Primary Direct Listings by Companies Gain Momentum

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SEC approves NYSE primary direct listing rule and Nasdaq proposes similar rule change

New developments this week will allow companies to raise funds in a direct listing. On Wednesday, the Securities and Exchange Commission (SEC) **approved** the NYSE's rule change that will permit companies to raise capital in a direct listing. Prior to this change, the NYSE only permitted sales by selling shareholders in a direct listing. This week the Nasdaq filed a similar **rule change proposal** with the SEC that would also allow companies to sell newly issued primary shares in a direct listing on the Nasdaq Global Select Market.

Both the NYSE's new rule and the Nasdaq's rule proposal retain existing requirements with respect to the number of round lot holders required at the time of listing. This means some of the initial flexibility proposed in earlier versions of the NYSE's new rule with respect to round lot holder requirements was eliminated from the final version of the rule, and was not included in Nasdaq's proposed rule.

NYSE's new primary direct listing rule

The new NYSE rule will allow a company to sell newly issued primary shares into the opening auction in a direct listing. Under the new rule, a company will be permitted to sell newly issued primary shares on its own behalf directly into the opening trade, without a traditional underwritten public offering and with the IPO price determined by the opening trade auction (a "primary direct listing"). In order to qualify for a primary direct listing, a company would need to either (i) sell at least $100 million in market value of shares in the opening auction, or (ii) have a market value of freely tradeable shares at the time of listing of at least $250 million. Market value for purposes of the second test would be calculated using a price per share equal to the bottom end of the price range disclosed in the registration statement. The company would be required to meet all other applicable NYSE initial listing requirements, including the requirement to have 400 round lot holders, 1.1 million publicly held shares outstanding and a price per share of at least $4.00, all at the time of the initial listing.

The NYSE rule details the auction process for a primary direct listing. Significantly, the auction process requires that the company disclose a price range and the number of shares to be sold in the SEC registration statement for a primary direct listing, and requires that the opening auction price be within the disclosed price range. As a result, a company participating in a primary direct listing on the NYSE would not have the ability to open trading at a price below the bottom end of the price range without filing a pre-effective amendment, unlike a traditional IPO where such a reduction would be possible within existing safe harbors. In addition, for purposes of the opening auction, the company will be required to submit a limit order for the number of shares that it wishes to sell, with the limit set at the bottom end of the price range. The rule does not allow the company's limit order to be canceled or modified, and the limit order will need to be executed in full in order to conduct the primary direct listing. Some companies raising capital in a direct listing may be more conservative in setting the price range for a direct listing and may also choose to raise a smaller amount of capital in order to reduce the risk that the company's limit order is not filled within the price range disclosed in the registration statement.

In its adopting release, the SEC noted some of the commentary on the rule change proposal concerning underwriter liability for financial advisors engaged on a direct listing, and stated that such financial advisors "may" be deemed to be statutory underwriters depending on the nature and extent of their activities and on the particular facts and circumstances. If found to be a statutory underwriter, a financial advisor would be subject to the attendant liabilities, including under Section 11 of the Securities Act.

However, the SEC also noted that a firm commitment underwriting is not necessary to provide adequate investor protection, and that the NYSE's proposed rule change—which does not require the involvement of an underwriter—was not inconsistent with investor protection given the existing liability framework under the Securities Act for registered offerings.

The NYSE rule is effective immediately.

Nasdaq's primary direct listing rule proposal

Nasdaq's proposed rule change would also permit a company to raise primary capital in a direct listing on the Nasdaq Global Select Market.

Nasdaq's proposed new Listing Rule IM-5315-2 would permit primary direct listings if the market value of the company's publicly held shares before the offering, along with the market value of the shares to be sold by the company in the opening auction, is at least $110 million (or $100 million if the company has stockholders' equity of at least $110 million). The proposed market value requirement is significantly lower than Nasdaq's current $250 million market value requirement for a direct listing without a primary capital raise. Market value would be calculated using a price per share equal to the price that is 20% below the bottom end of the price range disclosed in the registration statement. The company would be required to meet all other applicable Nasdaq Global Select Market initial listing requirements, including the requirement to have 450 round lot holders (or 2,200 total shareholders),1.25 million unrestricted publicly held shares outstanding and a price per share of at least $4.00, all at the time of the initial listing.

Under the proposed rule, a company would be required to submit an order for the number of shares that it wishes to sell in the opening auction as disclosed in the registration statement. The order must be executed in full at the price determined through the Nasdaq Halt Cross, which must be at or above 20% below the bottom end of the price of the range disclosed in the registration statement. Unlike the NYSE's new rule, this would afford companies flexibility to open trading at a price that is up to 20% below the bottom end of the price range in the registration statement. Similar to the NYSE's rule, the Nasdaq's proposed rule would not allow the company's market order to be canceled or modified, and the order would need to be executed in full in order to conduct the primary direct listing.

Key diferences between NYSE rule and Nasdaq proposal for primary direct listings

A summary of key differences between the NYSE rule and the Nasdaq proposal is in the table below:

	NYSE Rule	Nasdaq Proposal
Initial trading price	Must fall within the price range in the registration statement	Must be greater than or equal to 20% below the bottom end of the price range in the registration statement
Market value requirement	Either (i) the company must sell at least $100 million in market value of shares in the opening auction, ***or*** (ii) the market value of freely tradeable shares before the listing ***together with*** the market value of shares sold in the opening auction is at least $250 million	The publicly held shares before the listing ***together with*** the market value of the shares to be sold by the company in the opening auction, must have a market value of at least $110 million (or $100 million if the company has stockholders' equity of at least $110 million)
Market value calculation	Calculated using a price per share equal to the bottom of the price range in the registration statement	Calculated using a price per share that is 20% below the bottom of the price range in the registration statement

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