

FEBRUARY 12, 2021



## Primary Direct Floor Listings on the NYSE

By John C. Partigan

Primary direct floor listings, where the issuer sells its shares directly on the stock exchange in an auction, have been permitted by the New York Stock Exchange (NYSE) rules since December 22, 2020. Despite this favorable change, the expected surge in direct listings has not yet occurred. This alert will highlight the requirements for a “primary direct floor listing” by a domestic issuer on the NYSE and discuss some of the most significant pros and cons of this alternative for accessing the U.S. public capital markets.<sup>1</sup>

### Company eligibility requirements

The company eligibility requirements for a Primary Direct Floor Listing are set forth on the attached chart. A Primary Direct Floor Listing includes any such listing in which either (i) only the company itself is selling shares in the opening auction on the first day of trading or (ii) the company is selling shares and selling shareholders are also selling shares in the opening auction. The NYSE has discretion regarding which companies to list and offers a free, confidential review process to determine whether the company meets the eligibility requirements and what additional requirements, if any, might need to be satisfied.<sup>2</sup>

### Determining the auction price

To conduct a Primary Direct Floor Listing, the issuer must establish a price range for the sale and disclose such price range in the registration statement for the offering. Additionally, the Primary Direct Floor Listing has a new order type to be used by the issuer (Issuer Direct Offering Order or IDO Order), which is a limit order to sell to be traded only in the auction. The IDO Order must meet the following requirements:

- Only one IDO Order may be entered on behalf of the issuer 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 issuer in its effective registration statement;

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<sup>1</sup> Nasdaq has submitted a similar primary direct listing proposal, for which the SEC has requested public comments. See SEC Release 34-91062 (February 4, 2021).

<sup>2</sup> See Section 101 of the *NYSE Listed Company Manual*.

- The IDO Order must be for the quantity of shares offered by the issuer, as disclosed in the prospectus in the effective registration statement;
- The IDO Order may not be cancelled or modified; and
- The IDO Order must be executed in full in the direct listing auction.

Consistent with current rules, a Designated Market Maker (DMM) would conduct the auction manually and would be responsible for determining the price at which the auction is conducted. The DMM will not conduct the auction if (i) the auction price would be below the lowest or above the highest price of the price range established by the issuer in the effective registration statement or (ii) there is insufficient buy interest to satisfy both the IDO Order and all better-priced sell orders in full.

In the view of one Securities and Exchange Commission (SEC) commissioner, this auction mechanism represents a different price discovery method compared to traditional initial public offerings (IPOs) and is designed to provide fair and efficient pricing for participating investors, with the added benefit of increasing the opportunity for retail investors to purchase shares at the initial offering price, rather than having to wait to buy in the aftermarket.<sup>3</sup>

### **Pros and cons of Primary Direct Floor Listings**

Many of the uncertainties that we discussed when Spotify completed its direct listing in 2018<sup>4</sup> are raised again under the new NYSE rule. However, the new rule eliminated the principal disadvantage of the so-called Spotify Rule by amending the listing rules further to permit an issuer to raise capital using the facilities of the exchange and without engaging the services of an underwriter or the traditional book-building process to price the company's IPO.

In the final SEC Order approving the NYSE rule, the SEC cited the work of academics and their extensive studies relating to IPO underpricing.<sup>5</sup> A Primary Direct Floor Listing has the potential to eliminate the historical underpricing that has occurred in traditional IPOs. As discussed above, under the NYSE rule, the offering price to the public is set through an opening auction on the NYSE, similar to the ones that occur for listed stocks at the beginning of each trading day, instead of being established by negotiations between the underwriters and the issuer. In other words, the company could benefit from the first-day "pop" in the price that, in a traditional IPO, benefits clients of the underwriter only after secondary trading occurs.

In addition, in a Primary Direct Floor Listing, the shares would be sold directly to investors at the auction price. By contrast, in a traditional IPO, the shares are sold to the underwriters at a discount or gross spread, which is 7% in most IPOs in the U.S., and the shares are then resold by the underwriters to their clients at the IPO price. In commenting on the rule, two SEC commissioners cited an article from another former SEC commissioner which described the underwriter's gross spread as "The Seven-Percent Middle-Market IPO Tax," and in which the author viewed the gross spread as a deterrent to going public in the U.S.<sup>6</sup>

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<sup>3</sup> See Statement on NYSE Primary Direct Listing Proposal of Commissioner Elad L. Roisman (December 22, 2020).

<sup>4</sup> See our alert, "[Direct Listing under the NYSE's Spotify Rule](#)," August 26, 2018.

<sup>5</sup> See SEC Release 34-90768 (December 22, 2020) (Final Order) at note 113.

<sup>6</sup> See Statement on Primary Direct Listings of Commissioners Allison Herren Lee and Caroline A. Crenshaw (December 23, 2020), citing article of Robert Jackson, Jr., "The Middle-Market IPO Tax" (April 25, 2018).

Because Primary Direct Floor Listings do not require underwriters, they do not require lockup agreements from insider shareholders. This was a significant advantage for the insider shareholders of Spotify in its direct listing, where approximately 91% of the outstanding shares were eligible to be sold on the opening day of trading. By contrast, in a typical underwritten IPO, directors, officers, and large shareholders would be required to agree not to sell their shares in the market (subject to certain exceptions) for a lockup period of 180 days. The SEC noted, however, in the Final Order, that there is nothing prohibiting an issuer in a direct listing from entering into a lockup agreement, and pointed out that, in the recent direct listing by Palantir Technologies, Inc., insider shareholders entered into lockup agreements with respect to certain of their shares.<sup>7</sup>

A few companies have completed direct listings since the adoption of the Spotify Rule in 2018.<sup>8</sup> Although both the NYSE and Nasdaq had rules permitting direct listings prior to 2018, only a handful of relatively obscure companies completed direct listings under those rules. As a result, a principal risk of direct listings, including a Primary Direct Floor Listing under the new rule, relates to the lack of sufficient data regarding how the auction mechanism will perform for different types of issuers in terms of the impact on trading volume, price volatility, and more efficient pricing for the issuer and participating investors when compared against a traditional underwritten IPO.

In addition, as several commentators have noted, the most sensible candidate for a direct listing may be a company that already has substantial name recognition surrounding its brand, a company with an easily understood product or business model, or a company that is already listed on a foreign exchange and is seeking a dual listing in the U.S.

As the SEC noted in the Final Order, many issuers may continue to prefer a traditional underwritten IPO. For example, an underwritten IPO may be preferable if the issuer would require the assistance of underwriters to develop a broad investor base sufficient to support a liquid market or if the company would benefit from the brand recognition that can result from roadshows and other marketing efforts that often accompany such offerings.<sup>9</sup>

The Primary Direct Floor Listing, as a result of its ability to raise capital and provide liquidity to existing shareholders, merits serious consideration as an alternative to a traditional IPO. And, if it becomes more popular among issuers in the future, it has the potential to change the terms of the typical engagement between a company and its managing underwriter, even when the course of a more traditional IPO is chosen by the company to access the U.S. public capital markets.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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<sup>7</sup> See Final Order at note 95.

<sup>8</sup> Examples of direct listings include Spotify Technology (SPOT) in 2018; Watford Holdings Ltd. (WTRE) and Slack Technologies, Inc. (WORK) in 2019; Asana, Inc. (ASAN), Palantir Technologies Inc. (PLTR), and Thryv Holdings, Inc. (THRY) in 2020; and Roblox Corporation (pending).

<sup>9</sup> See Final Order at note 114.

# Primary Direct Floor Listing Standards on the NYSE

<p><b>Market Value of Publicly Held Shares<sup>1</sup></b></p>	<p>The Company must (i) sell at least \$100 million in market value of shares in the opening auction on the first day of trading on the NYSE or (ii) demonstrate to the NYSE that such shares to be sold in the auction, plus the aggregate market value of its Publicly-Held Shares immediately prior to the listing, is at least \$250 million calculated using the lowest price per share of the price range established by the company in its registration statement/prospectus filed with the SEC.<sup>2</sup></p> <p>Interestingly, shares sold in the auction to directors, officers, or owners of more than 10% of the company stock would count toward the \$100 million requirement.<sup>3</sup></p>
<p><b>Financial standards<sup>4</sup></b></p>	<p>The Company must meet one of the following standards:</p> <ul style="list-style-type: none"> <li>— (i) Each of (a) aggregate adjusted pre-tax earnings from continuing operations for the last three fiscal years of at least \$10 million, (b) with a minimum of at least \$2 million in each of the two most recent fiscal years, and (c) positive earnings in all three years; or</li> <li>— (ii) Each of (a) aggregate adjusted pre-tax earnings from continuing operations for the last three fiscal years of at least \$12 million, (b) with a minimum of at least \$5 million in the most recent fiscal year, and (c) a minimum of at least \$2 million in the next most recent fiscal year; or</li> <li>— (iii) For an Emerging Growth Company (as defined in Section 2(a)(19) of the Securities Act of 1933) that elects to report only two years of audited financial statements, aggregate adjusted pre-tax earnings from continuing operations of at least \$10 million for the last two fiscal years with a minimum of \$2 million in both years (clauses (i), (ii) or (iii), are referred to as the “<i>Earnings Test</i>”); or</li> <li>— (iv) Global market capitalization of at least \$200 million based on completion of the offering (or distribution) (referred to as the “<i>Global Market Capitalization Test</i>”).</li> </ul>
<p><b>Distribution criteria<sup>5</sup></b></p>	<p>The Company must meet all of the following distribution standards:</p> <ul style="list-style-type: none"> <li>— (i) 400 round lot shareholders (<i>i.e.</i>, holders of 100 shares or more) at the time of listing;</li> <li>— (ii) 1,100,000 Publicly-Held Shares outstanding at the time of initial listing; and</li> <li>— (iii) Minimum initial reference price of at least \$4.00 per share.</li> </ul>
<p><b>Engagement of financial advisor</b></p>	<p>Unlike a Selling Shareholder Direct Floor Listing, a valuation is not required because the Market Value of Publicly-Held Shares is based on the lowest price per share of the price range in the company’s registration statement/prospectus.</p>

<sup>1</sup> Excludes shares held by directors, officers, their immediate families and concentrated holdings of 10% or more.

<sup>2</sup> See NYSE Listed Company Manual Section 102.01(E).

<sup>3</sup> See Final Order at note 26.

<sup>4</sup> See NYSE Listed Company Manual Section 102.01(C).

<sup>5</sup> See NYSE Listed Company Manual Section 102.01(A) and Final Rule at note 29.