KIRKLAND & ELLIS

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

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On March 20, 2019, the U.S. Securities and Exchange Commission ("SEC") approved proposed amendments to the NYSE's shareholder approval rule for 20% stock issuances, effective immediately. The amendments are intended to enhance capital formation while maintaining dilution protection for shareholders, and are substantially similar to amendments approved by the SEC for Nasdaq in September 2018 (see our prior *Kirkland Alert*).

The amendments will provide NYSE-listed companies and investors with greater flexibility to structure private placement transactions that do not require shareholder approval.

Section 312.03 of the NYSE's Listed Company Manual requires companies to obtain shareholder approval before issuing common stock (or securities convertible into or exercisable for common stock) in a private placement that constitutes 20% or more of the company's pre-transaction outstanding common stock or voting power at a discounted price. Other provisions of Section 312.03 also require shareholder approval for equity compensation plans, certain issuances of securities to related parties, and issuances of securities that will result in a change of control of the company. Section 312.04 of the NYSE's Listed Company Manual provides definitions and explanations applicable to Section 312.03.

Summary of the Amended Rule

The amendments to Sections 312.03 and 312.04 of the NYSE's Listed Company Manual replace the term "market value" with "Minimum Price" and eliminate the requirement for shareholder approval of issuances at a price less than book value but greater than Minimum Price.

Section 312.03(c) states that shareholder approval is required prior to the issuance of common stock, or of securities convertible into or exercisable for common stock, in any transaction or series of related transactions if:

1. the common stock has, or will have upon issuance, voting power equal to or in excess of 20% of the voting power outstanding before the issuance of such stock or of securities convertible into or exercisable for common stock; or
2. the number of shares of common stock to be issued is, or will be upon issuance, equal to or in excess of 20% of the number of shares of common stock outstanding before the issuance of the common stock or of securities convertible into or exercisable for common stock.

Section 312.03(c) further provides a number of exceptions to the "20% rule." Shareholder approval is not required for any such 20% or greater issuance involving:

- any public offering for cash;
- any bona fide private financing, if such financing involves a sale of:
    - common stock, for cash, at a price at least as great as the Minimum Price; or
    - securities convertible into or exercisable for common stock, for cash, if the conversion or exercise price is at least as great as the Minimum Price.

Change from Market Value to Minimum Price and Elimination of the Book Value Test

Prior to the amendments, the "bona fide private financing" exemption required a cash sale of common stock at a price (or a cash sale of convertible or exercisable securities with a conversion or exercise price) at least as great as each of the book and market value of the common stock. "Market value" was defined in Section 312.04(i) as the official closing price on the NYSE as reported to the Consolidated Tape immediately preceding the entering into of a binding agreement to issue the securities. Therefore, to avoid shareholder approval, a private placement of 20% or more of the common stock (including on an as-converted basis) required the issuance price to be greater than both the book value of the shares and the immediately preceding closing price of the shares.

Under the amended listing rule, discounted price will no longer be determined by reference to the "market value" but instead by reference to the "Minimum Price," which is defined as a price that is the lower of: (i) the Official Closing Price immediately preceding the signing of the binding agreement to issue the securities; or (ii) the average Official Closing Price for the five trading days immediately preceding the signing of the binding agreement. "Official Closing Price" is defined the same way that "market value" was defined under the pre-amended rule.

> **The "Minimum Price" threshold provides greater flexibility to companies and investors because it allows for consummation of a private placement without shareholder approval if the issuance is priced below the immediately preceding closing price so long as it is priced above the five-trading day average closing price.**

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In addition, the NYSE eliminated book value as a minimum price threshold as a requirement to avoid shareholder approval because 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.

Shareholder Approval of Issuances to Related Parties

The amendments changing the reference from "market price" to "Minimum Price" and the elimination of the book value test also apply to the shareholder approval requirement for issuances to related parties of common stock, or of securities convertible into or exercisable for common stock, that exceed 1% of the outstanding shares or voting power. If the issuance is to a related party that is classified as a related party solely because such person is a substantial security holder (rather than a director or officer), so long as the issuance is for cash at a price at least as great as the Minimum Price, shareholder approval is only required if such issuance is for common stock, or for securities convertible into or exercisable for common stock, that exceeds 5% (rather than 1%) of the outstanding shares or voting power.

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

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.

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