

**SOLICITATION OF COMMENTS BY THE NASDAQ LISTING AND
HEARING REVIEW COUNCIL ABOUT
THE DEFINITION OF MARKET VALUE FOR PURPOSES OF
SHAREHOLDER APPROVAL RULES**

Nasdaq recently released its blueprint for revitalizing the U.S. capital markets: [The Promise of Market Reform – Reigniting America’s Economic Engine](#). In this white paper, Nasdaq called upon policy makers, regulators, market participants, companies, and investors to modernize rules and consider new approaches to help reinvigorate the U.S capital markets. Nasdaq recognizes that it also is not immune from the need to consider new approaches and that we must regularly reconsider whether our listing rules operate efficiently to provide meaningful protections to investors.

A year ago, Nasdaq, working with the Nasdaq Listing and Hearing Review Council,¹ solicited comments on potential updates to the shareholder approval rules. These rules were adopted in 1990 and have remained largely unchanged since then. But over the last 25 years, the capital markets and securities laws, as well as the nature and type of share issuances, have evolved significantly. The comment solicitation was designed to elicit views on whether the rules could be updated given these changes, without sacrificing the crucial investor protections they provide. However, neither Nasdaq, nor the Nasdaq Listing and Hearing Review Council, had made any determination that change was necessary or appropriate.

In response to the comment solicitation, Nasdaq received seventeen comment letters from Nasdaq-listed companies, investors and other market participants that expressed a wide range of views. Nasdaq staff also participated at a meeting of the SEC’s Investor Advisory Committee to discuss the comment solicitation and engage in a dialogue about the rules. Nasdaq is grateful to all who took the time to respond and participate in this important matter. We continue to consider whether it is appropriate to enhance the protections provided by these rules and also whether there are ways that would ease compliance and eliminate burdens imposed by the rules that are not valuable to shareholders.

In that regard, it is important to note that the benefit from reducing the burden of compliance, if done with due regard for the public interest, affects not just the company but also its current investors. These burdens could include the costs of obtaining shareholder approval, but also potential lost opportunities from the delay in completing a transaction and higher costs arising from structuring a transaction using less equity, but at a higher overall cost, to avoid the

¹ The Listing Council is a standing independent advisory committee appointed by the Board of Directors of The Nasdaq Stock Market, whose mission is to review the application of Nasdaq’s listing rules and public policy issues related to listing, and, where appropriate, suggest new or modified rules for consideration by the Board. The Listing Council is comprised of individuals with diverse credentials and each Listing Council member is a respected leader in his or her field, committed to working with Nasdaq to enhance investor protection and the integrity of the Nasdaq Stock Market.

requirement to obtain shareholder approval. To be clear, Nasdaq does not intend to weaken the shareholder approval rules simply to reduce costs; the focus, instead, is on whether the shareholder approval rules provide protections to existing shareholders in circumstances that are important to them, modernize the rules in cases where they do not, and enhance the rules in cases where they could provide greater protections to shareholders.

Many good suggestions were presented during the comment solicitation, some that would increase requirements and some that would relax them. Nasdaq and the Listing Council continue to consider these ideas and intend to engage with interested parties around the country to solicit further feedback.

One theme emerged in the comments received to date as an area for Nasdaq to initially review and consider changes. [Listing Rule 5635\(d\)](#) requires a company to obtain shareholder approval when issuing common stock or securities convertible into common stock equal to 20% or more of the shares outstanding at a price less than the greater of the book value or market value. Listing Rule 5005 defines “market value” as the closing bid price. Many commenters focused on the appropriateness of this definition of market value and the additional requirement for a company to obtain shareholder approval for issuances of common stock at a price less than book value.

In particular, several commenters expressed that bid price may not always be transparent to companies and investors and does not always reflect an actual price at which a security has traded. Generally speaking, the price of an executed trade is viewed as more reliable than a bid quotation; and the more shares executed, the more reliable the price. Further, it was noted by commenters that in structuring transactions, investors and companies often rely on an average price over a prescribed period of time for pricing issuances because it can smooth out unusual fluctuations in price.

Nasdaq and the Listing Council believe that a change from a single day’s closing bid price to a five-day average of closing prices, as reflected on Nasdaq.com, may have merit in addressing the concerns raised by commenters, while also enhancing transparency and investor protections provided by the rule. Closing price is generally more transparent to investors and companies because it is reported on financial websites. In addition, Nasdaq notes that closing price will represent an actual sale and is generally at the same or greater price than the bid price because such sales typically take place between the bid and ask prices. Thus, determining whether shareholder approval is required based on the closing price is a more stringent requirement than the current closing bid price requirement.

In addition, because prices are displayed from numerous data sources on different web sites, to provide certainty about the appropriate price, Nasdaq and the Listing Council propose to codify within the rule that Nasdaq.com is the appropriate source of the closing price information. Nasdaq.com displays as a securities closing price the Nasdaq Official Closing Price, which is, typically, derived from the closing auction on Nasdaq and thereby reflects actual sale prices at one of the most liquid times of the day. The Nasdaq closing auction is designed to gather the

maximum liquidity available for execution at the close of trading, and to maximize the number of shares executed at a single price at the close of the trading day. The closing auction promotes accurate closing prices by offering specialized orders available only during the closing auction and integrating those orders with regular orders submitted during the trading day that are still available at the close. The closing auction is made highly transparent to all investors through the widespread dissemination of stock-by-stock information about the closing auction, including the potential price and size of the closing auction. The Nasdaq closing auction has proven to be a valuable pricing tool for issuers, traders, and investors alike; and Nasdaq continually works to enhance the experience for those that rely upon it.

Nasdaq and the Listing Council also observe that there are potential negative consequences to using a five-day average as the measure of whether shareholder approval is required. For example, in a declining market, the five-day average price will always be above current market price, thus making it difficult for companies to close transactions because the investors could potentially buy shares in the market rather than from the company at the higher five-day average price. Conversely, in a rising market, the five-day average price will appear to be a discount to the closing price, potentially allowing dilutive transactions without shareholder approval. In addition, if material news is announced during the five-day period, the average could be a worse reflection of the market value than the closing price after the news is disclosed. Nonetheless, Nasdaq and the Listing Council believe that these risks are already accepted in the market, as evidenced by the frequent use of an average price in transactions, notwithstanding the risk both to the new investor and to the company and its current shareholders concerning price movement during the period. Further, there are state law obligations and federal anti-fraud provisions that also protect against some of these concerns. However, as an added safeguard against the misuse of the average price provisions, Nasdaq and the Listing Council are also suggesting that any transaction of more than 20% of the company's shares outstanding also be approved by either a committee of independent directors (as defined in [Listing Rule 5605\(a\)\(2\)](#)) or a majority of the independent directors on the board, unless it is approved by the company's shareholders.²

Many commenters also suggested that it would be appropriate to eliminate the book value requirement from the shareholder approval rules and there was virtually no indication that this test is considered an important protection to existing shareholders. Commenters suggesting the elimination of this part of the rule note that book value is primarily an accounting measure and its calculation is based on historic cost. As such, book value is not an appropriate measure of the current value of a stock. The commenters also noted that book value is rarely, if ever, considered when pricing capital raising transactions, nor is it considered by shareholders when they are asked to vote to approve a proposed transaction. The existing book value test can also have a disproportionate impact on companies in certain industries and at certain times. For example, during the financial crisis in 2008 and 2009, many banks and finance-related

² This requirement could be satisfied, for example, by an independent pricing committee or financing committee.

companies traded below book value. Similarly, companies that make large investments in infrastructure may trade below the accounting carrying value of those assets. Thus, even if these companies are able to raise capital on attractive terms above their current trading prices, they would nonetheless be required to obtain shareholder approval under the current rule.

Finally, it has been suggested that Listing Rules 5635(d)(1) and 5635(d)(2) are duplicative in many respects (see attached rule text). As such, Nasdaq is considering combining these two paragraphs, but does not intend for this change to affect the substance of these rules.

For the foregoing reasons, Nasdaq and the Listing Council are considering whether to modify Rule 5635(d) as reflected in Exhibit A. However, given the variety of views reflected in our initial comment solicitation and its broad, non-specific nature, we believe it is appropriate to seek comment on these specific proposed changes. The comment period will run until July 31, 2017. Please send comments by email to comments@nasdaq.com.

Following review of the comments, if Nasdaq determines to proceed with a proposed rule change, that proposal will be subject to public notice and comment as part of the Securities and Exchange Commission's review and approval process. Please note that Nasdaq must include any comments provided in response to this comment solicitation as part of its filing with the SEC and therefore any comments submitted could become publicly available.

Nasdaq and the Listing Council express gratitude for your comments and attention to this important matter.

Existing Rule 5635(d)**(d) Private Placements**

Shareholder approval is required prior to the issuance of securities in connection with a transaction other than a public offering involving:

- (1) the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable for common stock) at a price less than the greater of book or market value which together with sales by officers, directors or Substantial Shareholders of the Company equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; or
- (2) the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock.

Draft of Proposed Revised Rule 5635(d)**(d) Private Placements**

Shareholder approval is required prior to the issuance of securities in connection with a transaction, other than a public offering, involving the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable for common stock), which:

- (1) alone or together with sales by officers, directors or Substantial Shareholders of the Company equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; and
- (2) (A) is at a price less than 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 for the issuance; or

(B) is not approved either by: (i) Independent Directors constituting a majority of the Board's Independent Directors in a vote in which only Independent Directors participate, or (ii) a committee comprised solely of Independent Directors.

Redline Showing Proposed Revisions to Rule 5635(d)**(d) Private Placements**

Shareholder approval is required prior to the issuance of securities in connection with a transaction other than a public offering involving:

~~(1) the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable for common stock), at a price less than the greater of book or market value which:~~

(1) ~~alone or~~ together with sales by officers, directors or Substantial Shareholders of the Company equals 20% or more of common stock or 20% or more of the voting power outstanding before the issuance; ~~or~~and

(2) (A) is at a price less than 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 for the issuance; or

(B) is not approved either by Independent Directors constituting a majority of the Board's Independent Directors in a vote in which only Independent Directors participate or by a committee comprised solely of Independent Directors.

~~(2) the sale, issuance or potential issuance by the Company of common stock (or securities convertible into or exercisable common stock) equal to 20% or more of the common stock or 20% or more of the voting power outstanding before the issuance for less than the greater of book or market value of the stock.~~