ALERTS

PIPEs Update: Nasdaq Provides Temporary Relief from Certain Shareholder Approval Requirements for PIPEs (COVID-19)

May 11, 2020

On May 4, 2020, the U. S. Securities and Exchange Commission approved Listing Rule 5636T ("Temporary Shareholder Approval Exemption") proposed by The Nasdaq Stock Market LLC ("Nasdaq") to provide Nasdaq-listed companies with a temporary limited exception through June 30, 2020, to certain shareholder approval requirements under Nasdaq Listing Rule 5635(d)[1] (Transactions other than Public Offerings) and Listing Rule 5635(c)[2] (Equity Compensation) in an effort to streamline access to capital amidst the market uncertainty, reduced access to capital and new cash needs for issuers caused by COVID-19.[3]

Current Discounted Issuance Rules

Nasdaq Listing Rule 5635(d) requires shareholder approval for certain discounted private placements. Nasdaq Listing Rule 5635(c) requires shareholder approval for certain sales to officers, directors, employees or consultants that could be considered a form of "equity compensation." The Temporary Shareholder Approval Exemption provides an exception to these shareholder approval requirements through June 30, 2020 for issuers upon application to Nasdaq's Listing Qualifications Department (or automatically for issuers that qualify for the Safe Harbor described below). Nasdaq adopted this temporary rule recognizing that investors willing to deploy capital today will likely require a discounted price to compensate for the risk of investing in the current environment with issuers' sudden, unexpected cash needs to address the loss of business and supply shortages caused by COVID-19. Such investors may also require that an issuer's insiders put up capital as well.

A financial hardship exception to the shareholder approval requirements is already available within Nasdaq's rules when an issuer's financial viability is in serious jeopardy. However, many issuers that are in need of capital to continue to pay employees during this period may not qualify for this exception because their financial viability may not otherwise be in jeopardy. Furthermore, the financial viability exception requires issuers to mail notice to all shareholders ten days prior to issuing securities, but reduced operations and the need for capital quickly may make it impracticable for issuers to satisfy these requirements.

The Temporary Shareholder Approval Exemption

The Temporary Shareholder Approval Exemption is available to issuers that:

1. Execute a binding agreement governing the issuance of securities;
2. Submit a Listing of Additional Shares notification form and a supplement related to the requirements of the exception to the Nasdaq Listing Qualifications Department; and
3. Obtain approval from the Nasdaq Listing Qualifications Department (unless they qualify for the Safe Harbor described below) no later than June 30, 2020.

The actual issuance of the securities may take place after June 30, 2020, as long as the issuance occurs no later than 30 calendar days after the date of the binding agreement governing the issuance of the securities.

Issuers relying on this exception must demonstrate that:

- The transaction is needed due to circumstances related to COVID-19;
- The issuer undertook a process designed to ensure that the proposed transaction represents the best terms available to the issuer;
- The issuer's audit committee or a comparable body of the board of directors comprised solely of independent, disinterested directors has:

(A) expressly approved reliance on this exception; and (B) determined that the transaction is in the best interests of the issuer's shareholders; and

- Delay in the transaction to secure shareholder approval would:
  - Have a material adverse impact on the issuer's ability to maintain operations under its pre-COVID-19 business plan;
  - Result in workforce reductions;
  - Adversely impact the issuer's ability to undertake new initiatives in response to COVID-19; or
  - Seriously jeopardize the financial viability of the enterprise.

Safe Harbor

Issuers will not be required to obtain approval from the Nasdaq Listing Qualifications Department prior to issuing securities if they meet the following requirements ("Safe Harbor"):

1. The maximum amount of common stock, or securities convertible into common stock, issuable in the transaction is less than 25% of the total shares outstanding and less than 25% of the voting power outstanding before the transaction;
2. The maximum discount to the Minimum Price (discussed in footnote 1) is 15%; and
3. No warrants to purchase common stock are included in the transaction.

Public Disclosure Requirement

No later than two business days before the issuance of the securities relying on this exemption, Issuers must make a public announcement by filing a Form 8-K, where required by SEC rules, or by issuing a press release disclosing:

- The terms of the transaction (including the number of shares of common stock that could be issued and the consideration received);

- That shareholder approval would ordinarily be required under Nasdaq rules but for the fact that the issuer is relying on this temporary exception to the shareholder approval rules; and

- That the audit committee or a comparable body of the board of directors comprised of independent, disinterested directors expressly approved reliance on the exception and determined that the transaction is in the best interest of shareholders.

Insider Participation in These Offerings

Listing Rule 5636T temporarily amends Listing Rule 5635(c) to allow affiliates of the issuer to participate in such transactions, provided that affiliates participating in the transaction may not participate in negotiating the economic terms of the transaction and must have been specifically required to participate in the transaction by unaffiliated investors. In addition, each affiliate's participation must be limited to less than 5% of the transaction and affiliates may not collectively participate for 10% or more of the transaction.

The Temporary Shareholder Approval Exemption does not apply to Nasdaq Listing Rule 5635(b) (Change of Control). Accordingly, any issuance that would lead to an investor or group of investors owning 20% or more the stock or voting power of an issuer will still require shareholder approval.

As noted in our April 7, 2020 *Alert*, the New York Stock Exchange has also provided certain limited temporary relief to its shareholder approval rules through June 30, 2020, subject to certain conditions.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] Listing Rule 5635(d) requires shareholder approval prior to a 20% Issuance at a price that is less than the Minimum Price. The "Minimum Price" is defined in Rule 5635(d)(1)(A) as the lower of (i) the Nasdaq Official Closing Price (as reflected on Nasdaq.com) immediately preceding the signing of the binding agreement for the issuance; or (ii) the average Nasdaq Official Closing Price of the common stock (as reflected on Nasdaq.com) for the five trading days immediately preceding the signing

of the binding agreement for the issuance. A “20% Issuance” is defined in Rule 5635(d)(1)(B) as a transaction, other than a public offering as defined in IM-5635-3, 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.

[2] Listing Rule 5635(c) requires shareholder approval, with certain exceptions, prior to the issuance of securities when a stock option or purchase plan is to be established or materially amended or other equity compensation arrangement made or materially amended, pursuant to which stock may be acquired by officers, directors, employees or consultants.

[3] SEC Release No. 34-88805 (May 4, 2020), available here.

This is a fast-moving topic and the information contained in this Alert is current as of the date it was published.

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