Council of Institutional Investors®
The voice of corporate governance

Via email

September 8, 2020

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. SR-NYSE-2019-67, Council of Institutional Investors, Petition for Review of an Order, Issued by Delegated Authority, and Brief in Opposition to Motion to Lift the Automatic Stay

Dear Madam Secretary:

The Council of Institutional Investors (CII) [1] hereby files the attached Petition for Review of an Order, Issued by Delegated Authority, and Brief in Opposition to Motion to Lift the Automatic Stay, along with counsel notice of appearance, by UPS overnight mail and electronic mail pursuant to the Securities and Exchange Commission's March 18, 2020 Order requesting electronic submission of filings in light of COVID-19. Please confirm receipt of these filings at your earliest convenience.

CII has caused the attached to be served by UPS overnight mail, hand courier, and electronic mail on Davis Polk & Wardwell LLP, copied on this email, in

[1] The Council of Institutional Investors (CII) is 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 and defined contribution plans with more than 15 million participants – true "Main Street" investors through their 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. For more information about CII, including its board and members, please visit CII's website at http://www.cii.org.

accordance with 17 C.F.R. § 201.150, as reflected in the Certificate of Service attached to each.

Sincerely,

Jeff Mahoney

Jeff Mahoney
General Counsel

BEFORE THE
SECURITIES & EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

In the Matter of the Petition of:	)	Admin Proc. File No. ____
	)	Release No. 34-898
COUNCIL OF INSTITUTIONAL INVESTORS	)	File No. SR-NYSE-2019-67

PETITION OF COUNCIL OF INSTITUTIONAL INVESTORS FOR REVIEW OF AN ORDER, ISSUED BY DELEGATED AUTHORITY, GRANTING APPROVAL OF A PROPOSED RULE

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Dated: September 8, 2020

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In the Matter of the Petition of:	)	Admin Proc. File No. ____
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PETITION OF COUNCIL OF INSTITUTIONAL INVESTORS FOR REVIEW OF AN ORDER, ISSUED BY DELEGATED AUTHORITY, GRANTING APPROVAL OF A PROPOSED RULE

Pursuant to SEC Rules of Practice 430 and 431, the Council of Institutional Investors ("CII" or the "Council") petitions the Commission to review and reverse the decision of the Division of Trading and Markets, *Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings,* Exchange Act Release No. 89684 (Aug. 26, 2020), 85 Fed. Reg. 54454 (Sept. 1, 2020) (the "Order"). In that Order, the Division, acting pursuant to delegated authority, 17 C.F.R. § 200.30-3(a)(12), approved a proposal by the New York Stock Exchange ("NYSE" or the "Exchange") to amend Chapter One of the Listed Company Manual (the "Manual") to modify and liberalize provisions relating to direct listings.

Introduction.

In a nutshell, the Order makes it easier for private companies to bypass the need for an "initial public offering" if they want to go public and list their shares on the New York Stock Exchange. The alternative to such an IPO is a "direct listing," which allows existing shareholders of a private company to sell their existing shares

to the public, thus reducing the role of underwriters and avoiding post-IPO lockups on the ability of company insiders to sell shares. Such direct listings were authorized several years ago in *Order Granting Accelerated Approval of Proposed Rule Change,* Exchange Act Release No. 82627 (Feb. 2, 2018), 83 Fed. Reg. 5650 (Feb. 8, 2018). The Order would liberalize those rules on direct listings by making it easier for private companies to sell their existing shares to the public, thus making the direct listing option more attractive to companies.

Observers have described the Division's Order as potentially a major "game changer" for companies contemplating a public offering, as they will be able to have their shares publicly traded without the traditional underwriting process that lies at the heart of investor protections offered as part of an IPO.[1]

The issue raised by this Order is not whether direct listings are a good idea or a bad idea, and the Council has expressed support for providing more investment options to Council members and the public generally, provided those options are accompanied by suitable investor protections.[2] The issue here is whether the

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[1] *E.g.,* Posner, NYSE Proposal for Primary Direct Listings, Harvard Law School Blog on Corporate Governance (Jan. 2, 2020), available at https://corpgov.law.harvard.edu/2020/01/02/nyse-proposal-for-primary-direct-listings/; Huff, Arnold & Porter Discusses SEC Approval of NYSE Direct Listing Proposal, CLS Blue Sky Blog (Aug. 31, 2020), available at https://clsbluesky.law.columbia.edu/2020/08/31/arnold-porter-discusses-sec-approval-of-nyse-direct-listings-proposal/

[2] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Securities and Exchange Commission (Feb. 22, 2018), available at https://www.cii.org/files/issues_and_advocacy/correspondence/2018/February%2022,%202018%20NYSE%20direct%20listing%20(final).pdf (expressing general support

changes made by this specific Order, which could significantly liberalize access to U.S. capital markets, contain adequate investor protections. The Council believes that the answer is "no." At a minimum, however, the Order raises important policy concerns that the Order did not adequately address and one that should be decided after plenary consideration by the full Commission.

The Council's interest in this Order.

The Council is 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. Its 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. Its 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. Additional information is available at www.cii.org.

The Council is filing this petition on behalf of its members, who, as investors, purchase shares in the open market and thus have a direct interest in the integrity of U.S. capital markets and the need for suitable investor protections. To the extent that the Order does not provide such adequate protections, CII members are

for NYSE proposed rule change to modify the listing requirements standards to facilitate direct listings).

"aggrieved" by that Order within the meaning of Rule 430, and CII, as their representative is thus entitled to seek review by the full Commission.

The NYSE proposal and the Division's Order.

In *Notice of Filing of Proposed Rule Change to Amend Manual*, Exchange Act Release No. 87821 (Dec. 20, 2019), 84 Fed. Reg. 72065 (Dec. 30, 2019) the Division of Trading and Markets, on behalf of the Commission, gave notice of and invited public comment on a proposed change to the NYSE Listed Company Manual that would modify the provisions relating to the direct listing of a company's shares if those shares had not previously been registered under the Securities Exchange Act of 1934. That notice was the first step in proceedings under section 19(b)(2)(B) of the Exchange Act to determine whether to approve or disapprove the proposed rule change.

As that notice explained, section 102.01 of the NYSE Manual allows listings under which a private company's existing shareholders (such as its employees) to sell their shares directly to the public. The proposed "Amendment No. 1" to that section of the Manual would deem such a listing to be a "Selling Shareholder Direct Floor Listing" and would, in addition, authorize a company to sell shares on its own behalf, either in addition to or instead of a Selling Shareholder Direct Floor Listing. Such company sales would be known as a "Primary Direct Floor Listing," in which either (i) 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 may also be selling shares in such an opening auction.

The Division issued an order extending the comment period on the petition, *Notice of Designation of Longer Period for Commission Action*, Exchange Act Release No. 88190 (Feb. 23, 2020), 85 Fed. Reg. 9891 (Feb. 20, 2020), and then opened a proceeding in a release that raised questions about some of issues that might prompt disapproval of the proposal. *Order Instituting Proceedings,* Exchange Act Release No. 88485 (Mar. 26, 2020), 85 Fed. Reg. 18292 (April 1, 2020). The Exchange responded by revising some of the details of its proposal and submitting that revision as "Amendment No. 2," in lieu of Amendment No. 1.[3] Upon that filing, the Division extended the comment period. *Notice of Designation of Longer Period for Commission Action,* Exchange Act Release No. 89147 (June 24, 2020), 85 Fed. Reg. 39226 (June 30, 2020), and invited comment on proposed Amendment No. 2, *Notice of Filing of Proposed Rule Change to Amend Manual,* Exchange Act Release No. 89148 (June 24, 2020), 85 Fed. Reg. 39246. The Council was an active

[3] The text of Amendment No. 2 is set out in Letter from Martha Redding, Associate General Counsel and Assistant Secretary, New York Stock Exchange to Secretary, Securities & Exchange Commission (June 22, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7332320-218590.pdf

The Order approving Amendment No. 2 summarized the changes made by Amendment No. 2 as: (1) deleting proposed changes that would have provided more time in some cases for companies involved in a direct listing could meet the initial listing distribution standards; (2) adding provisions specifying how companies involved in a direct listing would qualify for listing if the listing were to include both sales of securities by the company and possible sales by selling shareholders; (3) adding a new order type for companies to use when selling shares in a direct listing and describing how such companies would participate in a direct listing auction; and (4) removing references to direct listing auctions from Rule 7.35C, Exchange-Facilitated Auctions. Order at 2 n.7.

participant in these proceedings and filed three comment letters, one in response to the initial petition, and one apiece after the two subsequent notices that invited public comment.[4]

After consideration of multiple comments that had been filed, both in favor of and in opposition to the proposal, the Division issued the Order at issue here, which approved Amendment No. 2, as proposed by the Exchange. That Order discussed a number of details about how company listings would operate in practice and adopted limitations that sought to ensure that direct listings are pursued only by companies of suitable size and that there is sufficient liquidity in the market to permit trading. Many of those details are not germane to the issue that the Council is raising in this petition, and so we do not discuss them in detail.

Reasons for granting review.

Standard of review.

In considering a petition for review the Commission "shall consider" whether the petition "makes a reasonable showing" that the decision embodies: "(A) A finding or

[4] The Council's three letters appear in the rulemaking record as:
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (Jan. 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-203855.pdf;
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (April 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7074298-215548.pdf; and
Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Secretary, Securities and Exchange Commission (July 16, 2020), available at https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7435112-220582.pdf

conclusion of material fact that is clearly erroneous; or (B) A conclusion of law that is erroneous; or (C) An exercise of discretion or decision of law or policy that is important and that the Commission should review." Rule of Practice 411(b)(2), incorporated into Rule of Practice 431(b)(2). That standard is clearly met with respect to the Order at issue here, which has enormous policy significance, as we explain more fully below.

The Commission may approve a proposed rule change only if the Commission finds that such a change would be "consistent with the requirements of this chapter and the rules and regulations issued under this chapter that are applicable to such organization." 15 U.S.C. § 78s(b)(2)(C). In this case, the pertinent provision is section 6(b)(5) of the Exchange Act, 15 U.S.C. § 78f(b)(5), which requires that exchange rules must be—

> . . . 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* (emphasis added).

The proposal at issue here falls way short with respect to the highlighted elements, which involve investor protection. Moreover, in its approval of the proposed rule change, the Division failed to respond to substantive comments illustrating those deficiencies, an omission that renders the Division's approval "arbitrary, capricious, and not in accordance with law" within the meaning of the Administrative Procedure Act.

The amendment compounds the problems shareholders face in tracing their share purchases to a registration statement.

Traceability concerns often arise when there have been successive offerings, as shareholders seek to establish their standing to litigate claims under federal securities laws. Section 11 of the Securities Act creates liability if there are material misstatements or omissions in connection with securities offered in a registration statement, in which event any person purchasing "such security" may sue. The key phrase is "such security," and courts have generally read "such security" to require that a plaintiff must trace his or her purchase to a specific registration statement. In the seminal case in this area, the U.S. Court of Appeals for the Second Circuit upheld a settlement involving claims that arose under registration statements issued in 1961 and 1963, and the settlement limited recovery to claimants who could trace their purchases to the 1963 offering. *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). The court (per Friendly, J.) reasoned that section 11's reference to "such security" should be given a narrow reading, one that is limited to securities offered pursuant to a specific registration statement, and not a broader reading that would cover company securities generally.

Traceability may not be a significant concern as to shares purchased immediately after an IPO. The situation becomes murkier, however, after the end of an IPO lockup period, when insiders are free to sell their shares in the company. In that situation, traceability problems occur because of *successive* offerings – the first according to a registration statement and then offerings by company insiders after the lockup period is over.

The 2018 rule change that authorized secondary direct listings of insider shares blurred this distinction because the registration of employee shares permitted not only the sale of shares covered by the registration statement, but also the simultaneous sale of unregistered shares held by insiders, assuming that the owner of those shares could satisfy the requirements of the Rule 144 exemption from registration.

Investor concerns about the traceability of shares in a direct listing were drawn into sharp focus in current litigation involving the Slack Technologies direct listing, one of the first two such listings. In a case of first impression, the Slack defendants sought dismissal of a section 11 claim on the ground that plaintiffs could not trace their purchases to Slack's registration statement, because once Slack registered the employee-held shares, a shareholder could not establish whether he or she bought shares that had been registered or unregistered shares that had been sold by an insider once the registration statement took effect (again assuming eligibility to sell those shares under Rule 144 standards).

The district court denied that motion, finding that the narrow reading of section 11 liability was not warranted when dealing with direct listings. Recognizing the significance and the novelty of the issue, however, the district court certified the legal question to the U.S. Court of Appeals for the Ninth Circuit, which agreed to hear the matter.[5]

[5] *Pirani v. Slack Technologies, Inc.* 445 F.3d 367 (N.D. Cal. 2020), also available at http://securities.stanford.edu/filings-documents/1071/STI00_19/2020421_r01x_19CV05857.pdf. The Ninth Circuit order

It is far from clear whether the Ninth Circuit will uphold the district court's reasoning. That Court has explicitly endorsed the narrow reading of "such liability" in *In re Century Aluminum Securities Litigation*, 729 F.3d 1104 (9th Cir. 2013), so it is at best uncertain whether that court will overrule or distinguish that precedent. Moreover, as several commentators have noted, "many of the concerns expressed by the District Court are similar to other situations where courts have uniformly declined to dispense with the existing standing requirements of the Securities Act, including secondary offerings."[6] A ruling by the Ninth Circuit against shareholder standing in the Slack case could have an outsized impact on securities markets, given the number of tech startups and "unicorns" that are located in Silicon Valley and elsewhere in the Ninth Circuit and that may opt for a direct listing when they are ready to go public.

Independently of what may happen in the Slack case, the Order raises important investor issues that the Commission should consider before opening U.S. capital markets to what could turn out to be a vastly increased number of direct listings. Whatever conclusion the Commission may ultimately reach, the issue is unquestionably of enough policy significance to warrant plenary review.

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agreeing to hear the case on an interlocutory basis is available in *Pirani v. Slack Technologies, Inc*. No. 20-16419 (9th Cir., July 23, 2020), Docket No. 1.

[6] Grabar *et al., Cleary Gottlieb Discusses How Court Allowed Securities Liability for Slack's Direct Listing*, CLS Blue Sky Blog (May 4, 2020) (footnotes omitted), available at https://clsbluesky.law.columbia.edu/2020/05/04/cleary-gottlieb-discusses-how-court-allowed-securities-liability-forslacks-direct-listing/.

The loss of investor protections in direct listings has been acknowledged, even praised. Indeed, proponents of direct listings have trumpeted the loss of investor protections as an "important advantage" of direct listings, given the "potential to deter private plaintiffs from bringing claims under Section 11 of the Securities Act of 1933." Latham & Watkins, *Complex and Novel Section 11 Liability Issues of Direct Listings,* Corporate Counsel, at 1 (Dec. 20, 2019), available at https://www.lw.com/thoughtLeadership/section-eleven-liability-direct-listings. That law firm acted as counsel to Spotify and Slack in their direct listings, and the cited firm memorandum bluntly states that that "few (if any) purchasers will be able to trace their stock to the challenged registration statement" when "both registered and unregistered stock are immediately sold into the market in a direct listing." *Id.* at 2.

Does the Commission share that view? If so, does the Commission endorse expanding the number of offerings knowing that this could be the outcome? Whatever the answer may be, the issue is of unquestioned importance to investors and warrants plenary consideration and a ruling by the full Commission.

The point of this petition is not to start a debate about the wisdom of direct listings at an abstract policy level. The Council believes – and has long believed – that traceability problems of the sort raised here should impel the Commission to update its "proxy plumbing" regulations *before* any liberalization of direct listing regulations. We incorporate by reference the comments in the three letters that the

Council filed in this proceeding (see n. 4, *supra*), as well as the January 2019 letter to the Commission, which lays out the arguments in greater detail. In brief:

> 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.[7]

Granting plenary consideration of this petition for review would, at a minimum, allow the Commission to explore those questions in the context of direct listings. What steps, if any, can be taken to tag or identify shares sold pursuant to the registration statement for a direct listing from shares sold from another source? If nothing can be done, and if direct listings will extinguish investor rights under section 11, does it make sense to let the Order take effect?

In this case, and at this stage of the proceeding, our point is simple: Given the traceability problems of the sort identified above, it would be contrary to the standards set out in Exchange Act § 6(b)(5) for the Commission to make it *easier* for

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[7] 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), available at https://www.cii.org/files/20190131%20CII%20Follow%20Up%20Letter%20to%20SEC%20on%20Proxy%20Mechanics%20FINAL.pdf

companies to initiate direct listings, at least until the Commission has approved some basic proxy plumbing reforms to make traceability less of a concern.

How did the Division substantively respond to this point about traceability? The response was cursory at best, even though the Administrative Procedure Act requires agencies to respond to significant comments raised during the comment period. See *Perez v. Mortgage Bankers Ass'n*, 575 U.S. __, 135 S. Ct. 1199, 1203 (2015). *Susquehanna International Group, LLC v. SEC*, 866 F.3d 442, 447 (D.C. Cir. 2017). Footnote 74 of the Order did acknowledge that the Council made this traceability argument, but the text of the Order sought to minimize the issue with a generalization that—

> . . . even in the context of traditional firm commitment offerings, the ability of existing shareholders who meet the conditions of Rule 144 to sell shares on an unregistered basis may result in concurrent registered and unregistered sales of the same class of security at the time of an exchange listing, leading to difficulties tracing purchases back to the registered offering.

Order at 26, 85 Fed. Reg. at 54461.[8] After making this statement, the Order acknowledged the district court's Slack decision (without acknowledging that

[8] Page 15 of the Order (85 Fed. Reg. at 54458) summarized a laundry of list of investor protections in the Order, though none of them spoke directly the issue raised by the petition. Those items were:

> (i) Addition of the IDO Order type and other requirements which address how the issuer will participate in the opening auction; (ii) discussion of the role of financial advisors; (iii) addition of the Commentary that provides that specified activities are to be conducted in a manner that is consistent with the federal securities laws, including Regulation M and other anti-manipulation requirements; (iv) retaining of FINRA to monitor compliance with Regulation M and other anti-manipulation provisions of the federal securities laws and NYSE Rule 2020; (v) clarification of how market value will be

the case is on interlocutory appeal), but concluded not with facts, but an assertion that the Division "does not believe that that the proposed rule change poses a heightened risk to investors, and finds that the proposed rule change is consistent with investor protection." *Id.*

The Order did not cite any cases where the sale of registered and unregistered shares shortly after an IPO and prior to the end of a lockup period was both proven and used as the basis to dismiss a claim of a Section 11 violation. Reliance on something that "may result" and "beliefs" rather than facts is not the sort of "reasoned decision making" required under the Administrative Procedure Act." *Motor Vehicle Manufacturers Ass'n v. State Farm Auto Mutual Insurance Co.*, 463 29, 52 (1983). Moreover, the Order fails to take into account the fact that the very purpose of the rule change is to facilitate, if not encourage, a significant increase in the number of securities that can be sold to the public without Section 11 protections. It is hard to understand how a rule change that encourages that result poses no "heightened" risk to investors.

Perhaps the Division sidestepped the proxy plumbing and traceability issues because the Division did not believe that it could, on its own, change proxy plumbing system in ways that would mitigate the traceability problem. Be that as it may, the full Commission has unquestioned authority to put the horse *before* the

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determined for qualifying the company's securities for listing; and (vi) elimination of the grace period for meeting certain listing requirements.

cart, not after it, by examining the issue and assuring that any liberalization of the rules provide adequate investor protections.

Conclusion.

For these reasons and for those stated in the Council's prior comments, the Council of Institutional Investors respectfully requests that the Commission grant this petition for review, open a proceeding, and [in the absence of suitable protections on traceability of shares] reverse the Order at issue here.

Respectfully submitted,

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Dated: September 8, 2020

CERTIFICATE OF SERVICE

I hereby certify that on this 8th day of September, I caused copies of this petition for review to be filed electronically at Secretarys-Office@sec.gov, with copies sent by overnight courier to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street, N.W., Washington, D.C. 20549 and also caused this petition to be served by electronic mail upon Paul S. Mishkin, Joseph A. Hall, Marcel Fausten, Daniel J. Schwartz and Lindsay Schare at paul.mishkin@davispolk.com, joseph.hall@davispolk.com, marcel.fausten@davispolk.com, daniel.schwartz@davispolk.com, and lindsay.schare@davispolk.com and by overnight courier to Davis Polk and Wardwell, 450 Lexington Avenue New York, N.Y. 10017.

Jeffrey P. Mahoney

CERTIFICATE OF COMPLIANCE

I hereby certify that this brief in opposition complies with the word count limitation in 17 C.F.R. § 201.154(c). Excluding tables of contents and authorities, as provided by 17 C .F .R. § 201.154(c), but including cover pages, case captions, and signature blocks, the brief and motion together include 3,989 words. The undersigned relied upon the word count of this word-processing system in preparing this certificate.

Jeffrey P. Mahoney