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NASDAQ Provides Temporary COVID-19 Exception From Shareholder Approval Requirements Under 20% Rule

SUMMARY

In light of the impact of the COVID-19 pandemic, The Nasdaq Stock Market LLC ("Nasdaq") filed notice of a proposed rule change on May 4 with the Securities and Exchange Commission ("SEC"), which became effective immediately.[1] Specifically, Listing Rule 5636T (the "Temporary Rule") provides a limited temporary exception to the shareholder approval requirements in Listing Rule 5635(d)—also known as the "20% Rule"—and a limited attendant exception for Listing Rule 5635(c) (Equity Compensation).[2] Any securities issued in reliance on the exception must be issued by the later of June 30, 2020 and 30 calendar days following the date of the binding agreement governing the issuance, in each case, after the company has submitted a certification of its compliance with the requirements of the Temporary Rule to Nasdaq by the earlier of June 30, 2020 and two business days before the issuance of the securities. The SEC is soliciting comments on the Temporary Rule for 21 days following publication in the Federal Register.[3]

DISCUSSION

Nasdaq-listed companies must obtain shareholder approval for transactions (other than public offerings) that involve the sale, issuance or potential issuance of common stock (or securities that are convertible into or exercisable for common stock) which, alone or together with sales by officers, directors or substantial shareholders of the company, equal 20% or more of the common stock of the company or voting power outstanding before the issuance for less than the lower of (1) the Nasdaq official closing price (as reflected on Nasdaq.com)[4] immediately preceding the signing of the binding agreement and (2) the average Nasdaq official closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement (the lower of (1) and (2), the "Minimum Price")[5]. A listed company must also obtain shareholder approval when it establishes or materially amends a stock option or purchase plan or other arrangement pursuant to which stock may be acquired by certain affiliates (i.e., officers, directors, employees or consultants).[6] NASDAQ interprets this listing rule to require shareholder approval for certain issuances to such affiliates when the issuance could be considered a form of equity compensation.

The Temporary Rule provides Nasdaq-listed companies a general exception to the shareholder approval requirements under the 20% Rule. In addition, the Temporary Rule provides listed companies with an exception to the shareholder approval requirements for equity compensation under Listing Rule 5635(c), but only for issuances to affiliates in transactions covered by the Temporary Rule, and provided that (1) any single affiliate's participation is less than 5% of the transaction; (2) all affiliates' aggregate participation is less than 10% of the transaction; (3) any affiliate's participation was specifically required by unaffiliated investors; and (4) the affiliates have not participated in negotiating the economic terms of the transaction.

In proposing the Temporary Rule, Nasdaq notes that while listed companies in financial distress already benefit from an exception from the shareholder vote requirement if the delay associated with securing shareholder approval would seriously jeopardize the financial viability of the company (the "Financial Viability Exception"),[7] the Temporary Rule would cover circumstances where the financial viability of the company may not be in serious jeopardy, but the company nevertheless needs access to additional funding during the COVID-19 pandemic on an accelerated timeline.[8] Nasdaq further noted that the accelerated need for funds, in combination with a company's curtailed operations, may make it impractical to mail notice to all shareholders 10 days prior to issuing securities as required by the Financial Viability Exception.

A Nasdaq-listed company seeking to avail itself of the temporary exception under the Temporary Rule must demonstrate the following:

- the need for the transaction is due to circumstances related to COVID-19;
- 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;
- the company undertook a process designed to ensure that the proposed transaction represents the best terms available to the company;
- the company's audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors has (A) expressly approved reliance on the exception and (B) determined that the transaction is in the best interests of shareholders; and
- the company has submitted a supplement to the Listing of Additional Shares notification form by the earlier of June 30, 2020 and two business days before the issuance of the securities certifying that it complies with all of the foregoing requirements and describing how it complies.

Unless the transaction falls under the "Safe Harbor Provision" described below, the Nasdaq Listing Qualifications Department will review a company's Listing of Additional Shares notification form supplement for compliance with the requirements of the Temporary Rule and must approve the company's reliance on the Temporary Rule before the company may issue any securities in the applicable transaction. Where the maximum issuance of common stock (or securities convertible into common stock) in the transaction is less than 25% of the total shares outstanding and less than 25% of the voting power outstanding before the transaction and the discount to the Minimum Price is no more than 15%, a company may avail itself of the Temporary Rule's "Safe Harbor Provision" and, after submitting its Listing of Additional Shares notification form supplement, issue securities without waiting to obtain Nasdaq approval. The Safe Harbor Provision does not cover warrants that are exercisable for common stock.

Any company that relies on the Temporary Rule must also make a public announcement by filing a Form 8-K, if required by SEC rules, or by issuing a press release as promptly as possible, but not later than two business days **before** the issuance of the securities. Such public announcement must disclose:

- the terms of the transaction (including the number of shares of common stock that could be issued and the consideration received);
- that shareholder approval would ordinarily be required under Nasdaq rules but for the fact that the company is relying on an exception to the shareholder approval rules; and
- that the audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors expressly approved the company's reliance on the exception and determined that the transaction is in the best interests of shareholders.

After executing a binding agreement governing the issuance of the securities prior to June 30, 2020, submitting the required notices, making the required announcements and obtaining the required approval (if applicable), a company may issue securities governed by such agreement by the later of June 30, 2020 and 30 calendar days following the date of the binding agreement.

All securities issued in reliance on the Temporary Rule will be aggregated with any subsequent issuance by the company at a discount to the Minimum Price if the binding agreement for the subsequent issuance is executed within 90 days of the reliant issuance (other than a public offering under IM-5635-3), and if, following the subsequent issuance, the aggregate amount of shares issued in the reliant and subsequent issuance equals or exceeds 20% of the total shares or the voting power outstanding before the reliant issuance, shareholder approval will be required under Listing Rule 5635(d) prior to the subsequent issuance.

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ENDNOTES

[1] Under Rule 19b-4(f)(6)(iii) under the Exchange Act, a proposed rule change may be immediately effective if it does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate.

[2] Securities Exchange Act Release No. 34-88805; File No. SR-NASDAQ-2020-025 (May 4, 2020), *available at* https://www.sec.gov/rules/sro/nasdaq/2020/34-88805.pdf.

[3] At any time within 60 days of the filing, the SEC may temporarily suspend the rule change if it appears to the SEC that action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

[4] Generally, the Nasdaq Official Closing Price is the Nasdaq Closing Cross price as determined in the Nasdaq Closing Cross, the process for determining the price at which orders will be executed at the close and for executing those orders. See Nasdaq Listing Rule 4754 for more details, *available at* http://nasdaq.cchwallstreet.com/.

[5] Nasdaq Listing Rule 5635(d), *available at* http://nasdaq.cchwallstreet.com/.

[6] Nasdaq Listing Rule 5635(c), *available at* http://nasdaq.cchwallstreet.com/.

[7] Nasdaq Listing Rule 5635(f), *available at* http://nasdaq.cchwallstreet.com/.

[8] Securities Exchange Act Release No. 34-88805; File No. SR-NASDAQ-2020-025 (May 4, 2020), *available at* https://www.sec.gov/rules/sro/nasdaq/2020/34-88805.pdf.

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