Nasdaq Modifies Certain Shareholder Approval Rules on Temporary Basis

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Temporary waiver of 20% rule and certain deemed equity compensation plans, as well as advanced notification and aggregation provisions, in light of COVID-19-related financing needs

Recognizing the need to ease companies' access to capital during the COVID-19 pandemic, Nasdaq has adopted temporary exceptions to certain of its shareholder approval rules. New Nasdaq **Listing Rule 5636T** provides a limited temporary exception to its requirement of shareholder approval for private issuances of 20% or more of the company's common stock or voting power at less than market price. The new rule also provides, in certain narrow circumstances relating to new money investments by members of management, a limited temporary exception to shareholder approval rules relating to equity compensation plans. Finally, Nasdaq has relaxed its aggregation and notification rules related to issuances under this new exception. The Nasdaq rule waivers follow on the heels of waivers enacted recently by the NYSE (discussed **here**), but covers different ground.

The rule is effective immediately and will remain in place through June 30, 2020.

Waiver of 20% Rule

Nasdaq's newly-adopted **Listing Rule 5636T** allows a company to issue 20% or more of its common stock at a price below the market price without shareholder approval in certain circumstances. Under the current Nasdaq Listing Rule 5635(d), shareholder approval is required prior to the issuance of 20% or more of the company's common stock or voting power if the price is lower than the "minimum price" (defined as a price that is the lower of: (i) the last closing price before the signing of the agreement to issue stock and (ii) the average of the closing prices over the last five trading days immediately before signing the agreement). Under the "financial viability" exception to this rule, a company may apply to Nasdaq for a waiver when a delay in securing shareholder approval would seriously jeopardize the financial viability of the company. If approved by Nasdaq, the company must mail an alert to all shareholders not later than ten days before the issuance. The temporary rule would provide an additional exception besides financial viability that would allow companies in some instances to bypass waiting for Nasdaq approval and, in all instances, to issue a press release or Form 8-K at least two business days before the issuance instead of mailing notice to all shareholders at least ten days before.

In order to qualify for the exception under the temporary rule, a company must certify to Nasdaq that:

- the need for the transaction is due to circumstances related to COVID-19;
- the delay in securing shareholder approval would either:
  - have a material adverse impact on the company's ability to maintain operations under its pre-COVID-19 business plan;
  - result in workforce reductions;
  - adversely impact the company's ability to undertake new initiatives in response to COVID-19; ***or***
  - 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; and

- the company's audit committee (or a comparable body of the board of directors comprised solely of independent, disinterested directors) has expressly approved reliance on this exception and has determined that the transaction is in the best interest of shareholders.

The certification should "describe with specificity" how the company complies with the Listing Rule 5636T. After submitting this information, the company does not need to wait for Nasdaq approval (unless it is issuing warrants) if the maximum amount of shares to be issued is less than 25% of the total shares and voting power outstanding before the transaction and the maximum discount to the "minimum price" at which the shares will be offered is 15%. Otherwise, the company must wait for Nasdaq to notify the company in writing that it has approved the transaction prior to issuing any securities.

In addition, in order to rely on the exception, a company must file a Form 8-K (where required) or issue a press release, as promptly as possible, but no later than two business days before the issuance of the securities, disclosing:

- the terms of the transaction (including the number of shares 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 this temporary exception to the shareholder approval rules; and
- that the audit committee (or a comparable body of the board of directors) expressly approved reliance on the exception and determined that the transaction is in the best interest of shareholders.

Companies have historically tried to avoid using the financial viability exception and it will remain to be seen whether they will more readily utilize this new exception.

It is important to note that the exception in the temporary rule does not apply to the existing requirement to obtain shareholder approval prior to an issuance of securities in connection with a change of control pursuant to Nasdaq Listing Rule 5635(b). Accordingly, any issuance that would result in an investor, or group of investors, owning more than 20% of the company's stock would need to be analyzed under that rule.

Waiver of Issuances Under Equity Compensation Plans

The temporary rule also provides a limited exception for issuances of securities under an equity compensation plan. Under current Nasdaq Listing Rule 5635(c), shareholder approval is generally required prior to the issuance of securities when an equity compensation plan or arrangement is established or materially amended. Nasdaq has historically interpreted this rule to require shareholder approval for certain sales to employees when such sales could be considered a form of equity compensation (e.g., when the issuance occurs at a price less than the market value of the stock). The temporary rule provides an exception to the shareholder approval requirements under Rule 5635(c) for an affiliate's participation in a transaction that satisfies (1) all of the requirements described for the exception above, *plus* (2) the following requirements:

- any affiliate's individual participation must be less than 5% of the transaction;
- all affiliates' participation collectively must be less than 10% of the transaction;
- any affiliate's participation must have been specifically required by unaffiliated investors; and
- the affiliates must not have participated in negotiating the economic terms of the transaction.

This narrow exception is directed at providing relief from the shareholder approval requirements in circumstances where, for example, unaffiliated investors require a company's senior executives to put their own capital "at risk" by participating in capital raising transactions in light of the uncertainty due to COVID-19. In circumstances that do not meet the above requirements, listed companies must continue to comply with the current shareholder approval requirements under Rule 5635(c), including, for example, companies who are now seeking to increase the share capacity under their equity compensation plans in light of increased burn rates as a result of depressed stock prices due to the effects of the COVID-19 pandemic.

Aggregation of Issuances

Issuances of stock in reliance on the rule will be aggregated with any subsequent issuance by the company, other than a public offering, at a discount to the minimum price if the binding agreement governing the subsequent issuance is executed within 90 days of the prior issuance. This is a relaxation of Nasdaq's current practice of aggregating issuances made within a six month period. If, following the subsequent issuance, the aggregate amount of shares issued (including those issued in reliance on the exception) equals or exceeds 20% of the total shares or the voting power of the company before the issuance, then shareholder approval will be required under the current rules prior to the subsequent issuance.

Timing

The temporary rule waives the current requirement that a company notify Nasdaq at least 15 days prior to an issuance of stock greater than 10% of the outstanding shares or voting power. Companies are, however, still required to provide the notification required by the current rule, along with the supplement certifying compliance with the requirements of the temporary rule (as described above), as promptly as possible, but not later than the time of the required public announcement of the stock issuance and in no event later than June 30, 2020. For issuances that require Nasdaq approval, Nasdaq expects companies to allow Nasdaq "enough time" to complete its review.

In order to rely on the rule, a company must execute a binding agreement for the issuance of stock and obtain approval, if needed, from Nasdaq prior to June 30, 2020. The issuance of stock relying on this exception may take place after June 30, 2020 so long as the issuance occurs within 30 calendar days following the date of the binding agreement.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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