

SEC STAYS APPROVAL OF NYSE RULE CHANGES ALLOWING PRIMARY CAPITAL RAISES BY ISSUERS IN DIRECT LISTINGS

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On August 26, 2020, pursuant to delegated authority by the Commission, the SEC's Division of Trading and Markets approved [changes to NYSE listing rules](#) to allow companies to raise capital in connection with a direct listing on the NYSE without a firm commitment offering. Currently, the NYSE has discretion to approve direct listings at the time of effectiveness of a company's initial registration statement under the Securities Act of 1933 filed solely for the purpose of allowing existing shareholders to sell their shares without a firm commitment offering (a "selling shareholder direct listing"). Under the new rules, the NYSE would be permitted to approve a direct listing by a company that sells shares itself in the opening auction on the first day of trading on the NYSE (a "primary direct listing") in addition to, or instead of, a selling shareholder direct listing.

On August 31, 2020, the SEC [notified the NYSE](#) that the rule changes have been stayed following receipt of notice, reportedly by the Council of Institutional Investors (CII), that CII plans to submit a petition for review by the full Commission of the delegated approval by the Division of Trading and Markets.

The CII had commented on the rule proposal expressing concern about, among other things, the potential for reduced liability under technical principles under Section 11 of the Securities Act of 1933 due to challenges in tracing shares back to the registration statement. The SEC staff had considered those concerns, but had noted such issues already exist in the context of aftermarket securities purchases due to the ability of existing shareholders to sell shares pursuant to Rule 144, resulting in concurrent registered and unregistered sales. Further, it had noted that, even absent the involvement of a statutory underwriter, investors could still pursue claims under the Securities Act for false or misleading offering documents, and the absence of a statutory underwriter would not affect the amount of damages.

The SEC staff noted the direct listing approach to becoming a public company provides companies greater choice in their path to going public, and that the ability to include a primary capital raise in a direct listing will further enhance this flexibility. Further, it believes primary direct listings may have benefits to investors compared to firm commitment offerings, including:

- Some investors who would not receive allocations in a traditional IPO may be able to purchase shares at the original auction price in a primary direct listing rather than in aftermarket trading, potentially broadening the scope of investors in IPOs
- The original offering price for a company's securities may be more accurately determined in a primary direct listing, because it will be based on market interest and matching of buy and sell orders, instead of negotiation between the issuer and the underwriters

The stay of the rule changes does not affect the NYSE's existing standards for *selling shareholder direct listings*, for which a company must satisfy the market value of publicly-held shares listing requirement. The NYSE will continue to determine that a company has met the \$100 million aggregate market value of publicly-held shares requirement based on a combination of both (i) an independent third-party valuation ("Valuation") of the company; and (ii) the most recent trading price for the company's common stock in a trading system for unregistered securities operated by a national securities exchange or a registered broker-dealer ("Private Placement Market"). Alternatively, in the absence of any recent trading in a Private Placement Market, the NYSE will determine that the company has met the market value requirement if it provides a Valuation evidencing a market value of publicly-held shares of at least \$250 million. With respect to calculating these publicly-held shares requirement, the shares of the company's officers, directors and greater than 10% shareholders must be excluded.

With respect to a *primary direct listing*, under the rule changes, the NYSE would deem a company to have met the applicable aggregate market value of publicly-held shares requirement if the company will sell at least \$100 million in market value of the shares in the NYSE's opening auction on the first day of trading, which may include shares purchased in the opening auction by the company's directors, officers and greater than 10% shareholders. Alternatively, where a company will sell shares with a market value of less than \$100 million, the NYSE would determine that such company has met such requirement if the aggregate market value of the shares the company will sell (which again may include shares sold in the auction to company insiders) and the shares that are publicly held immediately before the listing is at least \$250 million, with such market value calculated using a price per share equal to the lowest price of the price range established by the company in its registration statement. The \$100 million threshold is higher than the NYSE's \$40 million requirement for a traditional underwritten IPO to ensure an adequate public float and liquid trading market and comparable to the \$100 million and \$250 million minimum market value requirements for selling shareholder direct listings.

The new rules establish a new Issuer Direct Offering Order type to be used by the issuer in a primary direct listing, with limitations imposed on the Designated Market Maker (DMM) to assure that the method by which the issuer participates in the opening auction is clearly defined, that the issuer is not in a position to improperly influence the price discovery process, and that the auction is otherwise consistent with the disclosures in the registration statement.

Any company seeking to list in connection with a direct listing would need to meet all other applicable initial listing requirements, such as having 400 shareholders of round lots and 1.1 million publicly-held shares outstanding at the time of initial listing, and to have a price per share of at least \$4.00 at the time of initial listing.

With respect to compliance and liability considerations, in the adopting release the SEC staff noted:

- FINRA will monitor compliance of primary direct listings with Regulation M and other anti-manipulation provisions of the federal securities laws, and Rule 2020. Any consultation that the financial advisor to the issuer provided to the NYSE and any consultation between the DMM and financial advisor is required to be conducted in a manner that is consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements.
- Direct listings on the NYSE will be required to be registered under the Securities Act through the same process as an underwritten public offering.
- The NYSE's view that the due diligence process in a primary direct listing will be the responsibility of gatekeepers such as the board of directors, senior management and the independent accountants.
- The company's financial advisor would not necessarily incur underwriter liability, which would be determined based on the nature and extent of its activities and the facts and circumstances; however, given the broad definition of "underwriter", the required involvement of such advisors, and their reputation interests and potential liability, the SEC believes they will be incentivized to engage in "robust due diligence".

It is unclear how long the review process will take or whether the Commission will ultimately disagree with the Staff. It is possible that the review process will also delay consideration of a similar [rule change proposal](#) submitted by Nasdaq last week. The CII is expected to file additional documents with the SEC in the coming days, setting forth its arguments in support of its opposition to the direct primary offering rule. The NYSE is expected to push the Commission to reject the CII's arguments and lift the stay as quickly as possible.

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