



NYSE direct listing — proposal for NYSE listing as an alternative to a traditional IPO

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Spotify reportedly plans direct NYSE listing in 2018, without filing any registration statement under the Securities Act of 1933. Proposed changes in the NYSE's listing standards, filed on May 16, 2017, which are called the "Spotify rule" by some, would allow simultaneous listing upon effectiveness of a registration of a class of securities under the Securities Exchange Act of 1934, if an independent valuation establishes a market value of the publicly held shares of the listed company of at least \$250 million.

Why would an issuer want to list shares on the New York Stock Exchange without doing a simultaneous equity offering?

Reports in the media cite Spotify's success at private capital-raising—no new equity is required. Other commenters note that public market liquidity could be achieved without the hefty underwriting fees associated with most initial public offerings (IPOs). In addition, in a direct listing, existing shareholders would be permitted to cash out more quickly and without being subject to the 180-day lock-up period in a traditional IPO.

Why list on the New York Stock Exchange?

NYSE-traded shares have greater market acceptance because of the NYSE's minimum listing standards, market-makers and auction market trading. Existing shareholders who purchased in private placements and have held shares for the requisite time periods, and are not affiliates of the issuer, could have existing restrictive legends lifted from their shares and trade freely. The issuer's public filings, required upon registration under the 1934 Act (as well as the 1933 Act)¹, will form

¹ *What is the difference between registration under the Securities Act of 1933 ("1933 Act") and the Securities Exchange Act of 1934 ("1934 Act")?* Registration Statements filed with the Securities and Exchange Commission (SEC) under the 1933 Act register the offer and sale of securities. The registration statements may be for primary sales of securities by the issuer, or for re-sales by existing shareholders referred to as "secondary sales." An issuer is required to register a class of securities with the SEC under the 1934 Act within 120 days after the end of any fiscal year in which the issuer has total assets in excess of \$10 million and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors. Various rules apply to counting the persons.

the basis for development of market pricing. Also, in addition to developing a secondary trading market for its shares, the company will raise its profile as a result of becoming a public reporting company.

Why is the NYSE seeking to broaden its criteria for listing to permit listing without a simultaneous IPO, a transfer from another exchange, a spin-off or, under certain circumstances, secondary registered offering by existing shareholders?

The NYSE rule proposal states that companies have expressed interest in providing liquidity to existing shareholders without the expense of an underwritten IPO or a registered secondary offering, and that the NASDAQ Stock Market permits direct listing under these circumstances. The proposed NYSE rule would permit the listing at the discretion of the Exchange based on rules for satisfying the market capitalization requirements.

What are the proposed NYSE market capitalization requirements for a direct listing?

The NYSE seeks to modify its current Footnote (E) to Section 102.01B of the NYSE Listing Company Manual (“Manual”) to permit a listing upon effectiveness of a 1934 Act registration, without a concurrent 1933 Act registration, in its discretion, if the \$100,000,000 market value of publicly held shares requirement is satisfied by **both**: (i) an independent third-party valuation, and (ii) the most recent trading price of the issuer’s common stock in a trading system for unregistered securities operated by a national securities exchange or a registered broker-dealer (a “Private Placement Market”), or, if the issuer’s common stock is not traded in a Private Placement Market (or if the trading is not adequate to support a price based on sustained trading over several months), by providing an independent third-party valuation of the market value of publicly-held shares of at least \$250,000,000.

What are some of the risks of a direct listing?

Compared to a traditional IPO, there is a greater risk that the company’s shares will tank on the first day of trading because there are no underwriters to support the initial price. The potential for large sales by existing shareholders (not subject to lock-ups) may also put additional pressure on the stock price. In addition, the company must absorb the additional cost and expense of preparing for and becoming a public reporting company using its existing cash reserves since it will not be raising any cash from an equity offering.

How many companies have done direct listings?

According to a May 26, 2017, article in *The Wall Street Journal*, NASDAQ has completed only about six direct listings since 2006 and the NYSE has not yet completed any direct listings under its current rules.

What was the amendment to the NYSE proposal?

The NYSE proposal was initially submitted to the SEC on March 27, 2017. Under its statutory authority, on May 12, 2017, the SEC extended the time for it to approve (or disapprove) the rule change until June 29, 2017. The NYSE filed an amendment to the proposed rule change on May 16, 2017, which added clarity to the definition of independence for the third-party valuation agent. These changes may significantly affect the plans of issuers contemplating a direct listing by foreclosing investment banks most familiar with the issuer from providing the third-party valuation. The following valuation agents will **not** be deemed independent under the revised proposal:

- (i) at the time of the valuation, the valuation agent or any affiliated person or persons, beneficially own more than 5% of the class of securities to be listed (including any right to acquire such securities exercisable within 60 days);
- (ii) the valuation agent or any affiliated entity has provided investment banking services to the issuer within 12 months preceding the date of valuation; and
- (iii) the valuation agent or any affiliated entity has been engaged to provide investment banking services to the issuer in connection with the proposed listing, or any related financings, or other related transactions.

“Investment banking services” are defined broadly as including acting as an underwriter in an offering for the issuer; acting as a financial adviser in a merger or acquisition; providing venture capital, equity lines of credit, PIPES or similar investments; serving as a placement agent for the issuer; or acting as a member of a selling group in a securities underwriting.

Are there additional NYSE listing requirements?

Yes, even if an issuer can provide a \$250,000,000 valuation from an independent valuation agent, listing by the NYSE is discretionary and the NYSE may have other requirements. The Exchange provides issuers with a free confidential eligibility review before the filing of an original listing application.

Are there ongoing requirements to maintain a NYSE listing?

Listed companies are required to agree, among other things, to maintain a minimum float, disclose material information promptly, follow the Exchange’s corporate governance rules regarding independent directors, audit, nominating corporate governance and compensation committees (in some cases, after an initial grace period), file compliance reports and pay annual fees.

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