SULLIVAN & CROMWELL LLP

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NYSE Proposes to Expand Permitted Use of Direct Listings

Proposal Would Permit Companies to Raise Capital in Direct Listings and Modify Distribution Requirements

SUMMARY

On November 26, 2019, New York Stock Exchange LLC ("NYSE") filed notice of a proposed rule change with the Securities and Exchange Commission to modify its listing rules relating to direct listings. The proposed rule change would allow companies to raise capital and sell new shares in a direct listing, in contrast to the current rules, which only permit secondary sales by existing shareholders. In addition, the proposed rule would modify the distribution requirements for direct listings, thereby expanding the number of private companies that would be eligible for direct listings. If adopted, the proposed rules would significantly increase the number of IPOs that would occur via a direct listing. If the SEC approves the proposed rule change, it is not expected to become effective until at least 45 days after the publication of the notice in the Federal Register.

BACKGROUND

Traditionally, a company would list its shares on a national securities exchange, such as NYSE or NASDAQ, in connection with a firm commitment underwritten IPO, upon transfer from another market or as part of a spin-off transaction. Over the past couple of years, NYSE and NASDAQ have amended their listing requirements to permit companies to list their shares upon effectiveness of a registration statement filed solely for the purpose of allowing existing shareholders to sell their shares (a "Selling Shareholder Direct Listing"), without undertaking a traditional underwritten IPO. Direct listings have received significant investor and media attention following the high-profile direct listings of Spotify (April 2018) and Slack (June 2019). One of the main perceived benefits of direct listings is that they allow shareholders to sell directly into the market at the opening auction price, rather than at an agreed price to underwriters where the opening trading price on the national securities exchange is sometimes substantially higher than the price at which shares are sold to the underwriters.

The existing direct listing rules preclude many companies from pursuing direct listings because (i) they are limited to Selling Shareholder Direct Listings, without allowing companies to raise capital in the transaction, and (ii) few private companies can satisfy the current requirement that the issuer have 400 round-lot shareholders (holding at least 100 shares) before the listing. NYSE's proposed rule change would address each of these concerns by (i) permitting companies to sell shares and raise new capital in primary direct listings and (ii) providing companies with a grace period of up to 90 trading days after the initial listing date to comply with the distribution requirements.

DISCUSSION

NYSE's proposed changes to Section 102.01B of its Listing Company Manual (the "Manual") would provide that, upon effectiveness of a registration statement, a company could sell shares on its own behalf in the opening auction on the first day of trading, without a traditional underwritten public offering (a "Primary Direct Listing"). The proposal would permit companies to conduct a Primary Direct Listing in addition to, or instead of, a Selling Shareholder Direct Listing.

Section 102.01B currently provides that a company listing in connection with a Selling Shareholder Direct Listing must demonstrate that it has at least a $100 million market value (excluding shares held by directors, officers, their immediate families and 10% or larger shareholders) based on a combination of both an independent third-party valuation of the company and recent trading prices in a private placement market. Alternatively, in the absence of recent trading prices in a private placement market, NYSE will deem a company to have met the market value requirement if the company provides an independent third-party valuation of at least $250 million. Under the proposal, in a Primary Direct Listing, NYSE would deem a company to have met the market value requirement if:

- the company sells at least $250 million in market value of shares in the opening auction on the first day of trading; or
- the aggregate market value of shares sold by the company in the opening auction, *plus* the market value of publicly held shares demonstrated by the company immediately prior to the time of initial listing, is at least $350 million.

The proposal would also amend Section 102.01A of the Manual to modify the distribution requirements applicable to Primary Direct Listings and Selling Shareholder Direct Listings. Under the current rules, at the time of listing, a company is required to have at least 400 round lot holders and 1.1 million publicly held shares. In a traditional IPO, the underwriters are able to ensure that the shares sold in the IPO are distributed to a sufficient number of accounts to satisfy these distribution requirements at the time of listing. But the existing requirements pose a challenge to many private companies seeking a direct listing because they may have less than 400 round lot shareholders. NYSE recognizes that following a sufficiently large direct listing, it would be highly likely that the listing requirements would be satisfied shortly after listing. Accordingly, the proposed rule change would delay the 400 round lot holder requirement until 90 trading days after the initial listing date if:

- in the case of a Primary Direct Listing, the company meets the market value requirements described above; or
- in the case of a Selling Shareholder Direct Listing, the company demonstrates that it has at least $350 million in market value of publicly-held shares at the time of initial listing.

IMPLICATIONS

NYSE's proposed rule change would eliminate significant roadblocks to direct listings for many private companies. If adopted as proposed, companies that desire to provide liquidity for shareholders and/or seek to raise capital may consider direct listings as a viable alternative path to becoming a publicly-traded company. Moreover, if these rules are adopted, we expect that the current debate among issuers, investors and the financial community will intensify as to whether a direct listing or an underwritten IPO is more favorable for the various constituencies.

In the wake of the filing by NYSE of its proposed rule change, NASDAQ indicated that it is also considering proposing rule changes that would allow direct listings with a primary share sale component.

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