

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-75599; File No. SR-NYSE-2015-02)

August 4, 2015

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change Amending Sections 312.03(b) and 312.04 of the NYSE Listed Company Manual to Exempt Early Stage Companies From Having to Obtain Shareholder Approval Before Issuing Shares for Cash to Related Parties, Affiliates of Related Parties or Entities In Which A Related Party Has A Substantial Interest

I. Introduction

On April 16, 2015, New York Stock Exchange LLC (“NYSE” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to exempt early stage companies from having to obtain shareholder approval before issuing shares to related parties, affiliates of related parties or entities in which a related party has a substantial interest. The proposed rule change was published for comment in the Federal Register on May 6, 2015.<sup>3</sup> The Commission received no comment letters on the proposal. On June 18, 2015, the Commission designated a longer period for Commission action on the proposed rule change, until August 4, 2015.<sup>4</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to disapprove the proposed rule change.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 74849 (April 30, 2015), 80 FR 26118 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 75248 (June 18, 2015), 80 FR 36385 (June 24, 2015).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

## II. Description of the Proposal

The Exchange proposes to amend Sections 312.03(b) and 312.04 of the NYSE Listed Company Manual (“Manual”) to provide an exemption to an “early stage company” listed on the Exchange from having to obtain shareholder approval, under certain circumstances, before issuing shares of common stock, or securities convertible into or exercisable for common stock, to a (1) director, officer<sup>6</sup> or substantial security holder<sup>7</sup> of the company (“Related Party” or “Related Parties”), (2) subsidiary, affiliate or closely-related person of a Related Party or (3) company or entity in which a Related Party has a substantial direct or indirect interest (together, a “Proposed Exempted Party” or “Proposed Exempted Parties”).<sup>8</sup> In particular, shareholder approval would no longer be required for an “early stage company,”<sup>9</sup> before the issuance of shares for cash to a Proposed Exempted Party, provided that the company’s audit committee or a comparable committee comprised solely of independent directors reviews and approves of all such transactions prior to their completion. Today, shareholder approval would be required prior to the issuance of shares, among other things, where the number of shares to be issued to the Proposed Exempted Party exceeds either 1% of the number of shares of common stock or 1% of

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<sup>6</sup> Section 312.04(h) of the Manual states that the term “officer” has the same meaning as defined by the Commission in Rule 16a-1(f) under the Act.

<sup>7</sup> Section 312.04(e) of the Manual states that an interest consisting of less than either 5% percent of the number of shares of common stock or 5% of the voting power outstanding of a company or entity shall not be considered a substantial interest or cause the holder of such an interest to be regarded as a substantial security holder.

<sup>8</sup> The Commission notes that there is an inconsistency between the proposed rule text in Exhibit 5 and the proposed shareholder approval exception discussed in the Notice. The proposed rule text in Exhibit 5 states that the exception only applies to Related Parties, which is defined in Section 312.03(b)(1) of the Manual. However, the Notice clearly states that the proposed rule change is meant to apply to all Proposed Exempted Parties, as set forth in Sections 312.03(b)(1), (2), and (3) of the Manual, not just Related Parties under Section 312.03(b)(1) of the Manual. See Notice, supra note 3, at 26119.

<sup>9</sup> See supra notes 11 through 13 and accompanying text.

the voting power outstanding before the issuance (or 5% of the number of shares or voting power, if the Related Party is classified as such solely because it is a substantial security holder, and the issuance relates to a sale of stock for cash, at a price at least as great as each of the book and market value of the company's common stock).<sup>10</sup>

The Exchange also proposes to amend Section 312.04 to include a definition of the term "early stage company."<sup>11</sup> The Exchange proposes to define an early stage company as a company that has not reported revenues greater than \$20 million in any two consecutive fiscal years since its incorporation. Further, an early stage company would lose that designation at any time after listing on the Exchange that the company files an annual report with the Commission in which the company reports two consecutive fiscal years with revenues greater than \$20 million in each year.<sup>12</sup> The Exchange represents that a company's annual financial statements prior to listing on the Exchange would also be considered when determining if the company should lose its early stage company designation.<sup>13</sup>

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<sup>10</sup> The Exchange states that neither The NASDAQ Stock Market LLC ("NASDAQ") nor NYSE MKT LLC has a rule comparable to Section 312.03(b) requiring listed companies to obtain shareholder approval prior to 1% (or in certain cases 5%) share issuances in cash sales to a Proposed Exempted Party. See Notice, supra note 3, at 26120. Thus, the Exchange believes the proposed rule change is necessary to enable the Exchange to compete with NASDAQ for the listing of early stage companies. See id.

<sup>11</sup> See proposed Section 312.04(k) of the Manual.

<sup>12</sup> The Exchange believes that only a small number of currently listed companies would qualify under the proposed exemption from shareholder approval. See Notice, supra note 3, at 26120.

<sup>13</sup> See Notice, supra note 3, at 26119, n.6. As an example, the Exchanges states that if a company files an annual report with the Commission one year after listing on the Exchange and such annual report shows that the company has had revenues greater than \$20 million in each of two consecutive years (even if one of those years was prior to listing on the Exchange), the company would lose its early stage company designation at that time. See id. Moreover, once the early stage company designation is lost, it cannot be regained if the subject company later reports reduced revenues. See id. at 26120.

The Exchange also states that any issuance of shares that is not a sale for cash, including any issuance in connection with the acquisition of stock or assets of another company, would remain subject to the shareholder approval provisions of Section 312.03(b) of the Manual.<sup>14</sup> Additionally, the Exchange highlights that under Section 312.04(a) of the Manual, an exemption from one provision of Section 312.03 is not a general exemption from all of Section 312.03. Therefore, notwithstanding that a transaction by an early stage company may have an exemption under the proposed amendments to Sections 312.03(b) of the Manual, the Exchange states that shareholder approval requirements of Sections 312.03(c)<sup>15</sup> and 312.03(d)<sup>16</sup> would still be applicable.<sup>17</sup>

Lastly, the Exchange also proposes to delete obsolete text from Section 312.03 of the Manual related to a limited transition period that is no longer relevant.

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<sup>14</sup> See Notice, supra note 3, at 26119.

<sup>15</sup> Section 312.03(c) of the Manual, with certain exceptions, requires shareholder approval of any issuance of securities in any transaction or related transactions relating to 20% of more of a listed company's stock before the issuance. When applying Section 312.03(c), the Exchange states that it reviews issuances to determine whether they are related and should be aggregated for purposes of the rule. See Notice, supra note 3, at 26120. The Exchange analyzes the relationship between separate stock issuances if they occur within a short period of time, are made to the same or related parties, or if there is a common use of proceeds. See id. The Exchange represents that it would engage in this analysis with respect to any series of sales made by an early stage company to a Related Party. See id. Moreover, should the Exchange determine that it is necessary to aggregate the series of sales and, as aggregated, the total number of shares sold exceeds 19.9% of the shares outstanding, shareholder approval would be required pursuant to Section 312.03(c). See id.

<sup>16</sup> Section 312.03(d) of the Manual requires shareholder approval prior to an issuance giving rise to a change of control.

<sup>17</sup> See Notice, supra note 3, at 26119-20. The Commission notes, however, that Section 312.03(c)(2) of the Manual contains an exception for sales of common stock (or securities convertible into common stock) for cash in a "bona fide private financing," as defined in Section 312.04(g), if certain requirements are met.

III. Proceedings to Determine Whether to Approve or Disapprove SR-NYSE-2015-02 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>18</sup> to determine whether the proposed rule change should be disapproved. Institution of such proceedings appears appropriate at this time in view of the legal and policy issues raised by the proposal, as discussed below. Institution of disapproval proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to comment on the proposed rule change to inform the Commission's analysis whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>19</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the consistency of the proposed rule change with Section 6(b)(5) of the Act,<sup>20</sup> which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

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<sup>18</sup> 15 U.S.C. 78s(b)(2)(B). Section 19(b)(2) of the Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. See id. The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. See id.

<sup>19</sup> Id.

<sup>20</sup> 15 U.S.C. 78f(b)(5).

As discussed above, the Exchange proposes to amend Sections 312.03(b) and 312.04 of the Manual, in order to exempt early stage companies from having to obtain shareholder approval before issuing a substantial amount of shares for cash, even at a discount from book and market value, to Related Parties, namely officers, directors and substantial security holders, as well as the other Proposed Exempted Parties.<sup>21</sup> Although the Exchange conditions its proposed exemption on the company obtaining the approval of the transaction by its audit committee (or comparable committee comprised solely of independent directors), the Commission is concerned that audit committee approval may not be an effective substitute for the approval of shareholders, whose interests would be directly impacted by the potentially dilutive effect of such a transaction. In addition, while the Exchange believes that the proposal would benefit shareholders of early stage companies because it could allow those companies to raise additional capital quickly and inexpensively, any such benefit must be weighed against the potentially detrimental impact of a dilutive transaction on shareholders who would no longer have the right to approve it.<sup>22</sup>

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<sup>21</sup> See supra notes 6 and 7.

<sup>22</sup> The Commission also notes that the Exchange has not addressed how the proposal is consistent with the shareholder approval requirements of Section 303A.08 of the Manual that generally requires that shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exemptions. Under Section 303A.08, an equity-compensation plan is defined as a plan or other arrangement that provides for the delivery of equity securities of the listed company to any employee, director or other service provider as compensation for services. The definition specifically states “[E]ven a compensatory grant of options or other equity securities that is not made under a plan is, nonetheless, an ‘equity-compensation plan’” for purposes of the rule. Section 303A.08 also lists certain plans that would not be considered equity compensation plans under its definition, for example, plans that are made available to shareholders generally, such as a typical dividend reinvestment plan, and plans that merely allow employees, directors or other service providers to elect to buy shares on the open market or from the listed company for their current fair market value. The Commission notes that, in approving the equity compensation rules, it stated

The Commission therefore believes that questions are raised as to whether the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act, including whether it would be designed to promote just and equitable principles of trade, and protect investors and the public interest.

### III. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any others they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section 6(b)(5)<sup>23</sup> or any other provision of the Act, or the rules and regulation thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>24</sup>

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's

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that the rules should have the effect of safeguarding the interests of shareholders, while placing certain restrictions on listed companies, and provide shareholders with greater protection from the potential dilutive effect of equity compensation plans. See Securities Exchange Act Release No. 48108 (June 30, 2003), 68 FR 39995 (July 3, 2003) (SR-NYSE-2002-46 and SR-NASD-2002-140).

<sup>23</sup> 15 U.S.C. 78f(b)(5).

<sup>24</sup> Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the statements of the Exchange contained in the Notice,<sup>25</sup> and any other issues raised by the proposed rule change.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NYSE-2015-02 on the subject line.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NYSE-2015-02. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

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<sup>25</sup> See Notice, *supra* note 3.

available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NYSE-2015-02 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>26</sup>

Robert W. Errett  
Deputy Secretary

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<sup>26</sup> 17 CFR 200.30-3(a)(57).