Council of Institutional Investors®
The voice of corporate governance

Via Email

January 16, 2020

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number SR-NYSE-2019-67

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[1]

The purpose of this letter is to respond to the Securities and Exchange Commission (SEC or Commission) request for comments in response to a New York Stock Exchange LLC (NYSE) proposed rule to modify the Listed Company Manual provisions relating to direct listings (Proposed Rule).[2] The Proposed Rule would expand the use of direct listings by permitting "a company to conduct a Primary Direct Floor Listing in addition to, or instead of, a Selling Shareholder Direct Floor Listing."[3]

CII has generally supported permitting direct listings.[4] Our general support was based on our belief that a direct listing should be a choice open to companies considering a public listing that can be

---

[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

[2] Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No.1, To Amend Chapter One of the Listed Company Manual To Modify the Provisions Relating to Direct Listings, Exchange Act Release No. 87,821, 84 Fed. Reg. 72,065 (Dec. 20, 2019), https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-28029.pdf.

[3] *Id.*

[4] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Securities and Exchange Commission 1 (Feb. 22, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/February%2022,%202018%20NYSE%20direct%20listing%20(final).pdf (expressing general support for New York Stock Exchange LLC proposed rule change to modify the listing requirements standards to facilitate direct listings).

more cost-effective than an initial public offering (IPO) while still providing necessary investor protections.[5] However, we have become more concerned that shareholder legal rights under Section 11 of the Securities Act of 1933 (Section 11),[6] which arguably have become more important as other investor legal rights have eroded, may be particularly vulnerable in the case of direct listings. In other words, investors in direct listing companies may have fewer legal protections than investors in IPOs.[7]

As was recently reported in *The Wall Street Journal*:

> One difference between IPOs and direct listings is how they are handled in court when aggrieved shareholders sue companies. That is the focus of a brewing legal battle over Slack. Investors are suing the company in California federal court, alleging it failed to fully disclose certain risks when it sold securities.
>
> . . . .
>
> The company says it shouldn't be held liable under Section 11 of the Securities Act of 1933, a provision that underpins many shareholder suits. That is because when Slack went public, investors bought a mix of shares, Slack said in a November court filing. Some were covered by the company's registration statement filed with the SEC and other shares hadn't been registered because they were sold by Slack insiders rather the company itself.
>
> Because the investors suing Slack can't directly trace their shares to the registration statement, the suit should be dismissed, the company argued. Slack also said the plaintiffs can't seek damages because there was no offering price in its direct listing, which would determine how much money the plaintiffs had lost.[8]

Courts are divided on whether secondary market purchases can bring or join Section 11 claims.[9] Slack's lawsuit relies on (1) attacking the right of secondary market purchasers to bring a Section 11 claim; and (2) the inability to determine what shares were "covered" by Slack's registration statement.

We would note that the second problem, at least, appears solvable. The SEC should take real and substantial steps, on an urgent basis, to explore establishing a system of traceable shares before

---

[5] *Id.* ("We generally support permitting direct listings [and] . . . [w]e believe that they can be more cost-effective than an initial public offering (IPO) while still providing necessary investor protections.").

[6] *See* Civil Liabilities on Account of False Registration Statement, 15 U.S.C. § 77k (May 1933), *available at* https://www.law.cornell.edu/uscode/text/15/77k.

[7] *See, e.g.*, Alexander Osipovich, *Investor Advocates See Risks in Silicon Valley's Favorite IPO Alternative,* Wall St. J., Jan. 3, 2020, https://www.wsj.com/articles/investor-advocates-see-risks-in-silicon-valleys-favorite-ipo-alternative-11578047400.

[8] *Id.*

[9] *See* George S. Geis, *Traceable Shares and Corporate Law*, 13 Nw. U. L. Rev. 227, 239 (2018) https://scholarlycommons.law.northwestern.edu/cgi/viewcontent.cgi?article=1354&context=nulr ("Jurisdictions are split . . . on whether secondary market purchasers, who transact after the initial issuance, can bring or join claims under Section 11, and the U.S. Supreme Court has not weighed in on the topic.") [hereinafter Geis].

approving a direct listing regime.[10] In our view, the SEC has put the cart before the horse in seeking to change the shareholder proposal regime and to impose onerous regulation on proxy advice for institutional investors before correcting so-called "proxy plumbing" problems, which relate importantly to how shares are held.

Critical shareholder litigation rights also depend in some cases, particularly Section 11 claims, on a better system to prove provenance of shares.[11] SEC approval of the Proposed Rule before fixing our system of share ownership would follow the same disordered approach that the Commission has taken to fixing problems in proxy plumbing.

If Slack and other public companies are successful in limiting their liability to investors for damages caused by untrue statements of fact or material omissions of fact within registration statements associated with direct listings,[12] we cannot support direct listings as an alternative to IPOs.[13]

---

[10] CII has requested that the Securities and Exchange Commission (SEC) pursue efforts that could result in traceable shares. The SEC has taken only small steps so far to move toward a system that would permit issuers to list securities on blockchains using distributed ledger technology. *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Brent J. Fields. Secretary, Securities and Exchange Commission 2, 8 (Jan. 31, 2019), https://www.cii.org/files/20190131%20CII%20Follow%20Up%20Letter%20to%20SEC%20on%20Proxy%20Mechanics%20FINAL.pdf ("Technological change now offers the opportunity to construct a better system of share ownership based on traceable shares . . . . investors bringing Section 11 claims fall susceptible to chain of custody opacities when they cannot demonstrate, as is required, that they purchased shares that were issued in connection with a misrepresented registration statement. These practical obstacles present in the current system needlessly delay or prevent investors from proceeding with legitimate claims and receiving compensation, which harms the health and fairness of the capital markets. Intuitively, blockchain-based traceable shares would provide an immutable chain of custody ledger and enable investors to supply evidence of their provenance and voting decisions as necessary"); Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to Brent J. Fields, Secretary, Securities and Exchange Commission 6 (Nov. 8, 2018), https://www.cii.org/files/20181108%20CII%20Letter%20for%20SEC%20Proxy%20Roundtable.pdf ("traceable shares could substantially improve areas of corporation law that require share identification, including Section 11 claims and appraisal rights"); *see also* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Michael D. Crapo, Chairman, Committee on Banking, Housing, and Urban Affairs et al. 10 (Feb. 27, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/February%2027%202019%20Letter%20to%20Senate%20Banking%20Committee.pdf (advocating that the SEC "construct a better system of share ownership based on traceable shares").

[11] *See* Geis, *supra* note 9, at 238-44 (discussing untraceable shares and Section 11 claims); *see also* Vice Chancellor J. Travis Laster, Keynote Speech, CII: The Block Chain Plunger: Using Technology to Clean Up Proxy Plumbing and Take Back the Vote 6-8 (Sept. 29, 2016), https://www.cii.org/files/09_29_16_laster_remarks.pdf (discussing untraceable shares and the appraisal litigation that followed Michael Dell's 2013 management buyout of his company).

[12] 15 U.S. Code § 77k(a) ("In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . . .").

[13] *See, e.g.*, Brief for Council of Institutional Investors as Amici Curie in Support of Plaintiff-Appellee and Affirmance, Sciabacucchi et al. v. Salzberg (Oct. 25, 2019) (No. 2017-0931-JTL), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/CII--Blue-Apron----2019-10-25---Del-amicus-brief.PDF ("stockholders often have good reason to pursue Section 11 and other federal claims in Delaware or other

More specifically with respect to the provisions of the Proposed Rule, CII cannot support the proposed provision that permits direct listings that have at least $350 million in public float from being exempt for a 90 day grace period from the listing manual requirement that the company have at least 400 round lot holders and 1.1 million publicly held shares at the time of listing.[14] The NYSE argues that the exemption from this liquidity requirement "is consistent with the protection of investors because the enhanced public float requirement[] . . . would make it probable that there would be a quick development of a liquid trading market and that the company would comply with the initial listing distribution standards within the [proposed 90 day grace period] . . . ."[15] The NYSE, however, provides no data to support its argument other than the statement that the "$350 million public float requirement that would be required under this proposal . . . is far higher than [the $100 million public float that] . . . a newly-listed company would have to demonstrate under other circumstances."[16] And without evidence, the $350 million threshold appears arbitrary.

For all the above reasons we oppose the Proposed Rule. Thank you for considering our views on this matter. Please contact me with any questions.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

state courts, such as taking advantage of state-judiciary expertise on predominating issues of state law while simultaneously asserting a companion federal claim in the same forum").

[14] 84 Fed. Reg. at 72,066 (referencing Section 102.1A of Listing Manual).

[15] *Id.* at 72,067.

[16] *Id.* at 72,066.