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SEC Publishes Nasdaq's Proposal for Direct Listings with a Capital Raise

On September 15, 2020, the SEC published proposed listing rule changes filed by Nasdaq (available here) on September 4 that would permit companies undertaking a direct listing on Nasdaq to raise capital. Under the revised rules, companies would be permitted to undertake an initial public offering and concurrent Nasdaq listing without the use of underwriters to market the shares. Currently, direct listings on Nasdaq are available only for secondary offerings by existing shareholders.

Nasdaq's proposal follows the recent NYSE rule change permitting primary direct floor listings, *i.e.*, direct listings with a primary capital raise. The NYSE's rule was approved on August 26, 2020 but its effectiveness has since been stayed pending the outcome of a petition to review the rule filed by the Council of Institutional Investors.[1]

We summarize below the proposed requirements for Nasdaq's direct primary listing.

Nasdaq's current Listing Rule IM-5315-1 permits a company to proceed with a direct listing on the exchange at the time of effectiveness of a Securities Act registration statement filed solely to enable existing shareholders to sell their shares (a "Direct Listing"). The Direct Listing is conditioned on the company satisfying the initial listing requirements and the applicable Market Value of Unrestricted Publicly Held Shares requirements.

Proposed Listing Rule IM-5313-2 would further extend this accommodation by allowing a company to simultaneously list on the Nasdaq Global Select Market and sell on its own behalf its previously unregistered common equity shares upon the effectiveness of a Securities Act registration statement, in the opening auction on the first day of trading on the exchange (a "Direct Listing with a Capital Raise").

Companies undertaking a Direct Listing with a Capital Raise would be deemed to meet the applicable Market Value of Unrestricted Publicly Held Shares requirement if an aggregate market value of unrestricted publicly held shares immediately prior to listing, together with the market value of shares the company sells in the opening auction, total at least $110 million (or $100 million, if the company has stockholders' equity

[1] SEC order approving the NYSE's Primary Direct Floor Listing and the submissions relating to the petition to review the order are available here.

of at least $110 million), with such market value calculated using a price per share equal to the price that is 20% below the lowest price of the price range established by the company in its registration statement.[2]

The company listing via a Direct Listing with a Capital Raise would be required to comply with all other initial listing requirements, namely having the applicable minimum number of shareholders,[3] at least 1,250,000 unrestricted publicly held shares outstanding at the time of initial listing, and a price per share of at least $4.00 at the time of initial listing.

Securities being listed in connection with the Direct Listing with a Capital Raise would need to begin trading on Nasdaq following the initial pricing through the Nasdaq Halt Cross. The initial pricing would be facilitated by a broker-dealer appointed by the company to serve as a financial advisor to the company and to perform the functions typically assigned to an underwriter in a traditional initial public offering (as contemplated by Rule 4128(c)(8)).

Officers, directors and owners of 10% or more of the company's common shares prior to the opening auction would be permitted to purchase shares sold by the company as well as other shareholders or sell their own shares as long as such purchases and sales comply with general anti-manipulation provisions, Regulation M and other applicable securities laws.

A company undertaking a Direct Listing with a Capital Raise would have to use a new order type, the "Company Direct Listing Order" or "CDL Order," that would be a market order entered for the quantity of shares offered by the company as specified in the registration statement. The CDL order would be subject to the following conditions:

- it could be entered only on behalf of the company and by only one Nasdaq member representing the company;
- it could not be canceled or modified;

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2 The SEC cited the following example: if the company is selling 5,000,000 shares in the opening auction and there are 45,000,000 shares issued and outstanding immediately prior to the listing that are eligible for inclusion as unrestricted publicly held shares based on disclosure in the company's registration statement, then the Market Value of Unrestricted Publicly Held Shares will be calculated based on a combined total of 50,000,000 shares. If the lowest price of the price range disclosed in the company's registration statement is $10 per share, Nasdaq will attribute to the company a Market Value of Unrestricted Publicly Held Shares of $400,000,000, based on an $8 price per share, which is 20% below the bottom of the disclosed range (of $10).

3 Nasdaq Listing Rule 5315(f)(1) requires a security to have: (A) at least 550 total holders and an average monthly trading volume over the prior 12 months of at least 1,100,000 shares per month; or (B) at least 2,200 total holders; or (C) a minimum of 450 round lot holders and at least 50% of such round lot holders must each hold unrestricted securities with a market value of at least $2,500.

- it could only be executed in full, in the Nasdaq Halt Cross, at the price determined by the Halt Cross; and
- all orders placed better than the price determined in the Nasdaq Halt Cross would have to be satisfied.

The proposed rule changes amend certain other Nasdaq listing rules in order to establish requirements for disseminating information, establishing the opening price and initiating trading through the Nasdaq Halt Cross.

- Rule 4120(c)(9)(B) would be added to specify that a security must not be released for trading on Nasdaq unless the expected price at which the cross would occur is at or above the price of 20% below the lowest price of the price range established by the company in its effective Securities Act registration statement. There would be no upper limit to the price determined in the Halt Cross. The financial advisor to the company would be responsible for determining whether the Halt Cross for a Direct Listing with a Capital Raise can proceed.

- Rules 4573(a)(3) and 4753(b)(2) would be modified to make adjustments to the calculation of the Current Reference Price[4] and the determination of the price at which the Nasdaq Halt Cross would execute. If multiple prices existed that would satisfy the condition for determining the price, Nasdaq would modify the fourth tie-breaker for a Direct Listing with a Capital Raise to use the price closest to the price that is 20% below the lowest price range disclosed by the company in its effective Securities Act registration statement.

- Rule 4120(c)(9) would be amended to specify that the activities performed by a financial advisor under Rule 4120(c)(8) must be conducted in a manner consistent with all federal securities laws, including Regulation M and other anti-manipulation requirements.

The proposed rules will now be subject to a 21-day comment period following the date of the publication in the *Federal Register*.

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[4] "Current Reference Price" means:

- The single price at which the maximum number of shares of Eligible Interest can be paired.
- If more than one price exists under subparagraph (i), the Current Reference Price shall mean the price that minimizes any Imbalance.
- If more than one price exists under subparagraph (ii), the Current Reference Price shall mean the entered price at which shares will remain unexecuted in the cross.

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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