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NYSE Proposes New Rules on Direct Listings

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On November 26, 2019, the New York Stock Exchange (NYSE) filed a proposed rule change with the Securities and Exchange Commission (SEC) to modify its requirements with respect to direct listings. If approved by the SEC, the updated rules would permit companies seeking to directly list on NYSE to raise capital and issue new securities in connection with such listing. The update also would relax the currently applicable distribution requirements, permitting companies to satisfy these requirements within 90 days of listing rather than at the time of listing, provided certain market valuation thresholds are met.

Direct listings recently have emerged as an alternative for a small number of companies seeking to publicly list their securities, including Spotify Technology S.A. and Slack Technologies, Inc. Unlike in a traditional initial public offering (IPO), the direct option lists a company's outstanding securities on a stock exchange without a concurrent underwritten primary or secondary offering. Rather, existing security holders may elect (but are not obligated) to use a resale registration statement to sell their securities on the stock exchange. No underwriting relationship or corresponding underwriting fee is required. In addition to meeting valuation requirements (*e.g.*, in certain situations, NYSE listing rules require that an independent valuation of the company's publicly held securities exceed \$250 million before the company is eligible for a direct listing), companies pursuing a direct listing on either NYSE or Nasdaq currently may not offer securities on their own behalf as part of such listing process.

The restriction on raising new capital has limited the universe of companies that are in a position to take advantage of direct listings. In the past two years, only three companies have pursued direct listings, despite both NYSE and Nasdaq having specifically adopted new rules to accommodate the option. NYSE's proposed rule change attempts to address some of the potential roadblocks by amending Section 102.01B of its Listed Company Manual in order to permit a company to raise additional capital through a "Primary Direct Listing" in addition to or instead of a "Selling Shareholder Direct Listing," provided that such company sells at least \$250 million in securities in the opening auction or that the market value of securities sold in the opening auction, plus the market value of publicly held securities immediately prior to listing, is at least \$250 million. Upon approval of the proposed rules, direct listings no longer would be limited to resales of existing securities by selling shareholders; rather any company that is eligible for a Primary Direct Listing could use the process to raise capital outside of a conventional underwritten offering.

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The proposed rules also would modify the distribution requirements applicable to direct listings. Companies that list on NYSE currently are required to have at least 400 round lot holders (*i.e.*, the normal unit of trading of a security, which on NYSE is 100 shares of stock) and 1.1 million publicly held shares at the time of listing. In an IPO, underwriters typically ensure these distribution requirements are met through the bookbuilding process. Private companies pursuing a direct listing are unlikely to satisfy the distribution requirements upon listing, unless they already have a broad stockholder base, but may satisfy these requirements soon thereafter. In its proposing release, NYSE observes that a certain market value of publicly traded securities mitigates liquidity concerns. The proposed amendments would provide companies that directly list their securities on NYSE a 90-day grace period to comply with its distribution requirements provided that:

- for a company engaged in a Primary Direct Listing, the company sells at least \$250 million in securities in its opening auction on the first day of trading or the company can show the securities sold in its opening auction, plus its publicly held securities immediately prior to initial listing, realize an aggregate market value of \$350 million;
- for a company engaged in a Selling Shareholder Direct Listing, the company can show an aggregate market value of publicly held securities of at least \$350 million.

Companies that fail to meet the distribution requirements after 90 days would need to submit a compliance plan to NYSE that demonstrates the ability to achieve compliance in a period not to exceed six months.

Direct listings have received considerable recent attention as companies seek alternative ways to enter the public market. If the proposed rule changes are approved, NYSE will have taken an important step in increasing direct listings' attractiveness as an IPO alternative. However, it remains to be seen whether, for all but a small minority of companies, the traditional underwritten offering, complete with book building and pricing supports, is critical to developing a robust market in a newly public company's securities.

Nasdaq also has recently stated that it is engaged in conversations with the SEC and other stakeholders regarding rule amendments that would permit primary capital raises in the context of direct listings, though it has not yet proposed a similar rule. The SEC has declined to comment officially on NYSE's proposed rule change. If approved, the change would be expected to become effective after at least 45 days following the publication of the notice in the Federal Register.

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