Council of Institutional Investors®
The voice of corporate governance

Via Email

August 8, 2022

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

Re: File Number SR-NASDAQ-2022-027.

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, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[1]

Order

The purpose of this letter is to respond to the Securities and Exchange Commission's (SEC or Commission) solicitation of comments with respect to the *Order Instituting Proceedings to Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No.1, To Modify Certain Pricing Limitations for Companies Listing in Connection With a Direct Listing with a Capital Raise* (Order).[2] Under the proposed rule change, as modified by Amendment No. 1, the Nasdaq Stock Market LLC (Exchange) would:

> [M]odify the Pricing Range Limitation [[3]] to provide that the Exchange would release the security for trading if: (a) the actual price calculated by the Nasdaq Halt

[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] *See* Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, To Modify Certain Pricing Limitations for Companies Listing in Connection with a Direct Listing with a Capital Raise, Exchange Act Release No. 95,220, 87 Fed. Reg. 41,780 (July 12, 2022), https://www.govinfo.gov/content/pkg/FR-2022-07-13/pdf/2022-14887.pdf.
[3] *See id.* (The Pricing Range Limitation is defined as follows: "Currently, in the case of a Direct Listing with a Capital Raise, the Exchange will release the security for trading on the first day of listing if, among other things, the

> Cross [4] is at or above the price that is 20% below the lowest price of the disclosed price range; or (b) the actual price calculated by the Nasdaq Halt Cross is at a price above the highest price of such price range. For the Nasdaq Halt Cross to execute at a price outside of the disclosed price range, the company would be required to publicly disclose and certify to the Exchange that the company does not expect that such price would materially change the company's previous disclosure in its effective registration statement and that its effective registration statement contains a sensitivity analysis explaining how the company's plans would change if the actual proceeds from the offering are less than or exceed the amount in the disclosed price range. The Exchange would calculate the 20% threshold below the disclosed price range based on the maximum offering price set forth in the registration fee table in the company's effective registration statement, which the Exchange argues is consistent with the Instruction to paragraph (a) of Securities Act Rule 430A.[5] The Exchange has also proposed to make related conforming changes.[6]

As the leading voice for effective corporate governance and strong shareholder rights, CII respectfully recommends that the SEC disapprove the Exchange's proposed rule.

The SEC Does Not Have a Sufficient Basis to Make an Affirmative Finding

The Commission has indicated a proposed rule must be disapproved if the SEC does not have a sufficient basis to make an affirmative finding that a proposed rule change is consistent with Section 6(b)(5) of the Securities and Exchange Act of 1934 (Exchange Act).[7] The Exchange Act requires, among other things, that the rules of a national securities exchange be designed to: 1) prevent fraudulent and manipulative acts and practices; 2) promote just and equitable principles of trade; 3) remove impediments to, and perfect the mechanism of, a free and open market and a national market system; 4) protect investors and the public interest; and 5) prohibit unfair discrimination between customers, issuers, brokers, or dealers.[8]

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actual price calculated by the Nasdaq Halt Cross is at or above the lowest price and at or below the highest price of the price range established by the issuer in its effective registration statement").

[4] *See id.* n.10 (The Nasdaq Halt Cross "means the process for determining the price at which Eligible Interest shall be executed at the open of trading for a halted security and for executing that Eligible Interest . . . [and] 'Eligible Interest' means any quotation or any order that has been entered into the system and designated with a time-in-force that would allow the order to be in force at the time of the Nasdaq Halt Cross").

[5] *See* Prospectus in a registration statement at the time of effectiveness, 17 C.F.R. § 230.430A (as amended, June 1, 2020), *available at* https://www.law.cornell.edu/cfr/text/17/230.430A.

[6] 87 Fed. Reg. at 41,781 (footnotes omitted).

[7] *See* National Securities Exchanges § 6(b)(5), 15 U.S.C. § 78(f)(b)(5) (1934), *available at* https://www.law.cornell.edu/uscode/text/15/78f ("The rules of the exchange are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange").

[8] *Id.*

In addition, the Commission's Rules of Practice[9] provide that:

> [T]he ''burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change.'' The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding, and *any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations*.[10]

CII notes that the SEC has raised multiple questions in the Order as to whether provisions of the proposed rule are consistent with the protection of investors under Section 6(b)(5) of the Exchange Act.[11] We are particularly concerned about the following SEC staff observations and related questions about the proposed rule's disclosure of information to investors about the final offering price when the price falls outside of the range disclosed in the registration statement:

> Given the possibility under the proposed rules that the offering might price far outside the disclosed price range, *would issuers be less likely to update their disclosed price ranges, compared to firm commitment underwritten initial public offerings? Similarly, would disclosed price ranges for direct listings be less reliable as indicators of management's perceived valuation of the issuer? How would the ability to ultimately conduct the auction up to 20% below or anywhere above the disclosed price range affect issuer decisions as to what price range to disclose in the registration statement? Would this impact the usefulness of price range disclosure to potential investors or market analysts? If so, this raises concerns about the consistency of the proposal with investor protection and the public interest under Section 6(b)(5) of the Exchange Act*.[12]

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[9] *See* Rules of Practice Governing Disapproval Proceedings for SRO Proposed Rule Change Filings and For Proposed NMS Plans and Plan Amendments § 201.700(b)(3)(i), *available at* https://www.sec.gov/files/tm/no-action/rules-practice-disapproval-proceedings-02192021.pdf (demonstration of consistency with the Securities and Exchange Act of 1934).

[10] 87 Fed. Reg. at 41,787 (emphasis added and footnotes omitted).

[11] *See id.* at 41,785 - 87.

[12] *Id.* at 41,787 (emphasis added and footnotes omitted); *cf.* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 3 (July 28, 2022), https://www.cii.org/files/issues_and_advocacy/correspondence/2022/July%2028%202022%20NYSE%20letter%20(final).pdf ("We are particularly concerned about the following SEC staff observations and related questions about the proposed rule's disclosure of information to investors about the final offering price when the price falls outside of the range disclosed in the registration statement . . . ."); Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 2 (Oct. 21, 2021), https://www.cii.org/files/issues_and_advocacy/correspondence/2021/October%2021%202021%20Nasdaq%20letter%20(final).pdf ("We are particularly concerned about the following SEC staff observations that the [Nasdaq Stock Market LLC] . . . Exchange proposal lacks required company disclosure of material information about the final offering price prior to the time of the sale of shares in a direct listing with a capital raise . . . .").

Our sensitivity to this lack of disclosure under the proposed rules is heightened by our broader and repeated concerns about the loss of investor protections relating to direct listings generally, primarily focused on the difficulties investors face in effectively bringing claims under Section 11 of the Securities Act of 1933 (Securities Act)[13] for material misstatements or omissions in primary direct listing registration statements.[14] In that regard, we commend the SEC staff for explicitly raising the following Section 11-related issues in the Order:

- *"Given the limited judicial precedent addressing tracing requirements in the context of direct listings, and the typical absence of lock-up arrangements in connection with direct listings to date, we are considering whether the Exchange has met its burden of establishing that the proposal to allow a direct listing to proceed at a price outside of the disclosed price range is consistent with Section 6(b)(5) of the Exchange Act* that requires the rules of the Exchange be designed to protect investors and the public interest."[15]

- "While the Exchange has indicated that the proposal is intended to treat like cases alike with respect to pricing flexibility, it has not addressed certain differences between listings that would occur under this proposed rule change and firm commitment underwritten initial public offerings on the Exchange that may affect investor protection, *including the lack of a named underwriter, any challenges to bringing claims under Section 11 of the Securities Act due to the potential assertion of tracing defenses and how those differences could affect the consistency of the proposal with Section 6(b)(5) of the Exchange Act*. It is not clear from the proposal what consideration, if any, the Exchange has given to addressing these issues, or why it believes the proposal is consistent with investor protection, as required by Section 6(b)(5) of the Exchange Act, in light of the pricing flexibility proposed by the Exchange."[16]

Finally, if the Exchange chooses to address those critical investor protection issues, we believe its consideration should also include responding to a recent analysis in a forthcoming law review article by Professor Brent J. Horton, *Direct Listings and the Weakening of Investor Protections*.[17] The article concludes:

> *One of the primary remedies for harmed investors--Section 11 of the Securities Act--is largely unworkable in the context of a direct listing*.[18]

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[13] See Civil liabilities on account of false registration statement, 15 U.S.C. § 77k (1933) (Section 11 of the Securities Act of 1933), *available at* https://www.law.cornell.edu/uscode/text/15/77k.
[14] *See, e.g.*, Petition of Council of Institutional Investors for Review of an Order, Issued by Delegated Authority, Granting Approval of a Proposed Rule 8-13 (Sept. 8, 2020) (footnotes omitted), https://www.sec.gov/rules/sro/nyse/2020/34-89684-petition.pdf (describing in detail how direct listings with a capital raise "compounds the problems shareholders face in tracing their share purchases to a registration statement.").
[15] 87 Fed. Reg. at 41,786 n.90 (emphasis added).
[16] *Id.* at 41,785-86 (emphasis added).
[17] *See* Brent J. Horton, *Direct Listings and the Weakening of Investor Protections*, 50 Fla. St. U. L. Rev. (forthcoming 2023), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4081399/.
[18] *Id.* at 1.

> [I]n the case of a Direct Listing, a harmed investor faces two impediments to recovery under Section 11. The first impediment is the tracing requirement. The second impediment is the absence of the [traditional] underwriter as a defendant.[19]

For all these reasons, we believe the proposed rules are not consistent with Section 6(b)(5) of the Exchange Act and should be disapproved.[20] We appreciate your consideration of our comments. Please let me know if you have any questions.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

[19] *Id.* at 30.

[20] We believe the following facts may also be relevant to the consideration of whether the proposed rules are consistent with Section 6(b)(5) of the Securities and Exchange Act of 1934: In calendar 2021, CII tracked 287 traditional initial public offerings (IPOs), 6 direct listings and 121 special purpose acquisition (de-SPAC) mergers. *See* Council of Institutional Investors, Newly Public Operating Companies Snapshot: 2021, https://www.cii.org/Files/issues_and_advocacy/Dual%20Class%20post%206-25-19/2022_1_19%20Dual-Class%20IPO%20Snapshot%202021_.pdf. Out of these 415 companies, 94 had dual class structures in violation of a core principle of good corporate governance—the principle of one share, one vote. *See* Council of Institutional Investors, Corporate Governance Policies § 3.3 One Share, One Vote (Updated Mar. 7, 2022), https://www.cii.org/files/03_07_22_corp_gov_policies.pdf. Of those 94 companies with poor corporate governance due to dual class stock: 62 were traditional IPOs (21.6% of all traditional IPOs), 6 were direct listings (100% of all direct listings), and 25 were de-SPAC mergers (21.3% of all de-SPAC mergers). From this data, CII perceives that among those three paths of entry to the public markets, direct listings may have the highest risk of creating public companies that violate a core principle of good corporate governance.