

New NYSE Rules Ease Shareholder Approval Requirements, but May Expand Audit Committee Role

April 12, 2021

Rule Changes Should Ease Sales to Current Shareholders

On April 2nd, the SEC **approved** NYSE rule changes that will relax current requirements to obtain shareholder approval prior to certain equity issuances. The rule changes are substantially similar to temporary waivers issued by NYSE during last spring's pandemic outbreak and to NYSE's December rule proposal (discussed in our memos [here](#) and [here](#)). The changes will facilitate capital raises involving current shareholders and more closely align NYSE's rules with Nasdaq requirements. The revised rules also arguably expand the role of the audit committee in reviewing related party transactions.

The rule changes are effective immediately.

Changes to Shareholder Approval Requirement for Related Party Issuances

The changes amend Sections 312.03, 312.04 and 314.00 of the NYSE **Listed Company Manual** to expand the circumstances under which a company may sell shares to a "related party" without obtaining shareholder approval.

Under current Section 312.03(b), shareholder approval is required when a company sells shares to a related party if the amount to be issued exceeds 1% of the number of shares or voting power outstanding before issuance. A limited exception permits cash sales of up to 5%, at no less than the current market price (determined as provided in the rule), if the purchaser is a related party only by virtue of being a substantial shareholder.

The changes will:

- require shareholder approval of cash sales to related parties only at prices less than the current market price (assuming the 20% rule and change of control rule discussed below do not apply);
- no longer require shareholder approval for share issuances to related parties' subsidiaries or affiliates (unless a related party has a 5% interest in the company or assets being acquired with the share issuance); and
- require shareholder approval of any transaction where a related party has a 5% interest in the company or assets being acquired with the share issuance (or related parties collectively have a 10% interest), when the issuance results in a 5% increase in outstanding shares or voting power.

Share issuances to related parties of more than 1% by number or voting power will still require shareholder approval if the issuance is non-cash or below the current market price. The changes will make NYSE's rules for cash sales at no less than the current market price substantively identical to those of Nasdaq.

Changes to 20% Rule

Under the so-called 20% rule, shareholder approval is generally required for share issuances above 20% by number or voting power, otherwise than through a cash public offering. An exception to this rule currently exists for a "bona fide private financing," which permits sales for cash at no less than the current market price—but only if no purchaser acquires more than 5% by number or voting power. The changes eliminate the 5% limit. Note, however, that if the transaction involves a change of control, then shareholder approval under Section 312.03(d) would still be required.

Under the revised 20% rule, shareholder approval will be required when a company issues shares for cash (not in a public offering) in connection with an acquisition, when the shares issued, combined with any other issuance in connection with the acquisition, exceed 20% by number or voting power.

Audit Committee Review of Related Party Transactions

NYSE's rules have long required the audit committee (or other "comparable body") to review related party transactions, a term that the rules did not define. Many companies interpreted the term consistently with the proxy disclosure requirement specified in Item 404 of Regulation S-K, which requires disclosure of transactions with related parties in which the amount exceeds \$120,000 and the related party has a "material interest." NYSE's revisions to its rules define the term "related party transaction" as a transaction required to be disclosed pursuant to Item 404, but without regard to the "transaction value threshold" of that provision. The revisions also explicitly require "prior" review of transactions and explicitly require the audit committee to prohibit transactions that it determines are inconsistent with the interests of the company and its shareholders.

The revisions raise the question of whether the audit committee should review and approve even *de minimis* transactions involving directors, officers and other related parties. Because Item 404 specifies that the related party must have a "material interest" in the transaction—in addition to the transaction value threshold of \$120,000—we believe companies may conclude that for many small transactions, there is no such material interest and so prior audit committee approval is not necessary. Depending on the relevant industry and a company's ordinary business operations, companies may wish to review the types of transactions they regularly engage in with related parties in order to ensure continuing compliance with NYSE's rules.

Other Shareholder Approval Requirements Would Continue to Apply

NYSE's current rules requiring shareholder approval for the issuance of shares in connection with a change of control and an increase in share capacity under equity compensation plans remain unchanged.

Finally, Section 312.03T, adopted to provide temporary relief during the pandemic, will be eliminated pursuant to the proposal.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

Maurice Blanco	+1 212 450 4086	maurice.blanco@davispolk.com
Michael Davis	+1 212 450 4184	michael.davis@davispolk.com
Joseph A. Hall	+1 212 450 4565	joseph.hall@davispolk.com
Michael Kaplan	+1 212 450 4111	michael.kaplan@davispolk.com
James C. Lin	+852 2533 3368	james.lin@davispolk.com
Emily Roberts	+1 650 752 2085	emily.roberts@davispolk.com
Richard D. Truesdell, Jr.	+1 212 450 4674	richard.truesdell@davispolk.com
Elizabeth S. Weinstein	+1 212 450 3889	elizabeth.weinstein@davispolk.com

© 2021 Davis Polk & Wardwell LLP | 450 Lexington Avenue | New York, NY 10017

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's [privacy notice](#) for further details.