

SEC Approves Nasdaq Rule Change to Clarify Standards for Direct Listings Without an IPO

Effective as of February 15, 2019, the Securities and Exchange Commission (SEC) approved new Nasdaq rule changes to clarify standards for direct listings without an initial public offering (IPO), similar to the New York Stock Exchange (NYSE) rule changes approved in 2018. This new rule clarifies the criteria for direct listings of companies that desire to go public without raising new capital in a traditional IPO, including the calculation of price-based initial listing requirements and foreign exchange listings. Nasdaq's new rule comes about a year after Spotify used a direct listing to go public on the NYSE. The direct listing alternative to an IPO may appeal to cash-rich companies that do not need the publicity or new capital associated with a traditional IPO.

I. Background

Section 6(b) of the Securities Exchange Act of 1934 (the "Act") is designed to promote equitable and just principles of trade, to foster cooperation with individuals engaged in facilitating transactions in securities for the public interest, and to protect investors in support of the national open and free market system.¹ Consistent therewith, pursuant to the corporate governance requirements in Nasdaq's Rule 5600 Series direct listings are subject to all initial listing requirements applicable to equity securities and are also subject to the applicable exemptions thereunder.² Nasdaq's new Listing Rule IM-5315-1 outlines the direct listing criteria for common equity securities and compliance with the Nasdaq Global Select Market initial listing standards for the requirements relating to price, market capitalization and market value of publicly held shares.³

Prior to the Spotify direct listing on the NYSE in 2018, historically direct listings were limited to small companies and were generally rare. The SEC noted that Nasdaq's rule changes are similar to the rules that the SEC approved for the NYSE last year.⁴ There is increased speculation that additional companies may follow Spotify's example⁵, as the direct listing alternative may provide greater liquidity for existing shareholders and potentially make common shares more valuable in an acquisition context.

II. Listing Rule IM-5315-1; Foreign Exchange Listings

Listing Rule IM-5315-1 outlines the requirements for a company whose stock is not registered under the Act and seeks to list on the Nasdaq Global Select Market without a corresponding underwritten IPO, and also describes how Nasdaq will calculate compliance with the Nasdaq Global Select Market initial listing standards based on the price, market value and market capitalization of publicly held shares.⁶ Additionally, the new rule

¹ 15 U.S.C. § 78f(b).

² Corporate Governance Requirements, Nasdaq Rule 5600 Series.

³ Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt Listing Standards for Direct Listings and Clarify Related Rules, Exchange Act Release No. 34-85156, File No. SR-NASDAQ-2019-001 (Feb. 15, 2019) at 2.

⁴ *Id.* at 14.

⁵ Olivia Zaleski, *Message Platform Slack Moves Ahead Amid Direct Listing Plans*, BLOOMBERG (February 4, 2019), <https://www.bloomberg.com/news/articles/2019-02-04/messaging-platform-provider-slack-says-it-s-filed-to-go-public> (stating that workplace messaging platform Company Slack Technologies Inc. is believed to be pursuing a direct listing as early as mid-2019).

⁶ *Id.* at 2-3.

requires that a company that lists on the Nasdaq Global Select Market via a direct listing also file a registration statement pursuant to the Act at the time of effectiveness thereby allowing existing shareholders to sell their shares.⁷

Pursuant to IM-5315-1, Nasdaq will also require that companies listed on the Nasdaq Global Select Market via a direct listing provide an independent third-party valuation by an entity with demonstrable competence and significant experience.⁸ To qualify as an independent valuation expert, an entity or its affiliates, at the time of providing a valuation, cannot beneficially own in the aggregate “more than 5% of the class of securities to be listed,” or be entitled to any right to receive such listed securities within 60 days.⁹ Additionally, to be considered an independent valuation expert, neither the entity nor its affiliates can have provided investment banking services to the listing entity within the twelve-month period immediately preceding the date of such valuation or otherwise have been engaged to provide investment banking services to the listing entity “in connection with the proposed listing or related financings or other related transactions.”¹⁰ However, if a given security recently had sustained trading in a private placement market¹¹ prior to a direct listing on the Nasdaq Global Select Market, Nasdaq will determine the company’s price, market value (“the lesser of: (i) the value calculable based on valuation; and (ii) the value calculable based on the most recent trading price in a Private Placement Market”¹²) and market capitalization of publicly held shares.¹³ Alternatively, if a given security does not have recently sustained trading in a private placement market, Nasdaq will determine whether a company has met the market value of publicly held shares requirement for listing on the Nasdaq Global Select Market if the company provides a valuation of publicly held shares of at least \$250,000,000.¹⁴

With regard to foreign exchange listings, where a given company is transferring from a foreign regulated exchange with market liquidity for the company’s shares on that exchange, or listing on Nasdaq while continuing to trade on such exchange, Nasdaq’s new rule clarifies that the foreign company is not subject to the new requirements for direct listings.¹⁵

III. Conclusion

With this rule change, companies now will have clear standards, in certain circumstances, to accomplish a direct listing on either Nasdaq or NYSE in lieu of a traditional IPO. Although a direct listing alternative is more appealing than it was historically, it remains to be seen whether these changes have the effect of pushing more companies to pursue to this path to a public listing.

⁷ *Id.* at 3.

⁸ *Id.* at 3.

⁹ *Id.* at 4.

¹⁰ *Id.* at 4-5.

¹¹ A private placement market can be characterized as a trading system for unregistered securities operated by either a registered broker-dealer or a national securities exchange.

¹² *Id.* at 5.

¹³ *Id.* at 5-6.

¹⁴ *Id.* at 5.

¹⁵ *Id.* at 6-7.

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