Proskauer

New 20% Rule Offers Greater Clarity and Flexibility for Nasdaq-listed Companies

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On September 26, 2018, the Securities and Exchange Commission approved The Nasdaq Stock Market LLC's proposal to modify the so-called "20% Rule" contained in Nasdaq Listing Rule 5635(d). The modified rule expands the situations in which Nasdaq-listed companies can issue securities in private placements without receiving shareholder approval. Given the significant time and expense required to obtain shareholder approval, we believe the rule change will be welcomed by Nasdaq-listed companies and their financial advisors by eliminating shareholder approval requirements for transactions that do not implicate the concerns that the rules were designed to address.

Summary of New Rule

The new simplified 20% Rule provides that "[s]hareholder approval is required prior to a ***20% Issuance*** at a price that is less than the ***Minimum Price***."[1] For purposes of the 20% Rule, Nasdaq created two new defined terms, as follows:

"**20% Issuance**" is defined as a transaction, other than a public offering as defined in IM-5635-3, involving the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable for common stock), which alone or together with sales by officers, directors or Substantial Shareholders of the Company, equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance; and

"**Minimum Price**" is defined as a price that is the lower of: (i) the closing price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock (as reflected on Nasdaq.com) for the five trading days immediately preceding the signing of the binding agreement.

Summary of Changes

Elimination of Book Value Test

Previously, the 20% Rule required shareholder approval prior to the issuance in a transaction other than a public offering of 20% or more of a company's common stock or 20% or more of its voting power outstanding before the issuance (an "**Applicable Issuance**"), if the issuance was at a price less than market value or book value. The amendment removed the requirement that Nasdaq-listed companies receive shareholder approval for Applicable Issuances at a price less than book value. Nasdaq considered that book value may not be an appropriate trigger for requiring shareholder approval for a number of reasons, including that book value (i) is an accounting measure relying on the historical cost of assets, rather than the current value of assets, (ii) may not be an appropriate measure to determine whether a transaction is dilutive to shareholders, and (iii) often has little correlation to the real value of a company's stock resulting in unexpected consequences for companies conducting offerings, particularly those with high levels of assets such as natural resources.

Clarification of Minimum Price

As noted above, prior to the Release, the 20% Rule required shareholder approval of Applicable Issuances, if the issuance was at a price less than market value or book value. The 20% Rule previously defined "market value" by utilizing a security's bid price. Nasdaq determined that the bid price concept may not be transparent enough to investors and does not always reflect the actual trading price of a security. In the revised 20% Rule, Nasdaq uses Minimum Price instead of market value as the trigger for requiring shareholder approval, and Minimum Price is determined by the closing price of the security as reflected on Nasdaq.com. This change is intended to provide more transparency and additional flexibility for Nasdaq-listed companies to price transactions that are not public offerings.

Shareholder Approval Still Required for Other Transactions

While these modifications relax the shareholder approval requirement for Nasdaq-listed companies conducting a 20% Issuance, Nasdaq rules requiring shareholder approval for certain other transactions have not changed. Any discounted issuance of stock to a company's officers, directors, employees or consultants will still require shareholder approval under Nasdaq's equity compensation rules.[2] Furthermore, if the issuance of securities results in a change of control and the acquisition of stock or assets of another company, then shareholder approval will still be required.[3]

[1]Nasdaq Listing Rule 5635(d)(2).

[2] Nasdaq Listing Rule 5635(c).

[3] Nasdaq Listing Rule 5635(a)-(b).