SEC Re-Approves NYSE Direct Listings

December 23, 2020

SEC approves NYSE's third try to allow companies to raise funds in a direct listing

On December 22, the Securities and Exchange Commission **approved** for the second time the NYSE's proposed rule change that would permit companies to raise capital in a direct listing by selling newly issued shares into the opening auction. The newly approved rule is identical to the rule approved by the SEC in August 2020.

The new rule is effective immediately.

Background

The rule had been previously approved by the SEC in August 2020 (as described in our memo **here**), but the SEC's approval order was stayed in September 2020 after the Council of Institutional Investors ("CII") filed a petition for review of the approval order. After a *de novo* review of the NYSE's proposed rule, the SEC found that NYSE has met its burden to show that the proposed rule change is consistent with the Exchange Act and approved the rule.

NYSE's primary direct listing rule

The NYSE rule will allow a company to sell newly issued primary shares into the opening auction in a direct listing. Under the 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 rejected the argument by CII and other commenters that the rule change would limit the availability of investor protections under Section 11 of the Securities Act. The SEC noted that given the broad definition of "underwriters" under the Securities Act, financial advisors engaged in a direct listing "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.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your usual Davis Polk contact.

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