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NYSE Proposes Amendments to Eliminate the Treasury Share Exception

In May, the NYSE filed proposed amendments with the SEC to amend its shareholder approval policies to eliminate the “treasury share exception” under Section 312 of the NYSE’s Listed Company Manual (the “Manual”).

Background

Section 312.03 of the Manual requires that companies obtain shareholder approval before issuing stock in certain situations, or in significantly large amounts, by providing that shareholder approval is a “prerequisite to listing” additional shares by a listed company in specified circumstances.¹ While the precise terms of the requirement have changed over the years, the requirement historically has not been applied to company issuances of shares from its “treasury,” i.e., a reissuance of shares once issued but then reacquired by the company.

The “treasury shares exception” results from the way the requirement is written, which makes shareholder approval a “prerequisite to listing.” In the NYSE’s view, shares remain listed once they are listed even if they are repurchased by the company and taken back into “treasury.” As a result, when treasury shares are re-issued, the NYSE does not require that they be “re-listed.” Since no listing application is required, Section 312.03 of the Manual is not triggered.

¹ Under Section 312.03, shareholder approval is a prerequisite to listing additional shares resulting from the issuance of: (i) more than 1% of the current outstanding common stock to an insider (an officer or director, or an entity affiliated with an officer or director), (ii) more than 5% of the current outstanding to a 5% or greater shareholder or an affiliate thereof, or (iii) more than 20% of the current outstanding in any transaction other than a public offering or “bona fide private financing” (as defined in Section 312.04(f)). Shareholder approval is also required when an issuance will result in a “change of control of the issuer.” These provisions apply in the same way to offerings of securities that are convertible into common stock, and the percentages in each case apply either to outstanding common equity or common voting power.

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Prior to 2003, the NYSE's rule requiring shareholder approval of stock option plans resided in Section 312.03 as well, and the "treasury share exception" was also applied in that context. However, the rules were revised in 2003 so that the exception was specifically unavailable for equity compensation plans. Under Section 303A.08 of the Manual, shareholder approval is required regardless of whether a plan is funded in whole or in part through the use of treasury shares.

The "treasury share exception" has been criticized because it potentially allows companies to store up large reserves of stock against a future issuance of shares in transactions that could significantly dilute existing shareholders without their approval. In light of this criticism, the NYSE requested comment from listed companies and investors as to whether or not the treasury stock exception should be eliminated, but received only a modest number of comments, with institutional investors advocating the elimination of the exception, and a small number of issuers advocating maintenance of the status quo.

The Proposed Amendments

The NYSE agrees that there is a legitimate concern that the "treasury share exception" could result in an unacceptable level of dilution without shareholder input and, as a result, has proposed to amend Section 312.03 of the Manual to eliminate the exception. The NYSE has also proposed related amendments to Section 312.04, which amplifies and interprets the operative provisions of Section 312.03.

In addition, the NYSE has proposed to amend Section 703.01(A) of the Manual to require companies to notify the NYSE of issuances from treasury, so that the NYSE can determine whether the transaction is one that would require shareholder approval under Section 312.03. The NYSE has also proposed to amend Section 312.03(b) to specify that it covers issuances that are part of a "series of related transactions." This proposed change parallels the language used in Section 312.03(c) that calls for shareholder approval for issuances of 20% or more of a company's voting common securities.

The "treasury share exception" will cease to be available as of the date of the SEC's approval of the proposed rule changes. Issuers will be unable to rely on the exception after that date, even if the issuer were obligated to effect the issuance prior to that effective date.

The complete text of the proposed amendments is available on the NYSE's website (<http://www.nyse.com>).

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This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

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