Nasdaq Improves 20% Rule Requiring Shareholder Approval of Certain Private Placements

On September 26, 2018, the U.S. Securities and Exchange Commission (SEC) approved proposed amendments to Nasdaq's shareholder approval rule for 20% stock issuances, effective immediately. The amendments are intended to enhance capital formation while maintaining dilution protection for shareholders. Amended Rule 5635(d) will provide companies and investors with greater flexibility to structure private placement transactions that do not require shareholder approval.

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Nasdaq requires listed companies to obtain shareholder approval before issuing securities in a private placement that constitute 20% or more of their outstanding common stock or voting power at a discounted price. Other provisions under Rule 5635 also require shareholder approval for certain issuances of common stock involving an acquisition of stock or assets of another company, a change of control or equity compensation. Nasdaq did not propose to amend — and the amendments do not alter — these other shareholder approval provisions. Companies listed on the NYSE are subject to a similar shareholder approval listing rule regarding 20% share issuances that contains certain differences from the Nasdaq rule, which are beyond the scope of this alert.

Summary of the Amendments

Amended Rule 5635(d) provides: "Shareholder approval is required prior to a **20% Issuance** at a price that is less than the **Minimum Price**."

- "20% Issuance" means a transaction, other than a public offering, involving the sale, issuance or potential issuance by the issuer 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 issuer, equals 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance.
- "Minimum Price" means a price that is the lower of: (i) the closing price immediately preceding the signing of the binding agreement; or (ii) the average closing price of the common stock for the five trading days immediately preceding the signing of the binding agreement.

Change from Market Value to Minimum Price

Prior to the amendments, discounted price was determined by reference to "market value" — defined as the consolidated closing bid price (which can differ from the official Nasdaq closing price) immediately prior to entry into a binding agreement for issuance of the securities.

Under amended Rule 5635(d), discounted price is determined by reference to the "Minimum Price," which uses the closing price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement, rather than the bid price, as the pricing threshold. Nasdaq noted that the closing price reported on Nasdaq.com better reflects the market price of the security and is highly transparent to investors. Further, the use of closing price as opposed to bid price is consistent with the approach of the NYSE.

Nasdaq now only requires shareholder approval if the issuance price is less than the *lower of* the prior closing price and the trailing five-trading day average closing price.

The amendments also add the five-day average closing price as a new pricing threshold for shareholder approval. Nasdaq noted that the five-day average closing price test will provide benefits to issuers and their shareholders, as it provides flexibility to account for market fluctuations.

Further, Nasdaq now only requires shareholder approval if the issuance price is less than the *lower of* the prior closing price and the trailing five-trading day average closing price. Prior to the amendment, shareholder approval was required if the issuance price was less than the *greater of* market value and book value.

Elimination of the Book Value Test

Amended Rule 5635(d) eliminates the requirement for shareholder approval of private placement issuances at a price that is less than book value (if greater than the Minimum Price). Nasdaq noted that book value is an accounting measure that is based on historic costs of assets rather than current value and, therefore, is not an appropriate measure of whether a transaction is dilutive.

For further information, read the SEC's order granting approval of the proposed rule change.

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Listed companies and investors contemplating a private placement should consider the shareholder approval requirements early in the transaction process. Recognizing early on the possibility that shareholder approval may be required in a proposed transaction — and potentially structuring the transaction to avoid shareholder approval — can facilitate the timely consummation of the proposed investment.

If you have any questions about the matters addressed in this *Kirkland Alert*, please contact the following Kirkland authors or your regular Kirkland contact.

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