ROPES & GRAY

ALERT

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SEC Approves NYSE's Proposal to Facilitate Primary Direct Listings by Modifying Pricing Limitations; Follows Approval of Nasdaq Proposal

Each exchange's approved rule change relaxes the pricing limitations that must be met in order to directly list a primary offering by allowing the opening auction price to be up to 20% below or 80% above the price range included in the effective registration statement if certain conditions are met.

On December 15, 2022, the Securities and Exchange Commission (the "SEC") issued a release approving the New York Stock Exchange's (the "NYSE") proposal to modify the pricing limitations applicable to direct listings with a primary component. This comes after the SEC approved a similar proposal by The Nasdaq Stock Market LLC ("Nasdaq") on December 2, 2022. Both exchanges previously permitted a primary direct listing to proceed only if the price determined at the opening auction fell within the price range included in the effective registration statement covering the shares being offered (the "Stated Price Range"), and the modified rules of each exchange will now permit the opening auction price to be set up to 20% below and up to 80% above the Stated Price Range (the "Modified Price Range"), subject to certain conditions. Each of the NYSE and Nasdaq will calculate the Modified Price Range based on the highest price in the Stated Price Range (e.g., if the Stated Price Range is $28 – $30, the Modified Price Range will be $22 – $54).

Impact of the Modified Rules on the Prevalence of Primary Direct Listings

By creating more flexibility around the issuer's stock price at the time of listing, the rule changes by each of the NYSE and Nasdaq appear to be geared toward enhancing the prospects for primary direct listings. While the NYSE and Nasdaq adopted rules allowing for primary direct listings in late 2020 and early 2021, respectively, no such transaction has been effected on either exchange to date.[1] The NYSE stated that the modifications are intended to address concerns that "[t]he Price Range Limitation—which is imposed on a Primary Direct Floor Listing but not on an IPO—increases the probability of a failed offering because it contemplates there also being too much investor interest. In other words, if investor interest is greater than the company and its advisors anticipated, an offering would need to be delayed or cancelled." However, it remains to be seen whether these rule changes will lead to an increase of companies choosing to go public via primary direct listings as an alternative to traditional underwritten IPOs.

Conditions to the Availability of the Modified Price Range

Each of the NYSE and Nasdaq require that, in order for a company to avail itself of the option to proceed with a primary direct listing when the auction price falls outside of the Stated Price Range but within the Modified Price Range, the company must have certified to the applicable exchange and publicly disclosed that (i) they do not expect that the auction price would materially change the company's previous disclosure in its effective registration statement, and (ii) the effective registration statement covering the shares includes a sensitivity analysis explaining how the issuer's plans would change if the actual proceeds from the offering differ from the amounts assumed within the Stated Price Range.

In addition, the NYSE separately requires that the certification provided to the exchange include a statement that the price range included in the preliminary prospectus of the effective registration statement is a "bona fide" price range in accordance with Regulation S-K.

Nasdaq, on the other hand, separately requires that there be a brief "Post Pricing Period" implemented in circumstances where the opening auction price lands outside of the Stated Price Range, during which the company would need to separately confirm to Nasdaq that no additional disclosures are required under the federal securities laws based on the actual price calculated during the auction.

Nasdaq's Price Volatility Constraint and the 10% Price Collar

In a traditional underwritten IPO process, during the "road show," the underwriters build an order book by collecting indications of interest from potential investors. Based on this order book, discussions with investors, and the company, a price is set for sale to investors in the IPO. By contrast, in a direct listing, price discovery of the price per share in the opening trade on the first day of trading on an exchange is determined based on buy and sell orders submitted from a much broader pool of potential investors and sellers through the facilities of a stock exchange.

The largest difference between the proposals by the NYSE and Nasdaq is that Nasdaq included certain procedures to address volatility concerns. Specifically, Nasdaq adopts a new "Price Volatility Constraint" which, during a "Pre-Launch Period" of price discovery, requires that the current reference price (the price at which the maximum number of shares are paired based on investors' indications of interest) not deviate by 10% or more over a ten-minute period (such price once the Price Volatility Constraint is satisfied, the "Near Execution Price"). Once the Near Execution Price is initially established, the Pre-Launch Period will last for at least an additional five-minute period, during which time investors will be able to modify their orders prior to the finalization of the opening auction and the pricing of the offering. Additionally, the pricing may not execute if the final execution price as determined by the orders placed during such period exceeds 10% above or below the Near Execution Price (such range, the "10% Price Collar"). If, as a result of the final execution price falling outside the 10% Price Collar, the security is not released within 30 minutes of the Near Execution Price being initially satisfied, the Price Volatility Constraint will reset, and all requirements of the Pre-Launch Period will need to be met again.

Additional Modifications Included in the Approved Proposals

Each of the NYSE and Nasdaq also proposed and the SEC approved the following modifications to their respective rules.

Addition of a Named Underwriter in Registration Statement. Both exchanges will now require that a company offering securities for sale in a primary direct listing must retain an underwriter with respect to the sales of such shares, and such underwriter must be named in the registration statement. While the named underwriter will not perform traditional underwriting services of buying and then reselling the securities registered in the direct listing, each exchange expressed an expectation that the underwriter(s) "will perform substantially similar functions, including those related to establishing and adjusting the price range, to those performed by an underwriter in a traditional IPO because the underwriter will be subject to similar liability and reputational risk. The requirement to name an underwriter in the direct listing registration statement will likely offer similar investor protections to those that come with a traditional underwriter. Since being named underwriter would likely carry with it the potential for liability under Section 11 of the Securities Act of 1933,[2] we expect the underwriters to be incentivized to ensure the accuracy of disclosure in a registration statement and will likely require a due diligence exercise before agreeing to be named as an underwriter in the registration statement, including receipt of auditor comfort letters and legal opinions, similar to what is customarily performed in a traditional IPO. The orders approving both the NYSE and Nasdaq also note that underwriters will be able to impose lock-up arrangements on shareholders in connection with primary direct listings, as they do in traditional IPOs, though neither requires that underwriters must impose lock-ups. The attractiveness of primary direct listings may be diminished to the extent it becomes standard practice for underwriters to insist on lock-ups in those transactions.

Improved Transparency During Price Discovery. Given that the modified rules will allow the auction price to fall outside the Stated Price Range, both exchanges expressed the need to improve the transparency around price discovery during the auction. To address this, both exchanges adopted rules to require that the real-time pricing information be disseminated free of charge on a publicly available website established by the exchange during the pre-launch period.

Market Value Requirement Calculations. While the NYSE and Nasdaq have differing standards[3] that must be met to satisfy the minimum market value requirements, each of the exchanges included a proposal that such requirements be calculated using the lowest price in the Modified Price Range, as opposed to previously using the lowest price in the Stated Price Range.

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If you would like to follow up regarding any of the matters covered by this Alert, please contact your usual Ropes & Gray attorney.

1. While no primary direct listings have been completed, several high-profile companies including Spotify, Coinbase, Roblox, Warby Parker and Palantir became public companies via secondary direct listings in which their shareholders sold shares to the public with none of the proceeds going to the company.
2. The United States Supreme Court will soon hear an argument from Slack Technologies that a plaintiff asserting Section 11 or Section 12(a)(2) liability under the Securities Act against an issuer in a direct listing without a capital raise component is required to trace its purchased shares back to the registration statement for the direct listing. To the extent this tracing requirement is upheld, it could impact a plaintiff’s ability to assert Section 11 and/or Section 12(a)(2) claims in the future against underwriters in direct listings.
3. The NYSE requires that (i) a company sell at least $100 million in market value of shares in the opening auction on the first day of trading or (ii) the aggregate market value of the shares the company sell in the opening auction on the first day of trading plus the shares that are publicly held immediately prior to the listing is at least $250 million. Nasdaq requires that the market value of the shares to be sold by the company in the opening auction is at least $110 million (or $100 million, if the company has stockholders’ equity of at least $110 million).