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Legal Update

Temporary Nasdaq Relief from Shareholder Vote Requirement

On May 4, 2020, the Securities and Exchange Commission approved a rule filing from Nasdaq granting temporary relief from the shareholder approval requirements in respect of certain transactions (the "rule filing"). Nasdaq has adopted Listing Rule 5336T, which provides for limited relief from Nasdaq Listing Rule 5635(d) ("transactions other than public offerings") and under certain limited circumstances a limited attendant exception to Listing Rule 5635(c) ("equity compensation").

Discounted Issuances in Transactions Other than a Public Offering

Rule 5635(d) requires that a listed company obtain shareholder approval for certain transactions other than public offerings that involve an issuance of common stock or securities convertible into, or exercisable for, common stock in excess of 20% of pre-transaction total shares outstanding at a price below the "minimum price" or 20% or more of the voting power outstanding before the transaction. The minimum price is defined as 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.

The rule filing notes that many companies have suffered as a result of the recent pandemic and the associated market volatility, and seek to raise additional capital. Investors would like to be compensated for the risk associated with an investment during these uncertain times and for an investment in a troubled company. The Nasdaq listing rules do have an exception from the shareholder approval requirements for companies in financial distress, but this financial viability exception may not be helpful to most companies.

As a result until and including June 30, 2020, Listing Rule 5636T will provide an alternative to the extent that the delay in securing shareholder approval would (1) have a material adverse impact on the company's ability to maintain operations under its pre-COVID-19 business plan, (2) result in workforce reductions, (3) adversely impact the company's ability to undertake new initiatives in response to COVID-19, or (4) seriously jeopardize the financial viability of the enterprise. In addition to meeting one of such requirements, the company must also demonstrate to Nasdaq that the need for the transaction is due to circumstances related to COVID-19 and that the company undertook a process designed to ensure that the proposed transaction represents the best available terms for the company. In addition, the company's audit committee or a similar group consisting only of independent, disinterested directors must expressly approve reliance on the exception and that the transaction is in the best interest of the company's stockholders.

No prior approval from Nasdaq is required if the maximum issuance of common stock is less than 25% of pre-transaction 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% (referred to as the "Safe Harbor"). A transaction that includes warrants is not eligible for the Safe Harbor.

If the transaction does not fall within the Safe Harbor, then, the Nasdaq Listing Qualifications Department must approve the company's reliance on the exception before the securities can be issued. Nasdaq will provide written notification of its approval.

A company that chooses to rely on the exception must make a public announcement by filing a Current Report on Form 8-K or by issuing a press release no later than two business days prior to the issuance of the securities that discusses the terms of the transaction, that shareholder approval would have been required but for the temporary exception, and that the audit committee (or similar body) has approved the transaction.

Equity Compensation (Insider Participation)

Rule 5635 requires shareholder approval for certain sales to officers, directors, employees or consultants when such issuances could be considered a form of equity compensation. Generally, when an insider identified immediately above participates in a securities offering made at a discount, even if the terms of such transaction have been negotiated by third parties, and the insiders are buying on the same terms as such third parties, the discount is considered equity compensation.

As Nasdaq notes in the rule filing, insiders often are expected to participate in financing rounds, especially as a means of conveying their commitment to, and support for, their company. In order to address such instances during this challenging period, Nasdaq is adopting Listing Rule 5636T(c), which provides an exception from shareholder approval for an affiliate's participation in a transaction such as that described in Listing Rule 5636T(b) provided the affiliate's participation in the transaction was specifically required by the unaffiliated investors. In addition, the rule would limit such participation to a de minimis amount. Each affiliate's participation must be less than 5% of the transaction and collectively all affiliates' participation must be less than 10% of the transaction. Any affiliate that participates must not have participated in negotiating the terms of the transaction.

Notification

Under the Nasdaq rules, a company must notify the exchange at least 15 calendar days prior to the occurrence of certain events, including the entry into a transaction that may result in the potential issuance of common stock (or securities convertible into or exercisable for common stock) greater than 10% of either the total shares outstanding or the voting power outstanding on a pre-transaction basis (referred to as the Notification). Listing Rule 5636T(e) will provide that a company that relies on the exception in Rule 5636T will not be subject to the 15-day Notification. Notification must be provided as promptly as possible but no later than the time at which the public announcement is required. The Notification will be required to include a certification regarding compliance with the rule. For transactions that require Nasdaq approval, the company would have to provide the required Notification with sufficient time to allow for a review.

Aggregation

Nasdaq will aggregate issuance of securities in reliance on the exception in Listing Rule 5636T with any subsequent offering other than a public offering under Nasdaq's interpretative guidance (IM-5635-3) at a discount to the minimum price if the binding agreement governing the subsequent issuance is executed within 90 days of the prior issuance.

Conclusion

This is welcome relief for Nasdaq-listed companies. The Safe Harbor, we note, is quite limited and many transactions likely will continue to require Nasdaq review and approval. A listed company that is considering a transaction that will benefit from the temporary rule should consider how it documents the process it undertook with respect to evaluating that the terms are the best terms available to the company. Likewise, a listed company's audit committee should consider how it will document its determination that the transaction is in the best interest of stockholders. Compliance with the terms of the relief in connection with participation by affiliates may also be challenging in that the issuer will have to document the requirement by third parties to have affiliates participate. Usually, third parties would indicate an expectation that insiders would participate and have skin in the game but would not condition an investment on insider participation. Finally, it is more often than not directors and officers that are asked to participate in a financing round and these same persons will have participated in the discussions relating to financing options.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

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