May 8, 2020

COVID-19 Update for Public Companies: Nasdaq Provides Temporary Relief as to the 20% Shareholder Approval Requirement

On May 4, 2020, the SEC approved, with immediate effect, a proposed rule change filed by The Nasdaq Stock Market LLC ("Nasdaq") (available here) that provides Nasdaq-listed companies with a limited temporary exception (the "Temporary Exception") to the shareholder approval requirement for private placements and a narrow related exception for an affiliate's participation in these placements. The rule change, reflected in new Listing Rule 5636T, is aimed at streamlining listing companies' access to capital in the current difficult market conditions brought about by the COVID-19 outbreak and is available through June 30, 2020.[1] In effect, the shareholder approval requirement is waived, and while notification to Nasdaq is still required, in certain circumstances (referred to in the relief as the "Safe Harbor Provision") companies will be able to proceed without prior Nasdaq approval.

Existing shareholder approval requirements

Nasdaq Listing Rule 5635(d) requires listed companies to obtain shareholder approval in connection with (i) certain acquisitions of the stock or assets of another company; (ii) equity-based compensation of officers, directors, employees or consultants; (iii) a change of control; and (iv) a 20% issuance at a price less than the minimum price, other than in public offerings (collectively, the "Approval Triggers").[2]

Nasdaq rules provide an exception from the shareholder approval requirement for companies in financial distress where the delay in securing stockholder approval would seriously jeopardize the financial viability of the company. However, as noted by Nasdaq, this exception may be of limited use to companies affected by the COVID-19 pandemic given the high standard required for showing that the company's financial viability is in jeopardy and its strict procedural requirements that mandate express approval by the company's audit committee and by Nasdaq prior to proceeding with the transaction, and alerting

1 This relief marks the second Nasdaq action in response to COVID-19, which follows the April 17 Nasdaq rule change that temporarily modified tolling periods for calculating market value of publicly held shares and the $1.00 minimum bid price. For more information on the earlier COVID-19-related Nasdaq relief, see our prior alert here.

2 Listing Rule 5635(d)(1)(A) defines "minimum price" as a price that is the lower of: (1) the Nasdaq official closing price immediately preceding the signing of the binding agreement; or (2) the average Nasdaq official closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement.

shareholders of the omission to seek shareholder approval by letter mailed at least 10 calendar days prior to the issuance.

Shareholder approval – temporary relief

Scope of the exception

The Temporary Exception allows Nasdaq-listed companies to issue, without shareholder approval, securities in a private placement notwithstanding the 20% shareholder approval rule. The Temporary Exception is in force through June 30, 2020, and to take advantage of the relief, a binding agreement to issue the securities has to be signed, the requisite notices need to be submitted and the Nasdaq approval (unless the Safe Harbor Provision, as described below, is available) must be obtained prior to that date. Issuances may occur after June 30, 2020, provided they occur no later than 30 calendar days following the date of the binding agreement.

Key requirements

In order to take advantage of the Temporary Exception, the company must apply to the Listing Qualifications Department demonstrating that the transaction satisfies the following requirements:

- the delay in securing shareholder approval would (i) have a material adverse impact on the company's ability to maintain operations under its pre-COVID-19 business plan; (ii) result in workforce reductions; (iii) adversely impact the company's ability to undertake new initiatives in response to COVID-19; or (iv) seriously jeopardize the financial viability of the enterprise;

- the need for the transaction is due to circumstances related to COVID-19;

- 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 the transaction and has determined that the transaction is in the best interest of shareholders.

After submitting the application to the Listing Qualifications Department, unlike the requirement for the financial viability exception, the company does not need to obtain prior Nasdaq approval if it can avail itself of the Safe Harbor Provision, namely the maximum issuance of common stock (or securities convertible into common stock) issuable 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 maximum discount to the minimum price at which shares could be issued is 15%. In all other cases, the Listing Qualifications Department must approve reliance on the Temporary Exception based on the information provided.

The company must make a public announcement by filing a Form 8-K, where required by SEC rules, or by issuing a press release, disclosing as promptly as possible, but no later than two business days before the issuance of the securities: (i) the terms of the transaction (including the number of shares of common stock that could be issued and the consideration received); (ii) that shareholder approval would ordinarily be required under Nasdaq rules but for the fact that the company is relying on an exception; and (iii) 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.

The company, in lieu of obtaining prior approval following a 15-day advance notification, must nonetheless submit to Nasdaq in order to list the additional shares: (i) a written certification describing with specificity how the company complied with the requirements for the Temporary Exception and (ii) notification of the anticipated transaction. These submissions must be made as promptly as possible, but no later than the public announcement on via Form 8-K/ press release and in no event later than June 30, 2020.

Except for the foregoing and the limited exception described below for affiliate participation, the other Approval Triggers remain in effect.

Equity compensation exception

Nasdaq adopted an exception from the shareholder approval requirement for an affiliate's participation in a transaction qualifying for the Temporary Exception provided the affiliate's participation in the transaction is specifically required by unaffiliated investors and the affiliate has not participated in negotiating the economic terms of the transaction.[3] As a condition to qualifying for the relief, each affiliate's participation must be less than 5% of the transaction and all affiliates' participation collectively must be less than 10% of the transaction.

---

[3] Nasdaq has long interpreted its rules to require shareholder approval for certain sales to officers, directors, employees or consultants when such issuances could be considered a form of "equity compensation." Nasdaq has heard from market participants that investors often require senior management to put personal capital at risk and participate in a capital-raising transaction alongside the unaffiliated investors. Nasdaq believes that as a result of uncertainty related to the ongoing spread of the COVID-19 virus, listed companies seeking to raise capital may face such requests. Accordingly, Nasdaq proposes that the temporary exception allow such investments under limited circumstances.

Aggregation

Nasdaq will aggregate issuances of securities made in reliance on the Temporary Exception 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. As a result, if the aggregate issuance (including shares issued in reliance on the exception) equals or exceeds 20% of the total shares or the voting power outstanding before the initial issuance, then shareholder approval will be required prior to the subsequent issuance.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Rachael G. Coffey
+1-212-373-3982
rcoffey@paulweiss.com

John C. Kennedy
+1-212-373-3025
jkennedy@paulweiss.com

Tracey A. Zaccone
+1-212-373-3085
tzaccone@paulweiss.com

Securities practice management attorney Monika G. Kislowska contributed to this Client Alert.