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SEC Approves NYSE Rule Change Permitting Primary Direct Floor Listings

On August 26, 2020, the SEC approved¹ a proposed rule change filed by the NYSE that modifies provisions relating to direct listings to permit companies undertaking a direct listing on the exchange to raise capital. In effect, this rule change allows companies to undertake an initial public offering and concurrent NYSE listing without the use of underwriters to market the shares. Prior to the rule change, direct listings were available only for secondary offerings by existing shareholders. The rule change allows for primary direct listings to occur alone or together with a secondary direct listing.

On August 31, 2020, the SEC stayed the effectiveness of the rule change following a notice by the Council of Institutional Investors that it intends to challenge the rule change.²

We summarize below the requirements for primary direct listings based on the August 26 approval.

Primary Direct Floor Listings

Under current NYSE rules, NYSE-listed companies that previously have sold shares in one or more private placements have been able to undertake a direct listing of their shares on the NYSE concurrently with the effectiveness of a Securities Act registration statement filed to enable existing shareholders to sell their shares. To date, companies have not been able to raise any cash themselves as part of the listing process. The August 26 rule change goes one step further and provides companies with the option to sell, concurrently with a direct listing, the newly issued shares, without the involvement of underwriters.

The NYSE has introduced two new terms to differentiate between a direct listing previously permitted by the NYSE, in which only a company's existing shareholders are selling shares (a "Selling Shareholder Direct Floor Listing"), and a direct listing in which the company itself is selling shares in the opening auction or one in which both the company and its selling shareholders are selling shares in the opening auction (a "Primary Direct Floor Listing").

¹ See Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, SEC Release No. 34-89684, August 26, 2020 (available [here](#)).

² See Letter to John Carey, Senior Director NYSE Group (available [here](#)).

A company can qualify for a Primary Direct Floor Listing in two ways:

- by selling at least \$100 million in market value of shares in the opening auction on the first day of trading on the NYSE; or
- if the aggregate market value of the shares that the company sells in the opening auction on the first day of trading and of the shares that are publicly held immediately prior to listing totals at least \$250 million, with the market value calculated using a price per share equal to the lowest price in the price range set by the company in the Securities Act registration statement.

In either case, the company must have at least 400 security holders holding round lots and 1.1 million publicly held securities outstanding as of the time of listing, and the price per share must be at least \$4.00. Stabilization activities by insiders would have to comply with all federal securities laws, including Regulation M and other anti-manipulation rules.³

A company undertaking a Primary Direct Floor Listing must use a new type of limit order, an “Issuer Direct Offering Order” (“IDO Order”), subject to the following requirements:

- only one IDO Order may be entered on behalf of the company and only by one NYSE member organization;
- the limit price of the IDO Order must be equal to the lowest price of the price range established by the company in its Securities Act registration statement (with the price range defined as the “Primary Direct Floor Listing Auction Price Range”);
- the IDO Order must be for the quantity of shares offered by the company, as disclosed in the prospectus in the Securities Act registration statement;
- an IDO Order may not be cancelled or modified; and

³ In its June 22, 2020 filing (available [here](#)), the NYSE states that “Officers, directors or owners of more than 10% of the company’s common stock prior to the opening auction may purchase shares sold by the company in the opening auction, provided that such purchases are not inconsistent with general anti-manipulation provisions, Regulation M, and other applicable securities laws. In addition, in the same way as for shares of a company listing following a traditional underwritten IPO, such an insider owner may purchase shares sold by other shareholders or sell its own shares in the opening auction and in trading after the opening auction, to the extent not inconsistent with general anti-manipulation provisions, Regulation M, and other applicable securities laws.”

- an IDO Order must be executed in full in the Direct Listing Auction.⁴

An IDO Order will be guaranteed to participate in the Direct Listing Auction at the Auction Price.⁵ If the limit price of the IDO Order is equal to the Auction Price, the IDO Order will have priority at that price.

A Designated Market Maker (“DMM”) is to effect a Direct Listing Auction manually and is responsible for determining the Auction Price. In effect, the DMM determines whether the Direct Listing Auction can proceed. The DMM will not conduct a Direct Listing Auction for a Primary Direct Floor Listing if the Auction Price would be below the lowest price or above the highest price of the Primary Direct Floor Listing Auction Price Range, or if there is insufficient buy interest to satisfy both the IDO Order and all “better-priced” sell orders in full.⁶ If a Direct Listing Auction cannot be conducted, the NYSE will notify market participants via a Trader Update that the Primary Direct Floor Listing has been cancelled and any orders for that security that had been entered, including the IDO Order, will be cancelled back to the entering firms. Moreover, when the limit price of the IDO Order (which is already required to be at the lowest price in Primary Direct Floor Listing Price Range) is equal to the Auction Price (an at-priced IDO Order), the IDO Order would have priority over other orders at that price. All better-priced interest is guaranteed to participate in the opening auction for a Primary Direct Floor Listing.

A DMM will publish a pre-opening indication before a security opens if the Auction Price is anticipated to be a change of more than the Applicable Price Range⁷ from a specified Indication Reference Price. For securities offered in a Primary Direct Floor Listing, the Indication Reference Price will be the lowest price of the Primary Direct Floor Listing Auction Price Range. For securities offered in a Selling Shareholder Direct Floor Listing, the Indication Reference Price for a security that has had recent sustained trading in a Private Placement Market⁸ prior to listing will be the most recent transaction price in that market or, if none, a price determined by the NYSE in consultation with a financial advisor to the company. When facilitating the opening on the first day of trading of a Selling Shareholder Direct Floor Listing that has not

⁴ A “Direct Listing Auction” means a Core Open Auction for the first day of trading on the NYSE of a security that is a Direct Listing. Direct Listing means either a Selling Shareholder Direct Floor Listing or Primary Direct Floor Listing.

⁵ “Auction Price” is the price at which the auction is conducted.

⁶ A sell order is “better-priced” if it is priced lower than the Auction Price, and includes all Market Orders and Market-on-Open orders. A sell order is “at-priced” if it is priced equal to the Auction Price. This condition would be relevant where there are sales by selling shareholders.

⁷ The “Applicable Price Range” for determining whether to publish a pre-opening indication, with limited exception, is 5% for securities with an Indication Reference Price over \$3.00 and \$0.15 for securities with an Indication Reference Price equal to or lower than \$3.00.

⁸ “Private Placement Market” means a trading system for unregistered securities operated by a national securities exchange or a registered broker-dealer.

had a recent sustained history of trading in a Private Placement Market prior to listing, the DMM will consult with a financial advisor to the company in order to effect a fair and orderly opening of such security.

Any services that are to be provided by a financial advisor to the company in connection with a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing and by the DMM assigned to that security must be provided in a manner that is consistent with all federal securities laws, including Regulation M and other anti-manipulation rules. The NYSE has retained FINRA to monitor compliance with Regulation M and other anti-manipulation rules.

Considerations

The rule change should be seen in the context of more fundamental shifts in the capital markets. Over the past 20 years, the number of public companies in the United States has fallen by almost 50% (albeit some of the decrease reflects consolidation through acquisitions). While the JOBS Act made it easier for companies (*i.e.*, emerging growth companies) to go public, the increase in the registration thresholds under the Exchange Act reduced one imperative to go public – the concern that broad-based equity compensation arrangements would trigger premature registration. Ultimately, though, the significant increase in the availability of private capital, together with the availability of private secondary market platforms, has been the most significant driver of delayed IPOs. Efforts to broaden the availability of direct listings is consistent with SEC Chair Jay Clayton’s focus on increasing the attractiveness of the U.S. public markets.

The pool of candidates for direct primary listings, however, will be limited due to the need for companies seeking a listing to meet all of the listing standards at the time of listing, including 400 round lot holders. (The SEC declined to approve an earlier NYSE proposal for a grace period.) The shares in the direct listing must price within the range set in the Securities Act registration statement. A direct listing means that the company would have to be widely held based on secondary market trading, and be relatively well known to investors, since the direct listing process, by definition, skips the traditional road show and book-building process of an underwritten initial public offering. As SPACs are permitted under a separate rule (102.06) of the NYSE Listed Company Manual, the direct listing route does not apply to SPACs, but in any event, as a practical, matter SPACs would not have been potential candidates.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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