistent with Nasdaq's rule. The waiver does not apply to the change of control rule described below and, as a result, shareholder approval would still be required under that rule if the issuance also constitutes a change of control.

Early Stage Company Exception. A company that has not reported revenues greater than $20 million in any two consecutive fiscal years is considered an early stage company and is exempt from obtaining shareholder approvals for related party transactions provided that its audit committee or comparable committee is comprised solely of independent directors who approve such transactions prior to their completion (although other shareholder approval requirements continue to apply).</td><td></td></tr>
<tr><td>Change of Control</td><td>NYSE Listed Company Manual Section 312.03(d) requires a shareholder vote if securities issuances would result in a change of control of the company. The NYSE bases its determination on a facts-and-circumstances analysis but may presume a change of control for issuances of 20% or more of the outstanding shares of common stock or voting power to an investor or group.</td><td>Pursuant to Rule 5635(b), Nasdaq requires a shareholder vote if securities issuances would result in a change of control. Nasdaq presumes such change of control where the investor or group:
- would own or have the right to acquire 20% or more of the outstanding shares of common stock or voting power; and
- such ownership or voting power would be the largest ownership position.

However, Nasdaq will consider all facts and circumstances concerning a transaction, including existing relationships or agreements between the company and the investor or group.</td></tr>
<tr><td rowspan="2">Exceptions to the Shareholder Approval Rules</td><td colspan="2">Financial Viability. The NYSE and Nasdaq may grant an exception if a company:
- shows delay in securing shareholder approval that would seriously jeopardize the financial viability of company; and
- receives express approval to rely on the exception (generally from the audit committee).

Companies that intend to rely on the financial viability exception must notify their shareholders no later than ten days prior to the issuance of the securities.</td></tr>
<tr><td>Foreign Private Issuers. The NYSE does not apply the 20% issuance shareholder approval rule to foreign private issuers.

Limited Partnerships. The NYSE does not apply the 20% issuance, change of control or related party shareholder approval rules to limited partnerships.</td><td>Foreign Private Issuers. Foreign private issuers may follow home country practices, but if an issuer elects to do so, it must:
- promptly notify Nasdaq of intention to do so and disclose the practice followed in its annual report;
- have an audit committee that satisfies Nasdaq Rule 5605(c)(3) and whose members are independent; and
- not restrict or reduce existing shareholder voting rights in a manner prohibited by the home country, and obtain a written statement from home country independent counsel certifying that company practices are not prohibited by home country laws.</td></tr>
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Strategic Options	Obtaining shareholder approval can be time-consuming, expensive and logistically challenging. Companies will generally need to time the vote to coincide with the annual meeting or hold a special shareholders meeting. Companies may, however, structure their transactions to allow shareholders to approve issuances above 20% subsequent to the initial issuance, or to avoid triggering the shareholder approval rules entirely. Some alternatives may include: – Share caps limiting the issuance at less than 20% of shares outstanding. • Share caps may require cash settlement until shareholder approval is obtained for issuances greater than 20% of outstanding shares. – Alternative outcome clauses (contractual incentives/penalties that are triggered by whether or not shareholder approval is obtained) are not permitted by Nasdaq, but the NYSE is more flexible and will consider these on a case-by-case basis. – Conversion/exercise price floors can set a minimum price above the threshold for approval. • Companies can structure a transaction to include a floor on the conversion/exercise price (including in some cases applying such floor to provisions requiring adjustments to the conversion/exercise price) to prevent the loss of the bona fide private financing exception. – Nasdaq in the past expressed concerns about "future priced securities," whereby the conversion price of the security is generally linked to a percentage discount to the market price of the underlying common stock at the time of conversion. Nasdaq noted that the issuance of future priced securities could result in a failure to comply with Nasdaq listing standards and the delisting of the company's securities from Nasdaq. – In the case of exchanges of convertible securities into other securities, including other convertible debt or common stock, the stock exchanges would consider providing credit in certain circumstances with respect to the securities being exchanged for purposes of calculating the number of shares being issued. – Companies launching public offerings that are structured as such to comply with the 20% shareholder approval rule may wish to consider wall crossing investors prior to public launch in order to get feedback that may be helpful to the structuring of the offering.	

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