February 16, 2018

SEC Approves NYSE Proposal to Facilitate Listings of Companies Without a Trading History

SUMMARY

On February 2, 2018, the SEC issued an order approving, on an accelerated basis, a proposed rule filed by the NYSE to amend Section 102.01B of the NYSE Listed Company Manual to permit the listing of qualifying private companies that are presently unable to demonstrate a sufficient valuation for listing due to the lack of a prior trading history. Under the rule, companies that cannot provide a private placement market trading price for their stock may instead satisfy the listing requirement if they receive an independent valuation of at least $250 million. A prior iteration of the NYSE proposal included a more extensive change to the listing requirements and would have permitted the NYSE to exercise its discretion to list a company upon effectiveness of a registration statement under the Securities Exchange Act of 1934, rather than Securities Act of 1933. That element of the NYSE proposal was withdrawn prior to the rule's approval. The SEC is soliciting comments on the amendment through March 1, 2018.

BACKGROUND

The traditional way a company becomes listed on a national securities exchange is either in connection with a firm commitment underwritten IPO, upon transfer from another market, or pursuant to a spin-off. The NYSE also allows companies to list common equity securities that have been sold in a private placement once a resale registration statement has been filed under the Securities Act of 1933 (the Securities Act) and declared effective. Under a prior version of the NYSE proposal, qualifying private companies would also have been able to list securities in connection with the effectiveness of a registration statement under the Securities Exchange Act of 1934 (the Exchange Act), such as a Form 10 or Form 20-F, in the absence of Securities Act registration, provided the companies met all other listing requirements.[1] However, the NYSE withdrew this version of the proposal in December and submitted an

amended proposal without this element. Under the approved version of the rule, a company listing shares on the NYSE (other than pursuant to a spin-off) must have filed and declared effective a Securities Act registration statement, typically on Form S-1 for U.S. issuers or Form F-1 for foreign issuers. These registration statements are subject to the traditional review and comment process of the SEC staff and, unlike the Exchange Act registration statements in NYSE's prior proposal, are subject to liability for material misstatements and omissions under Section 11 of the Securities Act.

While the narrower proposal put forth by the NYSE in December and approved by the SEC does not allow companies to list with only Exchange Act registration, it does change the valuation methodology to allow companies without prior private placement market trading to list without concurrent primary offerings. Depending on the type of listing, the NYSE requires a listed company to demonstrate an aggregate market value of publicly held shares of either $40 million or $100 million at the time of listing. To verify this valuation, the NYSE generally relies on written representations from the underwriter, investment banker, or other financial advisor. However, in the case of previously private companies filing Securities Act resale registration statements, the NYSE determines the required $100 million market value of publicly held shares by reference to both (i) an independent third-party valuation and (ii) the most recent trading price for the company's common stock in a private placement market. The lesser of the valuation and trading value is used to determine if the $100 million threshold is satisfied. Because both an independent third-party valuation and private placement market trading price are required to demonstrate the valuation requirement is met for companies filing resale registration statements, companies that have not had prior private placement market trading, regardless of size, have been unable to list on the NYSE. This has barred certain private companies that do not need to raise capital through a primary stock offering from providing shareholders with the liquidity of a public resale market.

DISCUSSION

The rule makes two changes to Footnote (E) of Section 102.01B of the NYSE Listed Company Manual (the Manual).[2] The first is to provide that, if shares have not been recently traded in a private placement market, the NYSE will determine a company has met its market value of publicly held shares requirement if the company provides a recent independent third-party valuation of at least $250 million. The NYSE's proposal stated that the requirement to rely on private placement market trading in addition to an independent third-party valuation may cause difficulties for companies that are large enough to be suitable for listing but do not have their securities traded on a private placement market prior to going public. In other cases, private placement market trading is too limited to provide a reasonable basis for reaching conclusions about a company's qualification for listing.

In proposing to adopt a valuation requirement of at least two-and-a-half times the current $100 million requirement of Section 102.01B, the NYSE noted that this amount "will give a significant degree of comfort that the market value of the company's shares will meet the [$100 million] standard upon

commencement of trading on the Exchange," particularly since the valuation "must be provided by an entity that has significant experience and demonstrable competence in the provision of such valuations." In its approval order, the SEC said that requiring a company that does not have a recent and sustained trading history to provide a $250 million valuation should provide a reasonable level of assurance that the company's market value supports listing on the NYSE and the maintenance of fair and orderly markets.

The second change to Footnote (E) is the establishment of certain criteria that precludes a valuation agent from being considered independent. Under the criteria, a valuation agent is not independent if it or any affiliated person or entity:

- beneficially owns, at the time of the valuation, in the aggregate more than 5% of the class of securities to be listed (including any right to receive any such securities exercisable within 60 days);
- has provided any investment banking services to the listing applicant within the 12 months preceding the date of valuation; or
- has been engaged to provide investment banking services to the listing applicant in connection with the proposed listing, any related financings, or other related transactions.

"Investment banking services" is broadly defined to include acting as an underwriter, a financial advisor, placement agent or selling group member as well as providing venture capital, equity lines of credit, PIPEs, or similar investments.

In its approval order, the SEC noted that these new independence requirements should help ensure that the required $250 million valuations are reliable.

In light of the absence of a prior trading market, the NYSE also proposed an amendment to the manner in which the opening price is determined where a valuation, rather than a recent trading price, is used. Under the rule, the designated market maker (the DDM) for the company will consult with a financial advisor to the issuer on the approach to determining the opening price. The NYSE indicated in its proposal that the financial advisor could provide input to the DDM on where the new listing should be priced based on pre-listing buying and selling interest and other input that may not be available to the DDM. The SEC indicated that these changes should help establish a reliable reference price to help ensure fair and orderly markets.

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ENDNOTES

[1] For further information about the earlier NYSE proposal, see our Client Memorandum, SEC Considers NYSE Proposal to Permit Direct Listings: SEC to Determine Whether to Approve NYSE's Proposal to Permit Listings of Qualifying Private Companies Without Securities Act Registration, dated September 26, 2017, *available at* https://www.sullcrom.com/siteFiles/Publications/SC_Publication_SEC_Considers_NYSE_Proposal_to_Permit_Direct_Listings.pdf.

[2] Securities Exchange Act Release No. 34-82627 (Feb. 2, 2018), 83 Fed. Reg. 5650 (Feb. 8, 2018), *available at* https://www.sec.gov/rules/sro/nyse/2018/34-82627.pdf.

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