

March 1, 2019

Nasdaq Amends and Clarifies Listing Requirements for Direct Listings

SUMMARY

On February 14, 2019, the Nasdaq Stock Market LLC filed notice with the Securities and Exchange Commission of a rule change to “amend and clarify certain aspects of the listing process for Direct Listings.”¹ The rule, which became effective upon filing, clarifies the conditions under which private companies can list on Nasdaq through a direct listing, rather than by raising new capital through a traditional initial public offering, and is substantially similar to the direct listing rule adopted by the New York Stock Exchange in February 2018.² Like the NYSE rule, the Nasdaq rule covers companies applying to list their securities on Nasdaq upon effectiveness of a registration statement under the Securities Act of 1933 registering only the resale of securities sold in earlier private placements, and provides guidance on how Nasdaq calculates compliance with its initial listing standards for direct listings, including with respect to companies listing securities that do not have an established private placement market. The SEC is soliciting comments on the rule through March 15, 2019.³

BACKGROUND

The traditional ways a company becomes listed on a national securities exchange, such as the Nasdaq Stock Market LLC (“Nasdaq”) or the New York Stock Exchange (the “NYSE”), have been in connection with a firm commitment underwritten IPO, upon transfer from another market or as part of a spin-off transaction. Depending on the type of listing, in addition to meeting other initial listing requirements, Nasdaq requires a listed company to demonstrate a minimum aggregate market value of publicly held shares.⁴ To verify this valuation in a traditional listing, Nasdaq generally relies on written representations from the underwriter, investment banker, or other financial advisor engaged in connection with the IPO, transfer or spinoff. Nasdaq explains that the initial listing requirements, including those relating to the

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minimum market value of publicly held shares, “are designed to protect investors” and ensure that securities traded on Nasdaq have sufficient liquidity.⁵

The NYSE has similar listing standards requiring a listed company to demonstrate an aggregate market value of publicly held shares of either \$40 million or \$100 million. Prior to February 2018, for direct listings by companies filing Securities Act registration statements registering only the resale of securities issued in earlier private placements, the NYSE used the lesser of (i) an independent third-party valuation and (ii) the most recent trading price for the company’s common stock in a private placement market, in determining whether the required \$100 million listing threshold was satisfied. In February 2018, the SEC approved a proposed NYSE rule permitting domestic companies that cannot provide a private placement market trading price for their stock to instead satisfy the listing requirement by obtaining an independent valuation of at least \$250 million. Following the rule change, Spotify, an online music streaming service with a recent market capitalization of over \$25 billion, completed a direct listing of its stock on the NYSE in April 2018, rather than pursuing a traditional underwritten IPO.

Prior to the adoption of its direct listing rule, Nasdaq had listed a number of private companies without a concurrent underwritten public offering, although Nasdaq’s rules did not explicitly contemplate those listings.

DISCUSSION

Nasdaq’s new Listing Rule IM-5315-1 clarifies the circumstances under which a company whose stock has not previously been registered under Section 12 of the Securities Exchange Act of 1934 (the “Exchange Act”) may list its securities on the Nasdaq Global Select Market without an underwritten offering upon effectiveness of a Securities Act registration statement filed solely to allow existing shareholders to resell their shares. Like its NYSE counterpart, the Nasdaq rule distinguishes between securities that have been traded in a private placement market prior to listing and those that have not, and provides that companies whose securities have not been so traded may satisfy the market value listing requirement by providing an independent valuation demonstrating a market value of publicly held shares of at least \$250 million. Specifically, the Nasdaq rule provides that:

- For a security that has had sustained recent trading over the course of several months in a private placement market (defined in the Nasdaq rules as “a trading system for unregistered securities operated by a national securities exchange or a registered broker”) prior to listing, Nasdaq will determine a company’s price, market capitalization and market value of publicly held shares based on the lesser of: (i) the value calculable based on an independent third-party valuation and (ii) the value calculable based on the most recent trading price in the private placement market.
- For securities without any recent sustained trading in a private placement market, Nasdaq will determine that the company has met the market value listing requirement if the company provides an independent valuation evidencing a market value of publicly held shares of at least \$250 million. Nasdaq will also determine the bid price and market capitalization based on the independent valuation. In the notice filed with the SEC, Nasdaq notes that “a recent [v]aluation

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indicating at least \$250 million in market value of publicly held shares will give a significant degree of comfort that the company will meet the applicable market value of publicly held shares requirement upon commencement of trading.”

The Nasdaq rule also establishes criteria that preclude a valuation agent from being considered independent, which track the independence criteria adopted by the NYSE in its direct listing rule. Under these 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, financial advisor, placement agent or selling group member as well as providing venture capital, equity lines of credit, PIPEs, or similar investments.

Listing Rule IM-5315-1 also clarifies that, for a company transferring from a foreign regulated exchange that has a broad, liquid market for the company’s shares, Nasdaq will determine whether the company has met the applicable price-based listing requirements based on the most recent trading price in the foreign trading market. In adopting this part of the rule, Nasdaq notes that it “believes that the price of the issuer’s securities from such broad and liquid trading is predictive of the price in the market for the common stock that will develop” once the securities are listed on Nasdaq. Unlike the NYSE listed company manual, which provides that foreign private issuers may elect to qualify for listing either under the alternate listing standards specific to foreign issuers or under the NYSE’s domestic listing criteria, but does not specifically address direct listing criteria applicable to foreign issuers,⁶ the Nasdaq direct listing rule provides additional clarification with respect to the listing requirements applicable to companies with securities traded on a foreign exchange.

Although Listing Rule IM-5315-1 applies only to companies applying to list on the Nasdaq Global Select Market, in the notice filed with the SEC, Nasdaq announced that it intends subsequently to file similar rule changes for direct listings on the Nasdaq Capital and Global Markets.

In addition, Nasdaq also adopted modifications to Nasdaq Rule 4753 clarifying that: (i) for a direct listing of a security that has had recent sustained trading in a private placement market, the opening price will be based on the most recent transaction price in that market, and (ii) for a security without recent sustained trading in a private placement market, Nasdaq will consult with the company’s financial advisor in order to determine the appropriate price. In the notice filed with the SEC, Nasdaq indicated that it believed that the financial advisor would be well positioned to provide input to Nasdaq and the company on where the new listing should be priced, based on pre-listing buying and selling interest and its

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understanding of the company and its security. These modifications are substantially similar to changes adopted by the NYSE in February 2018.

IMPLICATIONS

By adopting Listing Rule IM-5315-1 and amending Rule 4753, Nasdaq has aligned key aspects of its listing rules to accommodate direct listings, in line with the requirements previously adopted by the NYSE. As a result, companies that need to provide liquidity for shareholders, have sufficient capital and do not need to raise additional cash associated with a conventional IPO will now consider similar listing requirements for both exchanges if they determine to proceed with a direct listing.

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ENDNOTES

- ¹ Securities Exchange Act Release No. 34-85156 (Feb. 15, 2019), 84 Fed. Reg. 5787 (Feb. 22, 2019), available at <https://www.sec.gov/rules/sro/nasdaq/2019/34-85156.pdf>. Under Rule 19b-4(f)(6)(iii) under the Exchange Act, a proposed rule change may be immediately effective if certain conditions are met. The SEC determined a waiver of the delay in the effectiveness of the proposed rule to be consistent with the protection of investors and the public interest and designated the rule change operative upon filing with the SEC.
- ² For further information about the NYSE rule, see our Client Memorandum, SEC Approves NYSE Proposal to Facilitate Listings of Companies Without a Trading History, dated February 16, 2018, available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_SEC_Approves_NYSE_Proposal_to_Facilitate_Listings_of_Companies_Without_a_Trading_History.pdf.
- ³ At any time within 60 days of the filing, the SEC may temporarily suspend the rule change if it appears to the SEC that action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.
- ⁴ The required aggregate market value of publicly held shares depends on the size of the company, but is either \$45 million or \$110 million (or \$100 million, if the company has stockholders' equity of at least \$110 million) at the time of listing.
- ⁵ Securities Exchange Act Release No. 34-85156 at 11.
- ⁶ See Section 103.01 of the NYSE Listed Company Manual.

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