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Spotify's Direct Listing and Foreign Private Issuers: Protecting Investors When Foreign Private Issuers List on a U.S. Exchange but Not on Their Home Exchange

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I. INTRODUCTION

Spotify Technology S.A. (Spotify) was the first high-profile direct listing, and the first issuer to conduct a direct listing on the New York Stock Exchange (NYSE)[1] under new NYSE rules

1. Roger Aitken, *Will Spotify's $30B NYSE 'Non-IPO' Direct Listing Hit the Spot?*, FORBES (Apr. 3, 2018, 2:27 PM), https://www.forbes.com/sites/rogeraitken/2018/04/03/will-spotifys-30b-nyse-non-ipo-direct-listing-hit-the-spot/#7fa4a57a1a35.

approved in February 2018 by the Securities and Exchange Commission (SEC).[2] Prior to the listing, the "unicorn"[3] reached a $19 billion private valuation in 2017.[4] By the time of the listing, Spotify had built a strong consumer brand with seventy-one million paying users, raised around $2.7 billion in funding from Silicon Valley heavyweights including Kleiner Perkins, Accel, and Founders Fund.[5] Spotify collects subscription fees upfront,[6] so the company did not need to raise funds in an initial public offering (IPO)—one of the traditional benefits of an IPO. Adding to the unique set of facts, the Swedish music-streaming startup was not then listed on any other exchange, even in its home country, and did not disclose any plan to list—and has not since listed—on an exchange other than the NYSE.

Many companies like Spotify eventually offer their shares to investors in an IPO to raise capital, provide liquidity to shareholders, create acquisition flexibility, advertise, and validate the company.[7] By choosing a direct listing instead, Spotify signaled something much different. Naturally, under these unique circumstances, the direct listing was eagerly anticipated. Investors, lawyers, analysts, and other executives carefully observed the Spotify direct listing and its aftermath, and many surmised that if Spotify's process was successful, other large, consumer-

2. Andrew Brady, Phyllis Korff & Michael Zeidel, *New NYSE Rules for Non-IPO Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 24, 2018), https://corpgov.law.harvard.edu/2018/02/24/new-nyse-rules-for-non-ipo-listings/.

3. In Silicon Valley parlance, a "unicorn" is a startup valued over $1 billion. Unicorns have become increasingly less fantastical since 2010 as private fund sizes have increased. *See* Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 587–88, 641 (2016).

4. Tom Zanki, *Spotify Touts 'Transparency' of Direct Stock Listing*, LAW360 (Mar. 15, 2018, 10:22 PM), https://www-law360-com.proxlaw.byu.edu/articles/1022737.

5. Katie Roof & Josh Constine, *Spotify Has Filed to Go Public*, TECHCRUNCH (Feb. 28, 2018, 12:56 PM), https://techcrunch.com/2018/02/28/spotify-has-filed-to-go-public/.

6. Erin Griffith, *Spotify and the Triumph of the Subscription Model*, WIRED (Apr. 3, 2018, 7:55 PM), https://www.wired.com/story/spotify-and-the-triumph-of-the-subscription-model/.

7. *See* Kyla Houge, *Reverse Mergers: A Legitimate Method for Companies to Go Public or an Easy Way to Commit Fraud?*, 36 J. NAT'L ASS'N L. JUDICIARY 325, 337 (2016) (noting that one reason a company might pursue an IPO "is to raise its overall profile"); Jesse Scott, *The JOBS Act: Encouraging Capital Formation but Not IPOs*, 7 J. BUS. ENTREPRENEURSHIP & L. 367, 368 (2014); Matthew Zolnierz, Article, *VI. Dual-Listed IPOs*, 36 REV. BANKING & FIN. L. 65, 66–71 (2016).

facing companies might eschew an IPO and opt for a direct listing instead.[8]

However, adoption of the direct listing approach may have negative consequences. The IPO procedures attempt to ensure that investors receive material information in a standardized form. Securities laws mandate that companies conducting an IPO provide detailed disclosures regarding past business performance and continuing quarterly, annual, and event-based disclosures after the IPO.[9]

Unlike an IPO, a direct listing is performed by a company that lists its existing shares on one of the U.S. exchanges, like Nasdaq or the NYSE, without offering newly issued shares to public investors.[10] The difference is essentially captured in the name—there is no initial public *offering* of newly created shares, just a listing of existing shares that can then be traded by the pre-direct listing stockholders. Often, direct listings are employed by companies already listed on international exchanges hoping to increase investor confidence by also listing the shares on a U.S. exchange.[11]

Direct listings, independent of listing on international exchanges, provide less information for potential investors, because investors do not have the assurance that the offering has been vetted and the price set by an investment bank. In addition, some foreign-based companies can qualify as "foreign private issuers," and thereby enjoy relaxed disclosure requirements as compared to domestic corporations.[12] Just one of these characteristics—a direct listing or a foreign private issuer—exposes investors to more risk than a traditional public offering or listing. Coupled together, a foreign private issuer conducting a direct listing leaves investors with more information asymmetry than may be healthy for the market. Therefore, if a foreign private issuer

8. *See* Yelena Dunaevsky, *Is Spotify's Direct Listing a Harbinger of Change in U.S. Capital Markets?*, BLOOMBERG BNA (Apr. 2, 2018), https://www.bna.com/spotifys-direct-listing-b57982090675/; Robert Pozen, *Spotify's Direct Listing is a Template for Unicorns Riding High*, FIN. TIMES (Jan. 30, 2018), https://www.ft.com/content/46a35692-01ce-11e8-9650-9c0ad2d7c5b5.

9. 17 C.F.R. §§ 249.308, 249.308a, 249.310 (2014).

10. *See* Houge, *supra* note 7.

11. *See* Zolnierz, *supra* note 7, at 67–68.

12. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018).

is offering securities only on a U.S. exchange as part of a direct listing and is not listed on any foreign exchange that requires periodic disclosures, the foreign private issuer should not be exempt from disclosure requirements of U.S. securities laws and regulations from which they are currently exempted.

Thus far, the Spotify direct listing has been heralded as a novel approach to going public.[13] In the days following the listing, it was lauded by many as a success with relatively little volatility in the market price.[14]

According to one author writing shortly after the listing, "Spotify seems pretty clearly to have accomplished the goals of increasing liquidity and reducing volatility for its shareholders."[15] Hopefuls predicted that if the stock continues to perform well, other companies will follow the pattern,[16] while detractors argue that the direct listing will not catch on and the hype is unfounded.[17] Many skeptics expressed concern that the traditional IPO process is a proven model of success most companies will not risk abandoning and point to similar excitement and predictions around Alphabet's 2004 Dutch Auction and its failure to change the IPO status quo.[18]

13. Matt Levine, *Spotify's Non-IPO Really Is Novel*, BLOOMBERG (Jan. 4, 2018, 7:55 AM), https://www.bloomberg.com/view/articles/2018-01-04/spotify-s-non-ipo-really-is-novel.

14. *See* Ben Sisario & Matt Phillips, *Spotify's Wall Street Debut Is a Success*, N.Y. TIMES (Apr. 3, 2018), https://www.nytimes.com/2018/04/03/business/media/spotifys-wall-street-debut-is-a-success.html; Colin Stutz, *Spotify Stocks Find Stability Following Sell-Offs to Close First Week of Public Trading*, BILLBOARD (Apr. 6, 2018), https://www.billboard.com/articles/business/8293424/spotify-stocks-close-first-week-trading-stability-sell-offs; Renaissance Capital IPO Research, *U.S. IPO Weekly Recap: Spotify Dances to Its Own Tune with a $32 Billion Listing*, SEEKING ALPHA (Apr. 7, 2018, 10:03 AM), https://seekingalpha.com/article/4161595-u-s-ipo-weekly-recap-spotify-dances-tune-32-billion-listing.

15. Matt Levine, *Spotify's Non-IPO Wasn't Much of an IPO*, BLOOMBERG (Apr. 5, 2018, 8:22 AM), https://www.bloomberg.com/view/articles/2018-04-05/spotify-s-non-ipo-wasn-t-much-of-an-ipo.

16. *See* Dunaevsky, *supra* note 8; Pozen, *supra* note 8.

17. Renaissance Capital IPO Research, *Spotify, Google and Facebook: Tech Giants Have a Spotty Record Spurning Wall Street*, SEEKING ALPHA (Apr. 7, 2018, 9:18 AM), https://seekingalpha.com/article/4161591-spotify-google-facebook-tech-giants-spotty-record-spurning-wall-street.

18. *Id. See generally* Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 227–32 (2015) [hereinafter Hurt, *Pricing Disintermediation*]; Christine Hurt, *What Google Can't Tell Us About Internet Auctions (And What It Can)*, 37 U. TOL. L. REV. 403, 403 (2006) [hereinafter Hurt, *What Google*] (arguing that despite difficulties in the auction process, Google's IPO was successful in some of its goals

In the months since Spotify's direct listing in April 2018, there has been more instability.[19] The stock price increased to just over $196 per share in July 2018, dipped to a low of about $109 in December 2018, and, at the time this Note was submitted to be published, the price was about $130, nearly even with the trading price at the end of the first day of trading.[20] Despite the fluctuation, which reflected the market more generally,[21] commentators have largely agreed that the listing was "at least a non-failure," and that despite the warnings "the direct listing has yielded a remarkably stable stock,"[22] which was, after all, the goal. Even more telling regarding the success of Spotify's direct listing is that predictions

and would "surely have some impact on the future of U.S. IPOs"). Alphabet, operating as Google at the time, partly in an effort to showcase the power of the internet to democratize the IPO process and Alphabet's commitment to its audience, chose an auction process to allow interested bidders who registered with the company and opened a qualifying account with one of the participating investment banks to submit bids for the purchase of shares to any of the twenty-eight underwriters. *See* Hurt, *What Google*, at 422–23. The bids could be submitted over the internet, by telephone or fax, or by hand delivery and could be withdrawn or changed by the bidder and accepted or rejected by Google. *Id.* at 423. The company then used the submitted bids to calculate the IPO price. *Id.* at 423–24. Despite Alphabet's intentions, the process was marred by nine amendments to the registration statement, bad timing, the disclosure of an SEC investigation against Alphabet, industry-wide and company-specific negative press, and disclosure of a potential violation of the SEC-imposed quiet period by the publication of a *Playboy* magazine interview with the founders, among other hiccups. *Id.* at 415–25. Though the process worked generally, and the registration statement was declared effective, subsequent analyst interest focused on the strong performance of the stock over the months that followed. The auction process was largely passed over in the aftermath (except, of course, by legal scholars). As one reporter wrote, "[t]here's a reason that people still talk about Google's Dutch auction IPO, 15 years later: [B]ecause it didn't inspire imitators. It *didn't* become a standard tool of corporate finance, an option that is on the table for every company." Matt Levine, *Direct Listings are a Thing Now*, BLOOMBERG (Jan. 11, 2019), https://www.bloomberg.com/opinion/articles/2019-01-11/direct-listings-are-a-thing-now.

19. Yahoo! Finance, https://finance.yahoo.com/quote/SPOT/ (last visited Sept. 15, 2019, 4:58 PM); *see also* Dan Rys, *Spotify Stock Slips to Lowest Price Since Going Public as Market Falls Overall*, BILLBOARD (Dec. 17, 2018), https://www.billboard.com/articles/business/8490710/spotify-stock-slips-lowest-price-since-public-market-falls-overall.

20. Yahoo! Finance.

21. *See* Rys, *supra* note 19.

22. Levine, *supra* note 18; *see also* Theodore Schleifer, *Spotify Tried to Reinvent the IPO, But Two Quarters Later, Things Look . . . Normal?*, RECODE (Jul. 26, 2018, 6:00 AM), https://www.recode.net/2018/7/26/17615094/spotify-ipo-earnings-direct-listing (noting that despite predictions the stock price would be volatile, it wasn't during its first two quarters).

that other companies might follow suit are proving true.[23] Most recently, Slack Technologies Inc. (Slack), which offers a cloud-based team collaboration tool,[24] has filed paperwork for a direct listing.[25] Unlike Alphabet's auction, which has, thus far, gone down in history as "just a weird thing that Google did once,"[26] if a second large company like Slack or Airbnb, which is also considering a direct listing[27], follows Spotify's approach, direct listings are "much more likely to become a thing."[28] In short, with the follow of Slack, Spotify's direct listing may well have paved the path to renegotiation of the established IPO process.[29]

With changes in the status quo, it is likely investors will face increased risk. Securities laws are meant to sufficiently protect shareholders while promoting capital formation and preserving confidence in the stock market.[30] Spotify's success with the direct listing is encouraging more direct listings. If the process is embraced, especially by foreign private issuers, the shift could push the balance against investor protection in favor of capital formation and market confidence. The approach may lead to increased capital formation and market confidence in the short term, but, as demonstrated by recent reforms,[31] if the securities regime fails to adequately protect investors, the short-term benefits of direct listings will eventually be extinguished as investors refuse to embrace the risks of investing in a public market full of unknowns.

This Note proceeds in six parts. Part I provides background information regarding (1) the regular IPO process and its

23. Theodore Schleifer, *Airbnb and Slack Are Considering Untraditional IPOs That Box Out Bankers Like Spotify Did*, RECODE (Dec. 10, 2018, 12:46 PM), https://www.recode.net/2018/12/10/18129880/airbnb-postmates-slack-direct-listing-ipo; *see also* Maureen Farrell, *Slack Plans to Follow Spotify on Unconventional IPO Route*, WALL STREET J. (Jan. 11, 2019, 5:32 AM), https://www.wsj.com/articles/slack-planning-to-pursue-direct-listing-11547202723 (noting that Spotify's stock "had little volatility").

24. *See* SLACK, http://slack.com (last visited Mar. 1, 2019, 11:28 AM).

25. Maureen Farrell, *Slack Files to Go Public With Direct Listing*, WALL STREET J. (Feb. 4, 2019, 3:46 PM), https://www.wsj.com/articles/slack-files-confidentially-to-go-public-with-direct-listing-11549301336 (noting that "Spotify executed its direct listing with nary a hiccup in April 2018, garnering publicity for the method in the process").

26. Levin, *supra* note 18.

27. *See* Schleifer, *supra* note 23.

28. Levin, *supra* note 18.

29. *Id.*

30. *See* Dura Pharmaceuticals v. Broudo, 544 U.S. 336, 345 (2005).

31. *See generally* Scott, *supra* note 7 (analyzing the shortcomings in impact of the JOBS Act on IPOs and capital formation).

requirements, (2) the direct listing process and its requirements, (3) the significance of foreign private issuers and dual- or cross-listing, and (4) the details regarding Spotify's direct listing. Part II examines the purpose of the IPO process—to protect investors by mandating disclosures—and the attempts of Congress and the SEC to alleviate some of the burdens of disclosure. Part III discusses the potential drawbacks of an alternative process to the traditional IPO. Part IV explains Spotify's reasons for choosing a direct listing rather than an IPO and shows how this may be bad for investors in the long term because more companies may circumvent the IPO process and the protections it provides investors. Part V suggests that a possible solution to this problem is to adjust the direct listing rules to require more disclosures from foreign private issuers. Finally, Part VI concludes.

II. BACKGROUND

Before proceeding, readers must understand the general IPO process, the process for direct listings, the foreign private issuer classification and the practice of dual-listing or cross-listing, and some details surrounding the Spotify direct listing.

A. The Traditional IPO Process and Its Requirements

The modern IPO process was established by the Securities Act of 1933 (the Securities Act).[32] The Securities Act provides extensive—and expensive—requirements that must be met to offer and sell securities to the general public.[33] For U.S. IPOs between January 1 and December 10, 2018, the combined legal, accounting, and printing fees and underwriter compensation for technology companies averaged over $18.8 million.[34]

To register shares under the Securities Act, an issuer must prepare a prospectus to share with initial investors and a registration statement to be filed with the SEC.[35] In the registration statement, generally prepared as required by Form S-1, issuers

32. Securities Act of 1933, 15 U.S.C. § 77 (2012).
33. Hurt, *Pricing Disintermediation*, *supra* note 18, at 225.
34. *2018 Technology and Life Sciences IPO Report*, Wilson Sonsini Goodrich & Rosati, https://www.wsgr.com/publications/PDFSearch/IPO-Report/YE2018/IPO-Report-YE-2018.pdf.
35. *See* Securities Act of 1933, 15 U.S.C. §§ 77a–77z (2012).

must provide between two and five years' worth of audited historical financial information, including balance sheets, statements of cash flow and income, select financial information, as well as a discussion and analysis of the company from the management and details about risks the company faces, operations, major shareholders, and compensation of executives.[36]

To prepare these documents, issuers work closely with attorneys, as well as investment banks—which are in turn represented by their own attorneys. In an IPO, investment banks operate as brokers, helping the issuer find large institutional investors willing to purchase the shares.[37] In this process, known as bookbuilding, investment banks and issuers hope to build interest and facilitate a strong IPO—that is, an IPO where there is great demand for the offered shares. In addition to participating as brokers, investment banks also underwrite the initial public offerings, normally agreeing to a firm-commitment underwriting—whereby they contract to purchase all of the offered shares, regardless of their ability to sell the shares to the large institutional investors when the registration becomes effective. Investment banks make money on the spread between the price at which they agree to purchase the shares in the underwriting and the price at which they sell the shares to the institutional investors.[38] They also take a customary seven percent commission on the total offering amount.[39]

Importantly, investment banks provide a valuable check on the IPO process. They work with their customers—the group of institutional investors—to determine an appropriate price for which the shares will be sold. They also sometimes purchase more

36. Carlos Berdejo, *Going Public After the JOBS Act*, 76 OHIO ST. L.J. 1, 8 (2015); *see* Form S-1 Registration Statement Under the Securities Act of 1933, http://www.sec.gov/about/forms/forms-1.pdf (last visited Sept. 15, 2019); *see also* 17 C.F.R. § 239.11 (2014). These disclosure requirements may be scaled back for companies that qualify as *Emerging Growth Companies* under Section 2(a)(19) of the Securities Act. *See* Emerging Growth Companies, SEC https://www.sec.gov/smallbusiness/goingpublic/EGC.

37. Hurt, *Pricing Disintermediation*, *supra* note 18, at 225.

38. *See id.* at 227–32.

39. Tom Zanki, *Spotify's Direct Listing Consideration Invites Risk*, LAW360 (Apr. 14, 2017, 9:45 AM), https://www-law360-com.proxlaw.byu.edu/articles/913168/spotify-s-direct-listing-consideration-invites-risk- [hereinafter Zanki, *Spotify's Direct Listing*] (noting that underwriters' fees are typically seven percent of offering proceeds, "though large companies have more negotiating power").

shares to stabilize the price.[40] Additionally, if underwriters do not see enough potential in IPOs, they may not agree to a firm-commitment underwriting. Rather, they will agree to a "best efforts" underwriting. Under this approach, they are not required to purchase any shares that are not allocated to institutional investors.[41] Under some best efforts agreements, if a threshold of shares is not allocated to institutional investors, any purchased allocation will be refunded, and the issuer will not go through with the IPO.[42]

In addition to mandating disclosures, the Securities Act also restricts issuers from communicating about the upcoming offering.[43] The Securities Act defines the communications, including, for example, broad definitions for what constitutes an offer: "'offer to sale', 'offer for sale', and 'offer' shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security."[44] Section 5 of the Securities Act provides a broad restriction against the sale or offer of securities without an effective registration statement,[45] and the gun-jumping rules lay out a complex set of regulations restricting the type of communications a company can make during an imposed "quiet period" depending on whether the registration statement has been filed or has become effective.[46] Failure to observe the gun-jumping rules can be costly, as issuers or other participants in the offering, like underwriters, may be liable for substantial damages under Section 12 of the Securities Act.[47]

Later, once securities are registered under the Securities Act, they can be sold to public investors, but the issuer is responsible for mandatory ongoing disclosures, including the filing of annual

40. Tom Zanki, *Spotify Opens Door to Direct Listings Among Tech Unicorns*, LAW360 (Apr. 3, 2018, 10:20 PM), https://www-law360-com.proxlaw.byu.edu/articles/1029200/spotify-opens-door-to-direct-listings-among-tech-unicorns [hereinafter Zanki, *Spotify Opens Door*].

41. Brianne M. Hess, *Google Inc.: The Dutch Auction Approach as an Alternative to Firm-Commitment Underwriting*, 7 DUQ. BUS. L.J. 89, 91–92 (2005).

42. *Id.*

43. *See* Securities Act of 1933 § 5, 15 U.S.C. § 77e(a) (2012).

44. Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3) (2012).

45. Securities Act of 1933 § 5.

46. *See, e.g.*, Securities Act Rules 134, 164, and 433; 17 C.F.R. §§ 230.134, 230.164, & 230.433 (2014).

47. Securities Act § 12(a)(1), 15 U.S.C. § 77*l*(a)(1) (2012).

reports in compliance with Form 10-K, quarterly disclosures in compliance with Form 10-Q, and current reports in accordance with Form 8-K.[48] Investors retain near-strict liability for any material misstatements or omissions in the effective registration statement under Section 11 of the Securities Act.[49]

B. The Direct Listing Process and Its Requirements

In contrast to IPOs, direct listings require no involvement from an underwriter, and companies initiating a direct listing are not subject to the same gun-jumping rules.[50] Instead, in a direct listing, a company registers only its existing shares. Direct listings have many of the same benefits as IPOs, including providing liquidity to initial investors and employees, allowing robust mergers and acquisitions through the use of equity as all or part of the purchase price, advertising and brand awareness, and validating the credibility of the company.[51] The main difference is that no new shares are issued, so no capital is raised. Of course, that difference is significant. "Raising capital is historically considered the main reason for conducting an IPO."[52]

Despite that history, a direct listing comes with its own benefits for the existing stockholders and the issuer.[53] An investment bank is not needed to underwrite the shares, so no seven percent commission is exacted for their services.[54] Existing shareholders aren't diluted by the issuance of new shares.[55]

Additionally, in most IPOs, shareholders who hold shares prior to the IPO, like venture capitalists or employees, cannot sell their shares at the time of the IPO.[56] Rather, they agree to a "lock-up" period, normally the first 180 days the stock is publicly traded,

48. 17 C.F.R. §§ 249.308, 249.308a, 249.310 (2014); Berdejo, *supra* note 36, at 14.

49. Securities Act of 1933 § 11, 15 U.S.C. § 77k (2012).

50. Harold S. Bloomenthal & Samuel Wolff, § 10:107 *Direct Listings*, *in* GOING PUBLIC AND THE PUBLIC CORPORATION (2018).

51. *See* Zolnierz, *supra* note 7, at 66–69.

52. *See* Zanki, *Spotify Opens Door*, *supra* note 40 (noting that today many companies can obtain the capital they need through private investors).

53. Erin Griffith, *How Will Spotify's Direct Listing Work?*, FORTUNE (Jul. 31, 2017), http://fortune.com/2017/07/31/spotify-ipo-direct-listing-2/.

54. *Id.*

55. *Id.*

56. Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 719–20 (2005).

during which they are restricted from trading.[57] A lock-up protects against insiders immediately flooding the market with supply and lowering the value of the shares.[58] Instead, investment banks and the issuer want to manage the supply to encourage a dramatic spike in the share price—particularly on the first day of trading.[59] For the issuer, a healthy spike on the first day of trading is a positive signal to media, public investors, and analysts.[60] For the underwriters, the first day spike is simply customary arbitrage.[61] The investment banks, working in tandem with other industry insiders, "extract wealth from the investing public" by buying the stock at a discount before then selling it at a price that reflects the pent-up demand created by the analysts and banks generating interest in the offering and the controlled-for-supply—also a mechanism of the underwriters' lock-up requirement.[62] With a direct listing, investors and employees agree to no such lock-up.

Of course, a company performing a direct listing still faces some requirements. First, a company that chooses a direct listing is not immune from disclosure requirements. Section 12(b) of the Securities and Exchange Act of 1934 (the Exchange Act) provides, "[a] security may be registered on a national securities exchange by the issuer filing an application with the exchange" that contains information necessary or appropriate to protect investors, as determined by the SEC.[63] To guide the SEC, Section 12 further enumerates several types of information that may be appropriate,

57. *Id.*; *see also* Zanki, *Spotify Opens Door*, supra note 40 (acknowledging six months as the customary lock-up period).

58. *See* Hurt, *supra* note 56, at 755.

59. *See id.* at 719–20, 725, 733–34 (explaining that an investment bank will basically manipulate the price of shares sold in the IPO by "pre-allocating most of the original shares and controlling the resale of those shares" to restrict founders and venture capitalists from selling shares to avoid a drop in the stock price).

60. Henry Blodget, *Everyone Who Thinks IPO "Pops" Are Good Has Been Brainwashed*, BUSINESS INSIDER (May 26, 2012, 11:41 AM), https://www.businessinsider.com/ipo-pops-2012-5 (explaining that despite the fact that a spike in the first-day trading price actually means the issuer left money on the table, many people, including the media, view a first day "pop" as a positive sign, and Facebook's pop of *only* ten percent was seen as a disappointment).

61. *See* Hurt, *supra* note 56, at 717, 719–20, 722 (explaining that IPO pricing is a "concerted effort" of the banks and private investors, friends, family, and other insiders to whom the issuers will agree to sell shares before the IPO who will recognize a profit when they subsequently sell the acquired shares on the first day).

62. *Id.*

63. Securities and Exchange Act of 1934 § 12(a), 15 U.S.C. §§ 77a-77z (2012).

including "the organization, financial structures, and nature of the business," the rights and terms of any outstanding classes of securities, the terms of any prior public or private offerings, a list of shareholders owning ten percent or more of any class of security, a list of directors and officers and their compensation, material contracts not made in the ordinary course of business, and the balance sheets and income statements for the prior three years.[64] Section 12 also suggests that companies should disclose voting agreements and underwriting agreements, and should provide copies of bylaws, material contracts, and articles of incorporation.[65]

Thus, just as Section 12 applies to companies registering shares on an exchange via IPO, it also regulates direct listings. To comply with Section 12(b) of the Exchange Act, companies still have to file disclosures in compliance with Form 10, or Form 20-F for foreign companies, which requires many of the same disclosures as a registration statement requires for an IPO.[66] However, there are some differences.

One difference is that management and advisers are allowed to speak publicly about the listing since SEC-mandated quiet-period restrictions—the gun-jumping rules—only prevent them from promoting an offering, and a direct listing is not an offering because no new shares are issued.[67] Of course, the issuer must still avoid triggering liability under Section 11 for material misstatements or omissions.[68] But the freedom of executives to discuss the upcoming offering without penalty of gun-jumping is a noticeable benefit as it allows them to generate buzz and excitement around the upcoming listing and, potentially, create demand that will pump up the stock price.

Direct listings traditionally occur under limited circumstances, such as following a spinoff or after companies exit bankruptcy.[69] They have previously been used only rarely, usually by small-cap

64. § 12(b)(1), 15 U.S.C. §§ 77a-77z (2012).

65. § 12(b)(2)-(3), 15 U.S.C. §§ 77a-77z (2012).

66. Bloomenthal & Wolff, *supra* note 50.

67. Zanki, *Spotify's Direct Listing*, *supra* note 39.

68. Ze'-ev D. Eiger & Brian D. Hirschberg, *Foreign Issuers Filing a Form 20-F*, Morrison & Foerster (Mar. 3, 2016) at 75, https://media2.mofo.com/documents/160303foreignissuersform20f.pdf.

69. Zanki, *Spotify Opens Door*, *supra* note 40.

companies in the biotech and life science industries[70] with little trading volume.[71] Since 2006, Nasdaq has completed only six direct listings, and until Spotify, the NYSE had not completed any.[72] Additionally, a small company exiting bankruptcy provides little precedent for a large private company like Spotify completing the process.[73]

C. The Foreign Private Issuer Classification and the Practice of Dual- or Cross-Listing

Many companies that conduct direct offerings are international companies. International companies can enjoy some unique benefits when listing securities on a U.S. exchange, particularly if they qualify as "foreign private issuers." In addition, international companies anticipate that by listing their shares on a U.S. exchange, as well as a local exchange, investors will value the securities higher.[74] This practice of listing shares on multiple exchanges is referred to as cross-listing or dual-listing.[75]

1. Foreign private issuer classification

Naturally, legislators, exchanges, bankers, and the SEC are very interested in encouraging many companies to list on U.S. exchanges, and that extends to foreign companies as well. An increase in the number of publicly listed companies can contribute to investor confidence in the public markets. To stimulate this

70. Griffith, *supra* note 53.

71. Zanki, *Spotify Opens Door*, *supra* note 40.

72. Alexander Osipovich & Maureen Farrell, *'Spotify Rule' Would Help New York Stock Exchange Woo Unicorns*, WALL STREET J. (May 26, 2017, 8:31 PM), https://www.wsj.com/articles/spotify-rule-would-help-new-york-stock-exchange-woo-unicorns-1495791000. In the past, the NYSE rules only allowed direct listings on its exchange on a case-by-case approach. *See* Brady et al., *supra* note 2 . In February the NYSE updated its rules to allow Spotify—and hopefully more companies—to list hassle-free without actually issuing new shares for sale. *See also Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, to Amend Section 102.01B of the NYSE Listed Company Manual*, U.S. SEC (Feb. 2, 2018), available at https://www.sec.gov/rules/sro/nyse/2018/34-82627.pdf.

73. Zanki, *Spotify's Direct Listing*, *supra* note 39.

74. *See* Zonierz, *supra* note 7, at 65.

75. *See id.* (Dual-listing may refer specifically to a company listing shares on its home country exchange and a U.S. exchange at the same time, but in this article they are used interchangeably.); Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141, 141–45 (2003).

increase, legislators have sought to provide international companies with a relatively less intensive mechanism—as compared to the normal registration process—for listing on U.S. exchanges. Under current securities laws, corporations that qualify as foreign private issuers face relaxed disclosure requirements. As Spotify noted in its registration statement risk factors, "[a]s a foreign private issuer, we are exempt from a number of U.S. securities laws and rules promulgated thereunder and are permitted to publicly disclose less information than U.S. companies must. This may limit the information available to holders of the ordinary shares."[76]

First, readers must understand the classification. A foreign private issuer can be any company except those for which U.S. residents are holders of record, directly or indirectly, of no more than 50% of outstanding voting securities, and the issuer does not (1) have a majority of executives or directors who are U.S. citizens or residents, (2) have more than 50% of its assets in the U.S., or (3) administer its business principally in the U.S.[77] If more than 50% of the shares are held by a U.S. resident and one of the three other conditions is met, the company will be treated as a domestic issuer.[78]

According to one legal researcher, the difference between disclosures for domestic companies and those that qualify as foreign private issuers is significant.[79] "The United States effectively has two securities regulation regimes: one for domestic issuers and another for foreign issuers. The latter 'cuts corners' on key issues of corporate governance."[80]

A foreign private issuer is required to submit a registration statement in accordance with Form F-1, rather than Form S-1. Disclosures for the F-1 are not significantly different than those required for an S-1. The significant changes come before and after the registration statement.

76. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018).

77. 17 C.F.R. § 240.3b-4 (2008).

78. *Id.*

79. Natalya Shnitser, *A Free Pass for Foreign Firms? An Assessment of SEC and Private Enforcement Against Foreign Issuers*, 119 YALE L.J. 1638, 1652 (2010).

80. *Id.*

A foreign private issuer is required to submit annual reports in accordance with Form 20-F rather than, as domestic issuers, filing interim disclosures via Form 10-Q and annual disclosures as proscribed by Form 10-K. As one reporter noted, "after a public listing, a unicorn would have to issue quarterly reports and become subject to the pressures of Wall Street. But the company can minimise the impact of these pressures by listing less than 20 per cent of its shares for public trading."[81] The requirement to issue quarterly reports does not apply to foreign private issuers, though, even if they list more than twenty percent of their shares. "[F]oreign private issuers are required to furnish as interim reports only whatever information the foreign private issuer has made or is required to make public pursuant to its home country's corporate laws or a non-U.S. stock exchange's requirements."[82] Some, like Spotify, explain in their F-1 that they *intend* to provide quarterly reports—without elaborating upon how quickly they will file the reports or whether they will include all the same information as required in a 10-Q—but they are not forced to do so.[83] What's more, in Spotify's case, the company did not explain what it would include in the quarterly filings.[84] Instead, whenever foreign private issuers file periodic disclosures or make periodic disclosures to local security holders, they are required to also file such disclosures on Form 6-K. This rule captures the assumption that foreign private issuers will be required, under local rules, to file periodic disclosures, and that U.S. investors will thus be provided with frequent disclosures. However, no remedy is provided for disclosures in the case that a foreign private issuer is not listed in its home country and therefore does not have even a local obligation to provide regular updates. As a foreign private issuer not subject to interim disclosures under local listing laws, Spotify

81. Pozen, *supra* note 8.

82. Shnitser, *supra* note 79, at 1653; *see* Nicolas Grabar et al., *A Look Under the Hood of Spotify's Direct Listing*, Harvard Law School Forum on Corporate Governance and Financial Regulation (Apr. 26, 2018), https://corpgov.law.harvard.edu/2018/04/26/a-look-under-the-hood-of-spotifys-direct-listing/ ("Since Spotify is not a reporting company elsewhere, it will have latitude to decide for itself what and how often to file.").

83. Grabar, *supra* note 82.

84. *Id.*

could decide independently the frequency and content of its event-driven disclosures.[85]

In addition to relaxed 20-F and 6-K disclosures, foreign private issuers are not subject to some conflicts of interest requirements.[86] For example, they do not have to disclose data regarding material transactions with affiliates like officers, directors, or control persons.[87] These issuers can also avoid several duties in connection with proxy statements required under Section 14 of the Exchange Act.[88] Issuers are also exempted from Section 16 of the Exchange Act, which prohibits short sales and short-swing profits by corporate insiders,[89] meaning that corporate insiders can sell without any requirement that the Company promptly disclose the sale.[90] Such an exemption allows more room to trade on inside information.[91]

2. The practice of cross-listing

Cross-listing is a common practice among both U.S. firms and international firms.[92] Cross-listing is simply the practice of registering securities on an exchange in Country A and then listing a replica or derivative of those securities on an exchange in Country B.[93] Most often, shares are cross-listed on U.S. exchanges as American depository receipts (ADRs)—U.S. bank-issued certificates that are placeholders for "a certain number of foreign shares on deposit with the bank or a custodian bank in the foreign country."[94] ADRs are appealing because they are listed in U.S. dollars, currency is converted by the bank at favorable rates, clearance and settlement practices adhere to U.S. laws, certificates can be exchanged for the foreign shares they represent at any time,

85. *Id.*
86. Licht, *supra* note 75, at 152.
87. *Id.*
88. *Id.*
89. *Id.* at 153.
90. Grabar, *supra* note 82.
91. *Id.*
92. Zolnierz, *supra* note 7.
93. *See* Amir N. Licht, *Genie in a Bottle? Assessing Managerial Opportunism in International Securities Transactions*, 2000 COLUM. BUS. L. REV. 51, 55 (2000).
94. *Id.* at 58.

and, for so-called "sponsored" ADRs that are registered by the issuer, routine disclosures must be provided.[95]

In conjunction with the increasing numbers of foreign companies listed on U.S. exchanges, many people have become increasingly interested in cross-listing since the mid-1980s.[96] According to a report by Ernst & Young, seven percent of 2017 IPOs were cross-listed, up from six percent in 2016, but still down from ten percent in 2014.[97] A total of 118 cross-border IPOs were completed in 2017.[98] Eight percent of all issuers based in Europe, the Middle East, India, and Africa cross-listed.[99] Ten Europe-based companies listed on a U.S. exchange (about twenty-five percent of global inbound cross-listings), representing a total of $1.8 billion in IPO activity.[100]

Primarily, companies cross-list for financial reasons.[101] By cross-listing, some companies listed on foreign market exchanges can reduce their cost to capital because investors are willing to pay more for stock if they know more about it.[102] That is, they do not have to price in the weak disclosures or limited institutional structure the company faces on its home exchange.[103] On the other hand, "companies that [are] already high-disclosing or from high-disclosing countries" can enjoy premiums on the U.S. market because they are de-risked for investors through the disclosures they are already required to make on a home exchange.[104] Lastly, "[c]ompanies may also list on foreign stock exchanges for standard business reasons such as marketing of products and improving their visibility."[105]

95. *Id.* at 58–59.
96. *See* Licht, *supra* note 75, at 143; *see also* Licht, *supra* note 93, at 55.
97. GLOBAL IPO TRENDS: Q4 2017, ERNST & YOUNG 5 (2017), http://www.ey.com/Publication/vwLUAssets/ey-global-ipo-trends-q4-2017/$FILE/ey-global-ipo-trends-q4-2017.pdf.
98. *Id.* at 13.
99. *Id.* at 23.
100. *Id.* at 10.
101. Licht, *supra* note 93, at 54.
102. Elizabeth F. Brown, *The Tyranny of the Multitude Is a Multiplied Tyranny: Is the United States Financial Regulatory Structure Undermining U.S. Competitiveness?*, 2 BROOK. J. CORP. FIN. & COM. L. 369, 405 (2008).
103. *Id.*
104. *Id.*
105. Licht, *supra* note 93, at 54.

To be clear, cross-listing via the process of direct listing is routine, especially among European companies.[106] Many companies do not conduct a public offering as part of the cross-listing process. Others choose to list the shares on both a local exchange and a U.S. exchange concurrently in a public offering.[107]

D. The Spotify Direct Listing

Unlike traditional direct listings often used as a mechanism for cross-listing, Spotify's direct listing on the NYSE was not simply a tool for cross-listing. Spotify's securities are not traded on any exchange besides the NYSE. Many companies registering their shares do so as part of an IPO and offer the primary shares for sale to investors to raise capital. Spotify's direct listing was different.

In the F-1, the company explained, "[u]nlike an initial public offering, the resale by the Registered Shareholders is not being underwritten by any investment bank. The Registered Shareholders may, or may not, elect to sell their ordinary shares covered by this prospectus, as and to the extent they may determine."[108] Resales were of "ordinary shares"[109] listed at U.S. prices, not ADRs used by cross-listed companies. Unlike the regular bookbuilding process conducted by investment banks that secure purchases of share allocations by specific institutional investors, Spotify's direct listing allowed everyday people to invest immediately.[110] As Spotify CEO Daniel Ek put it, "'[w]e don't believe in gatekeepers,'" (assumedly referring to the broker role typically played by investment banks) and the company touted the method as more transparent and "accessible to a wider array of investors."[111]

Additionally, Spotify qualified as a foreign private issuer. By qualifying as a foreign private issuer, the company accesses more lenient disclosure requirements. Though its F-1 was essentially as detailed as an S-1, the company is not forced into the same ongoing quarterly disclosure regime that domestic corporations face, and

106. *Id.* at 58.
107. Zolnierz, *supra* note 7, at 65.
108. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018).
109. *Id.*
110. Zanki, *supra* note 4.
111. Zanki, *supra* note 4.

the company is required to provide non-annual ongoing updates only in accordance with corporate laws of Sweden. As noted above, the company in its F-1 noted its intention to provide quarterly disclosures. Spotify likely committed to provide interim reports because, again, companies are often able to obtain better market prices in return for meaningful disclosures.[112]

Since the direct listing, Spotify has provided interim disclosures every three months, and these disclosures have been structured much the same as interim reports on Form 10-Q made by other companies, with consolidated financial metrics, discussion and analysis of financial conditions by management, and risk factors.[113] But as a foreign private issuer, U.S. securities laws do not mandate these filings, and Spotify is not required to make these interim disclosures under the corporate laws of Sweden.[114]

Many analysts, attorneys, and investors predicted the market price for Spotify's shares would be volatile without the regular underwriter price-setting and supply-and-demand smoothing.[115] Despite these concerns, the market price of the shares has been relatively stable during the first weeks of trading.[116] The process has prompted speculation that other firms may follow suit, which could significantly affect the IPO landscape, the types of companies that become publicly traded, and the investment banks that assist corporations in the IPO process. These changes may detract from the purposes of the regular IPO process.

III. The Purpose of the IPO Process and Attempts to Alleviate Its Burdens

The modern IPO process has developed over many years since the Securities Act. The Act provides a path to registration and

112. *See* Licht, *supra* note 75, at 144.

113. *See* Spotify Tech. S.A., Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 under the Securities Exchange Act of 1934 (Form 6-K) (May 3, 2018); Spotify Tech. S.A., Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 under the Securities Exchange Act of 1934 (Form 6-K) (July 26, 2018); Spotify Tech. S.A., Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 under the Securities Exchange Act of 1934 (Form 6-K) (November 1, 2018).

114. Aitken, *supra* note 1; *see also* Grabar, *supra* note 82.

115. *See* Zanki, *Spotify Opens Door*, *supra* note 40 (explaining that capital markets experts feared the unconventional process "would leave it vulnerable to sharp volatility").

116. *See* Levine, *supra* note 15.

public offering, but the path is difficult to traverse and full of restrictions and potential liabilities. As private capital has become more accessible and made some benefits of an IPO less enticing, the number of IPOs has slowed. Legislators recognized the deterrent effect of the restrictions and hoped to promote a stronger public market by relaxing disclosure requirements for some companies. In so doing, they sacrificed protections for investors in hopes that they can trim away burdensome nonmaterial disclosures while preserving those disclosures that investors will find material.[117]

A. The IPO Process and the Importance of Protecting Investors

As discussed above, the Securities Act regulates IPOs through its gun-jumping rules and restrictions on offers and sales to the public.[118] The process has been warily crafted by the legislature to prevent information asymmetries between investors by ensuring that all investors receive material information regarding the offered securities at the same time. The gun-jumping rules also prevent companies from creating hype about the offered securities, which would lead to an overpriced valuation for the shares.

For many companies, the IPO process takes about four months from the time of filing a registration statement with the SEC until the market debut when the shares are offered on an exchange.[119] Leading up to the IPO, the issuer and its executives are effectively precluded from discussing the IPO plans.[120] Under the securities laws, during the thirty days before the registration statement is

117. Dave Simpson, *SEC Trims Company Disclosure Requirements*, LAW360 (Mar. 20, 2019), https://www.law360.com/articles/1141159/sec-trims-company-disclosure-requirements (noting the SEC's approach of "easing burdens and providing more flexibility to issuers while insisting that investors won't be shortchanged access to material information").

118. *See, e.g.*, Securities Act § 2(a)(3), 15 U.S.C. § 77b(a)(3) (2012); Securities Act Rules 134, 164, and 433, 17 C.F.R. §§ 230.134, 230.164, 230.433 (2014).

119. Tom Zanki, *Spotify's Direct Listing Thrust 1 Firm into April Spotlight*, LAW360 (May 1, 2018, 8:23 PM), https://www-law360-com.proxlaw.byu.edu/articles/1039088/spotify-s-direct-listing-thrust-1-firm-into-april-spotlight.

120. Susan B. Heyman, *The Quiet Period in a Noisy World: Rethinking Securities Regulation and Corporate Free Speech*, 74 OHIO ST. L.J. 189, 196–98 (2013) (explaining that, as explained Infra, Part II.A, the securities laws regulate offers to sale and that offers is defined broadly, precluding a large swath of communications); *see* Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3) (2006).

filed, issuers cannot offer to sell or sell the securities.[121] Once the registration statement is filed, issuers are allowed to offer the shares vocally,[122] which enables issuers to work with investment banks in the bookbuilding process, part of which involves visiting prospective investors across the country in what is known as a roadshow to gauge interest in the offering and prepare an offering price[123]. But even after the registration statement is filed, companies are allowed to make written offers of the shares only using the statutory prospectus.[124] Any written communications prior to the effective date, even emails or handwritten notes, must comply with Section 10 preliminary prospectus requirements.[125] Otherwise, written or other broadcast communications, including video recordings, might qualify as a free writing prospectus,[126] but the issuer will be liable for any misstatements or omissions in the free writing prospectus.

During the waiting period—the time between when the registration statement is filed with the SEC and when it is declared effective—the SEC provides comment and feedback on the registration statement.[127] The SEC conducts a review of every IPO registration statement,[128] proceeds through the registration statement line by line, and routinely requests, using a comment letter, modifications or additional disclosures to the document. Under Section 8(a) of the Securities Act, a registration statement would become effective twenty days after the last filed registration statement, regardless of whether the issuer has responded to the SEC comments.[129] In practice however, except for shelf registrations, "no issuer allows its registration statement to become

121. *See* Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c) (2006) ("It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security . . . prior to the effective date of the registration statement."); *see also* Heyman, *supra* note 114, at 196.

122. *See* Heyman, *supra* note 120, at 196.

123. *See* Hurt, *supra* note 56, at 736–37 (explaining the roadshow process, which involves pitching groups of potential investors and responding to questions).

124. *See* Heyman, *supra* note 120, at 196.

125. STEPHEN J. CHOI & A. C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 424 (4th ed. 2015).

126. *Id.* at 428–29.

127. *Id.* at 436–37.

128. *Id.* at 437.

129. *Id.* at 435.

effective automatically . . . . Instead, issuers commonly file a registration statement with a Rule 473 notation [also known as a delaying amendment], which automatically amends the registration statement until the SEC has declared it effective."[130] Similarly, in a direct listing, a filed registration statement could become effective automatically thirty days after filing, regardless of whether the SEC approved the registration statement. Sticking with the common practice of domestic issuers conducting an offering, however, Spotify waited until the SEC declared the registration statement effective nearly three months after the initial confidential filing.[131]

Despite the precedent of IPO candidates waiting until the SEC approves the registration statement before declaring it effective, companies, including those conducting a direct listing, could allow the statement to become effective without SEC approval.[132] In fact, during the government shutdown beginning December 22, 2018, which lasted a record thirty-four days,[133] during which the SEC eventually stopped reviewing registration statements, Gossamer Bio, Inc., a company preparing for an IPO, actually removed the delaying amendment from its amended registration statement in what may have been the first IPO not to include the delaying amendment.[134] In that case, the company disclosed that its registration statement would become effective within twenty days, a risky action considering there could be no further changes without resetting the twenty-day clock, including changes to the offering price.[135] In the end, only a couple days after Gossamer Bio filed the amended registration statement with the delaying amendment removed, the shutdown ended and the SEC renewed

130. *Id.*

131. Grabar, *supra* note 82 (explaining that because "Spotify is not a reporting company elsewhere, it will have latitude to decide for itself what and how often to file").

132. There are several risks a company would face if it moved forward without a delaying amendment, including the threat that the SEC would issue a stop order, suspending the effectiveness of the registration statement. *See* Choi, *supra* note 125, at 435-36.

133. Mihir Zaveri, Guilbert Gates & Karen Zraick, *The Government Shutdown Was the Longest Ever. Here's the History.*, N.Y. TIMES (Jan. 25, 2019), https://www.nytimes.com/interactive/2019/01/09/us/politics/longest-government-shutdown.html.

134. *See* Gossamer Bio, Inc., Form S-1/A, https://www.sec.gov/Archives/edgar/data/1728117/000119312519014857/d690055ds1a.htm; *see also* Liz Dunshee, *First IPO Without a Delaying Amendment?*, BROC'S BLOG, (Jan. 24, 2019), https://www. thecorporatecounsel.net/blog/2019/01/first-ipo-without-delaying-amendment.html.

135. *See* Choi, *supra* note 125, at 436.

its review of registration statements.[136] The company promptly filed an amended registration statement including the delaying amendment.[137] Though the company did not proceed with making its registration statement automatically effective under Section 8(a), its action called into question the longstanding tradition of including the delaying amendment. Likewise, Spotify's direct listing called into question the longstanding IPO tradition more generally. As explained, the traditional IPO process is intensive, and more companies, by necessity—as in the case of Gossamer Bio, Inc.—or by choice—as with Spotify—are beginning to question it.[138]

Of course, Congress and the SEC made the IPO process arduous intentionally. The whole purpose of the registration system is "to protect investors and ensure confidence in the integrity of the public capital markets."[139] The Securities Act was intended primarily as a protection for investors as a response to the vagaries of the trusts and the fraud that prevailed prior to the legislation.[140] Since then, securities regulators and the federal courts have tried to balance the need for protection with the other purposes of the statute. Some efforts have been more effective than others. Most often, additional securities laws and required disclosures have been enacted as a response to perceived or actual improper activities and inadequate disclosures, like the Sarbanes-Oxley Act, which followed the disturbing accounting practices surrounding the collapse of Enron.[141] Similarly, the Dodd-Frank Act was meant to prevent a recurrence of the over-extension that led to the financial crisis of 2007–08.[142] On the other hand, restrictions and regulations

136. John Jenkins, *Corp Fin's Post-Shutdown Plan: "First Come, First Served"*, BROC'S BLOG (Jan. 28, 2019), https://www.thecorporatecounsel.net/blog/2019/01/corp-fins-post-shutdown-plan-first-come-first-served.html.

137. Dunshee, *supra* note 134.

138. *See* Levine, *supra* note 18 (prosing that Slack's embrace of the direct listing approach after Spotify's example will open the door to more companies questioning the typical IPO path, instead exploring options that better suit their individualized needs); *see also* Cydney Posner, *IPO Mix and Match*, COOLEY PUBCO (Jan. 15, 2019), https://cooleypubco.com/2019/01/15/ipo-mix-and-match/.

139. Berdejo, *supra* note 36, at 17.

140. *See generally* Maura K. Monaghan, *An Uncommon State of Confusion: The Common Enterprise Element of Investment Contract Analysis*, 63 FORDHAM L. REV. 2135, 2139–44 (1995).

141. *See generally* Byron F. Egan, *Major Themes of the Sarbanes-Oxley Act*, 42-WTR TEX. J. BUS. L. 339 (2008).

142. *See generally* Arthur E. Wilmarth, Jr., *The Dodd-Frank Act: A Flawed and Inadequate Response to the Too-Big-to-Fail Problem*, 89 OR. L. REV. 951 (2011).

have been pulled back or exceptions have been created when legislators become convinced the disclosure and regulation is stifling economic progress and determine that these costs outweigh the benefits of investor protection.

B. Attempts to Alleviate the Burdens of the IPO Process

After the strong IPO market of the 1990s and early 2000s, policymakers became alarmed when the IPO market slowed down and determined that changes to the disclosure requirements and gun jumping were necessary to restore confidence in the public market.

Thus, in 2012 Congress passed the Jumpstart Our Business Startups (JOBS) Act[143] as a direct response to this concern. The JOBS Act created a category called Emerging Growth Company (EGC) for companies with less than $1 billion in annual gross revenues,[144] among other requirements, and adjusted IPO rules for those EGCs. Among many adjustments, EGCs enjoy relaxed disclosure requirements, including that they only have to provide two years of audited financial data rather than three years' worth, in most cases.[145] They can also avoid disclosures regarding executive compensation mandated by the Sarbanes-Oxley Act.[146]

As well as trimming disclosures, the JOBS Act changed gun-jumping rules, allowing companies to confidentially file a draft registration statement with the SEC, which gives the company an opportunity to receive confidential feedback from the SEC and gauge the difficulty in meeting SEC approval.[147] EGCs can also "test the market" by communicating, orally or through written material, with Qualified Institutional Buyers and institutional Accredited Investors "before or after the initial filing of a registration statement."[148]

The JOBS Act and its creation of the EGC category and the special registration rules EGCs enjoy—not to mention the recent

143. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).
144. § 101.
145. § 102(b)(1), 126 Stat. 306, 309 (codified at 15 U.S.C. § 77g(a) (2012)).
146. *See* § 102.
147. *See* Securities Act Rule 433(h)(4), 17 C.F.R. § 230.433(h)(4) (2014).
148. Berdejo, *supra* note 36, at 26; *see also* Securities Act Rule 501(a), 17 C.F.R. § 230.501(a)(1)–(6) (2014); JOBS Act, Pub. L. No. 112-106, § 105, 126 Stat. 306, 310–11 (2012).

expansion by the SEC of the confidential filing rule to virtually all private companies, regardless of whether they have more than $1 billion in annual gross revenue[149]—is clear evidence of the efforts of Congress and regulators to encourage more IPOs in what has been a sluggish IPO market.[150] It is also a continuous move away from investor protection.

Other requirements have been relaxed, both as part of the JOBS Act and as subsequent legislation and rulemaking, in an effort to ease the burdens of companies going and staying public. In addition to special rules for EGCs, the JOBS Act (1) increased the avenues to obtaining financing from investors through the increase of Regulation A+ fundraising limits (moving the cap from $5 million to $50 million[151]), (2) allowed issuers to solicit more broadly, and (3) incorporated the CROWDFUND Act, which attempted to expand the ability of companies to disintermediate fundraising and solicit broad investor audiences across the internet.[152] More recently, the Senate passed a bill that would relax some of the regulations the banking industry faces under the Dodd-Frank Act.[153]

Unfortunately, the JOBS Act, in particular, was not as helpful as policymakers hoped in encouraging more IPOs, at least in the short term. Many companies—between seventy to eighty percent of all IPO companies[154]—have filed confidential registration statements, but only 98 IPOs were conducted on U.S. exchanges in 2016, down

149. Press Release, Draft Registration Statement Processing Procedures Expanded, SEC (June 29, 2017), available at https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded.

150. *See* Erik P.M. Vermeulen, *High-Tech Companies and the Decision to "Go Public": Are Backdoor Listings (Still) an Alternative to "Front-Door" Initial Public Offerings?*, 4 PA. ST. J. L. & INT'L AFF. 421, 421, 424 (2015) (expanding on alternatives to IPOs, particularly reverse mergers or reverse takeovers, commenting on the "sluggish IPO markets" and "costly and lengthy regulatory barriers," and explaining the efforts of policymakers and regulators to "stimulate IPO activity by high-tech companies" through the legislation like the JOBS Act).

151. 17 C.F.R. §§ 230.251(a)(2), 230.257(b)(3) (2015).

152. *See* CROWDFUND Act, Pub. L. No. 112-106, §§ 301–305, 126 Stat. 306, 315–23 (2012) (codified as amended in scattered sections of 15 U.S.C.); *see also* Hurt, *supra* note 18, at 227–32.

153. Alan Rappeport, *Senate Passes Bill Loosening Banking Rules, but Hurdles Remain in the House*, N. Y. Times, Mar. 14, 2018, at A18.

154. Vermeulen, *supra* note 150, at 442.

from 244 in 2014.[155] The year 2017 was an improvement, but still there were only 174 IPOs.[156] In 2018, the U.S. IPO market saw continued increase, with 205 offerings,[157] and 2019 is expected to be a banner year, if not in the number of offerings, at least in size[158]. Still, if the changes to the IPO process are helping, it has not been obvious. The expected increase in IPO activity is fueled, at least in large part, by strong performance of IPO stocks in 2018.[159] Many of the companies expected to conduct an IPO in 2019 have been able to delay the process much longer than companies historically delayed, "opting to stick with private captial."[160] Not surprisingly, lawmakers and investors seem as desperate as ever to encourage the growing number of unicorns and "decacorns"[161] to transition into the public market, which is part of the reason all eyes have been on Spotify, and why policymakers seem more willing than ever to continue making tradeoffs and adjustments to encourage companies to migrate to the public markets—whether by IPO or some other method.

IV. THE DRAWBACKS OF DIRECT LISTING AS AN IPO ALTERNATIVE

Despite these efforts to facilitate the movement of private companies to the public markets, the embrace of direct listings as an alternative to an IPO raises some concerns. Thus far, the Spotify direct listing is viewed as a success. Nevertheless, although one

155. Lia Der Marderosian, et. al, *2017 IPO Report*, Harvard L. Sch. Forum on Corp. Governance & Fin. Regulation (May 25, 2017), https://corpgov.law.harvard.edu/2017/05/25/2017-ipo-report/.

156. Global IPO Trends: Q4 2017, *supra* note 97, at 10.

157. Global IPO Trends: Q4 2018, ERNST & YOUNG 8, HTTPS://WWW.EY.COM/PUBLICATION/VWLUASSETS/EY-GLOBAL-IPO-TRENDS-REPORT-Q4-2018/$FILE/EY-GLOBAL-IPO-TRENDS-REPORT-Q4-2018.PDF.

158. Maureen Farrell & Corrie Driebusch, *IPO-Hungry Investors Look to Have Their Moment in 2019*, WALL STREET J. (Dec. 31, 2018), https://www.wsj.com/articles/ipo-hungry-investors-look-to-have-their-moment-in-2019-11546189200?mod=searchresults&page=1&pos=6.

159. Maureen Farrell & Corrie Driebusch, *IPO-Hungry Investors Look to Have Their Moment in 2019*, WALL STREET J. (Dec. 31, 2018), https://www.wsj.com/articles/ipo-hungry-investors-look-to-have-their-moment-in-2019-11546189200?mod=searchresults&page=1&pos=6.

160. Maureen Farrell & Corrie Driebusch, *IPO-Hungry Investors Look to Have Their Moment in 2019*, WALL STREET J. (Dec. 31, 2018), https://www.wsj.com/articles/ipo-hungry-investors-look-to-have-their-moment-in-2019-11546189200?mod=searchresults&page=1&pos=6.

161. A decacorn is a startup valued over $10 billion. Fan, *supra* note 3, at 584.

company successfully deviated from the typical IPO path to the public markets and investors do not seem harmed, other companies that follow the pattern may perform poorly and, in the case of more foreign private issuers, choose to withhold more information from their disclosures which will harm investors. As explained above, the IPO process and the scrutiny it requires are meant to protect investors. Even parts of the process that are not mandated—like working with an underwriter—serve as important checks on the quality of companies that offer shares to the public. The direct listing process increases investor risk because (1) issuers are not required to provide as many disclosures, (2) issuers are not subject to stringent gun jumping rules, and (3) investors are not as well protected against volatility as they are when an underwriter is involved who has guided the company through the bookbuilding process to determine an appropriate price and highlight any issues regarding investor confidence that should be addressed or disclosed before the offering.

First, disclosure requirements are critical to investor protection. Current rules for foreign private issuers do not adequately address the unique circumstances of a direct listing like that conducted by Spotify. When a foreign private issuer is not listing on any exchange that requires quarterly and annual disclosures, investors could be left without enough protection, particularly when the company is a high-profile consumer product or brand like Spotify. Without mandated, ongoing disclosures, companies like these could essentially present an *all-is-well* facade to investors and reporters. The market price may not reflect the true value of the company if there is negative information that would normally be revealed in mandated disclosures, but is not revealed under the special rules for a direct listing by a foreign private issuer.

Of course, investors will sometimes be better protected if shares are listed on a U.S. exchange by foreign private issuers than if the investors purchased shares listed only on a foreign exchange because the company cross-listing shares will be subject to U.S. securities laws.[162] U.S. securities laws, even under relaxed rules for foreign private issuers, are more stringent than the securities—or

162. *See* Christopher Hung Nie Woo, *United States Securities Regulation and Foreign Private Issuers: Lessons from the Sarbanes-Oxley Act*, 48 AM. BUS. L.J. 119, 121 (2011).

comparable—laws of some other countries.[163] Additionally, some writers have suggested that if a company does not provide adequate disclosures, investors will take that into account and discount the shares.[164] However, without adequate disclosures, particularly if the shares are not cross-listed, there's little way to know if the share price on the U.S. exchange appropriately discounts the value of the shares. Quite simply, without mandated disclosures, investors may not know enough to make informed decisions.

Second, gun-jumping rules (sometimes referred to as quiet-period rules) are also meant to protect investors by encouraging appropriate disclosure to all public investors at the appropriate time.[165] Though gun-jumping rules increase the IPO timeline, gun-jumping rules are intended to provide public investors with all relevant information by regulating not only the company directly but also indirectly the analysts and reports and even journalists, in some cases, by requiring that the company essentially police these other players, in turn, and provide in a public filing accessible by all investors any related communication leading up to the offering. Gun-jumping rules allow the SEC time to carefully review registration statements without the interference of the company making public comments about the offering, potentially artificially inflating the IPO stock price by fueling the interest generated by the media and analysts disseminating more "glossy" materials, or materials that would paint an unregulated, more positive review of the company.[166]

IPOs get a lot of attention, which provides investors more information, even though IPOs are usually bad long-term investments.[167] Reporters and analysts write a lot about upcoming IPOs, and IPOs generate plenty of hype even when issuers follow gun-jumping rules. The gun-jumping rules hold issuers responsible

163. *Id.*

164. Brown, *supra* note 102.

165. Heyman, *supra* note 120, at 193.

166. *Id.*

167. *See* Hurt, *Moral Hazard*, *supra* note 56, at 715-16 (explaining that the insiders who buy shares in the initial IPO are normally the most successful as "the average IPO share price will decrease over the first three years"); *see also* Coryanne Hicks, *IPOs Often Are More Hype Than Substance*, U.S. NEWS (Oct. 31, 2017), https://money.usnews.com/investing/investing-101/articles/2017-10-31/ipos-often-are-more-hype-than-substance.

even for journalist publications if the issuer becomes aware of the report and fails to file it with the SEC within four days.[168] But with a direct listing, executives do not have to comply with gun jumping rules, and they are free to discuss the upcoming listing. Again, the gun-jumping rules intentionally stifle executive communications leading up to an IPO in an effort to prevent over-pricing and market manipulation. If direct listings become a common alternative to IPOs, gun-jumping rules cannot protect investors.

The risk of trading newly public securities has been regulated very carefully in the past. Issuers that have not previously registered securities (non-reporting issuers) were traditionally regulated most carefully—as compared to a so-called seasoned issuer or "Well-Known Seasoned Issuer" (WKSI)—because investors face enormous information asymmetries when a company that has never provided public disclosure does so, and in close proximity to then offering those shares for sale to the public.[169] Though the SEC is concerned about protecting investors and potential investors in all companies, including seasoned issuers and WKSIs, seasoned issuers and WKSIs face less stringent rules about communicating because the companies have been filing ongoing disclosures for extended periods of time.[170] The stricter rules for offerings by non-reporting issuers illustrate the concerns specific to protecting investors at the time of the IPO.[171] Of course, the JOBS Act introduced special exemptions to gun jumping rules for EGCs, clearly moving away from investor protection. A trend toward direct listings as a replacement for IPOs, rather than their current use most often as a complement to IPOs, would further exacerbate the risks investors face when a company's stock is first traded publicly. Gun-jumping rules would do little to protect investors then.

Third, circumventing underwriters may be cost-effective for the issuer, but everyday investors benefit from the expertise and validity that investment banks bring to the IPO process. The benefits include lockup protections, support of long-term investors,

168. *See* Securities Act Rule 433(f), 17 C.F.R. § 230.433 (2014).
169. Heyman, *supra* note 120, at 199–202.
170. *Id.*
171. *Id.*

protection against volatility, price discovery, and added legal review.[172] As one legal writer noted,

> [t]he potential for volatility was a big concern with Spotify since it was departing from the traditional initial public offering path, which typically includes a 'lockup period' negotiated with underwriters that withholds most shares from being traded right after the IPO. Lockups are intended to limit the potential for unpredictable trading in the first few months after a company's public debut, but most of Spotify's shares immediately entered public markets free of those restrictions.[173]

Had the CEO or other executives wanted, they could have inundated the market with shares right at the start, before a price had stabilized.

In contrast, investment banks can choose from their customers—mostly institutional investors—to allocate shares to investors that have a track record of holding the securities after an IPO as long-term investments.[174] As discussed above, underwriters carefully assist with setting a price and shopping the securities to investors during the weeks leading up to the IPO and monitor the performance of the security in the minutes, hours, and days following an IPO.[175] They can also protect investors from volatility by purchasing additional shares to keep the market price steady.[176] Including underwriters in the registration process adds a layer of protection to investors because not only will the issuer obtain legal counsel, but the underwriter also obtains its own counsel to oversee the process and flag any concerns.[177]

Despite the potential harms of a migration away from IPOs and toward direct listings only, Spotify moved forward eagerly. The company limited the breadth of disclosures it was required to provide, avoided the frustrations of the gun-jumping rules, and bypassed the expensive underwriting fees.

172. Zanki, *supra* note 119.
173. *Id.*
174. Griffith, *supra* note 53.
175. Zanki, *supra* note 40.
176. Zanki, *supra* note 39.
177. *Id.*

V. SPOTIFY'S CHOICE FOR DIRECT LISTING AND ITS POTENTIAL IMPACT

Though Spotify could have registered its shares on its home country exchange and then cross-listed the shares in the United States, it chose a direct listing. But by refusing to cross-list on its own Stockholm stock exchange, Spotify made an unusual move. "The vast majority of corporations list their securities in their home markets. In 2006, 90% of corporations chose to list their shares in their home countries,"[178] though that number may be lower today as interest in cross-listing has grown.[179] Of course, it is common for foreign companies to list their shares on a U.S. exchange despite a primary listing on the exchange of their home market.[180] As of March 31, 2018, there were 502 foreign issuers listed on the NYSE and NYSE-American from forty-six different countries.[181] This number includes Delaware corporations with business headquarters abroad. Nasdaq lists 120 non-U.S. companies as issuers, and, unlike the NYSE report, all 120 appear to be foreign private issuers.[182]

However, Spotify is unique, even among other Sweden-based companies, for refusing to list on the local exchange. Before Spotify, the NYSE only had one issuer, Autoliv Inc., which the NYSE classified as a Sweden-based company.[183] Autoliv is incorporated in Delaware, though its principal executive offices are in Stockholm, Sweden.[184] Thus, Autoliv does not actually list on the NYSE as a foreign private issuer, but as a domestic issuer. Autoliv is structured as Spotify would be if Spotify maintained its principal place of business in Luxembourg but was incorporated in Delaware.

178. Brown, *supra* note 102, at 396 (citation omitted).

179. *See* Grabar, *supra* note 82 (explaining that today many foreign private issuers list only on a U.S. exchange); *see also* Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L. 141, 152 (2003) (noting an increase in cross-listing interest).

180. Aitken, *supra* note 1; *see also* Grabar, *supra* note 82.

181. *Current List of All Non-U.S. Issuers*, NYSE (Nov. 30, 2018), https://www.nyse.com/publicdocs/nyse/data/CurListofallStocks.pdf.

182. *Companies by Industry*, NASDAQ, https://www.nasdaq.com/screening/companies-by-industry.aspx?exchange=NASDAQ&market=ADR (last visited Feb. 27, 2019).

183. *Current List of All Non-U.S. Issuers*, *supra* note 181.

184. Form 8-K, SEC, https://www.sec.gov/Archives/edgar/data/1034670/000156459019001263/alv-8k_20190129.htm.

Only two Sweden-based issuers are list on Nasdaq, as of April 7, 2018—Ericsson, and Oasmia Pharmaceutical.[185] Ericsson is listed both on Nasdaq, as well as the Stockholm exchange—Nasdaq OXM Stockholm.[186] Ericsson's Class A and Class B shares trade on the Stockholm exchange, while ADRs, which represent Class B shares, trade on Nasdaq New York.[187] Oasmia Pharmaceutical also lists on both exchanges, but like Ericsson, it lists on the U.S. exchange as a foreign private issuer. So, of the three companies domiciled in Sweden, Spotify is the odd-company-out that is not cross-listed on both the Stockholm exchange and a U.S. exchange.

Though Spotify could have cross-listed its shares in the United States, it chose the direct listing path for reasons that were not at first obvious. When promoting the offering, Ek, the CEO, explained that while a traditional path makes sense for some, and that "[n]ormally, companies don't pursue a direct listing[,] . . . Spotify has never been a normal kind of company."[188] In the end, some suggested the CEO and other executives chose a direct listing to avoid hefty investment bank fees, time-consuming roadshows, and, presumably, intensive ongoing reporting requirements. In the F-1, the company points out that if it did not qualify as a foreign private issuer, domestic rules would require the filing of "more detailed and extensive" forms which it would avoid altogether. [189]

Of course, if one of Spotify's reasons for the direct listing was to avoid paying the investment banks the market-standard seven percent commission on the offering price,[190] it may still have incurred extensive fees from the investment banks.[191] Spotify engaged three investment banks to serve as financial advisors.[192] As the first large company to conduct a direct listing, there can be little

185. *Non US Companies*, NASDAQ, https://www.nasdaq.com/screening/companies-by-industry.aspx?exchange=NASDAQ&market=ADR&region=Europe&country=Sweden.

186. Form 20-F, SEC, https://www.sec.gov/Archives/edgar/data/717826/000119312518097690/d648137d20f.htm.

187. *Id.*

188. Daniel Ek, *Spotify Lists on NYSE as SPOT*, INSIDE SPOTIFY (Apr. 2, 2018), https://newsroom.spotify.com/2018-04-02/tomorrow/.

189. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018).

190. Felix Salmon, *Where Banks Really Make Money on IPOs*, Reuters (Mar. 11, 2013) (calculating that Goldman Sachs made $11.5 million in commissions on the eToys IPO in 1999).

191. *See* Grabar, *supra* note 82 (explaining that today many foreign private issuers list only on a U.S. exchange).

192. *Id.*

doubt that the process required considerable advice from the banks.[193] Naturally, if the direct listing process becomes more prevalent after Spotify, other companies conducting a direct listing may benefit from the path paved by Spotify and require less advisement from the investment banks. Until then, the fees are likely to remain relatively high, as evidenced by the fact that Slack, like Spotify, is working with three investment banks in its own direct listing.[194]

Regardless, many unicorns and startups could take a lesson from Spotify on this point of avoiding excessive and unnecessary expenses. Startups are known for burning through capital, even on arguably frivolous expenses like $1,300 conference room chairs, climbing walls, and gourmet meals.[195] No doubt, it is encouraging to see a well-reasoned CEO choosing to move to the public markets not as some end goal, with an enormous self-initiated media splash, but as a step toward providing liquidity for employees and investors who have supported the company.[196]

However, Spotify's direct listing, because of the unique circumstances of being a foreign private issuer, swings the pendulum too far away from investor protection. In the days leading up to the IPO, analysts and investors were unsure at what market price the shares would trade. Private investors had purchased shares at $132 most recently. When the listing began, the shares started at $165.90, jumped to $169 a few minutes later, and then dropped to $149.01 to end the day down 10% from the opening price.[197] More surprising, only 3.1% of Spotify's outstanding shares were offered for sale in the first day of trading.[198] Analysts were not sure whether to read the tiny percentage of shares being sold as a vote of confidence from existing investors who chose not to sell

193. *Id.*

194. Maureen Farrell, *Slack Files to Go Public With Direct Listing*, WALL STREET J. (Feb. 4, 2019), https://www.wsj.com/articles/slack-files-confidentially-to-go-public-with-direct-listing-11549301336 (naming Goldman Sachs Group Inc., Morgan Stanley, and Allen & Co. as advisors, the same as the advisors to Spotify).

195. Oliver Staley, *Startups Could Raise a Lot Less if Their Expenses Weren't So Lavish*, QUARTZ (Mar. 9, 2018), https://work.qz.com/1222655/startups-could-raise-a-lot-less-if-their-expenses-werent-so-lavish/ ("The free-spending habits of tech startups are so familiar they've become a cliché.").

196. Ek, *supra* note 188.

197. Levine, *supra* note 15.

198. *Id.*

immediately despite no lock-up provision or not. It may have protected early buyers, but nobody really knew. Either way, from the standpoint of litigation risk, because such a small percentage of shares were initially traded, legal writers noted "the size of the class that can sue and the potential damages may be much smaller, as the trading may be modest."[199] Without a large, distributed shareholder base, the economics of being a class action, if it became necessary, would likely be unworkable. In this case, investors have less protection than normal without the threat of shareholder class action—limited though that threat may be.

Even more importantly, the unknowns surrounding the listing are the conveniences afforded Spotify going forward, which may come at the expense of investors. Because the company is based in Luxembourg, it will "face minimal litigation exposure" by listing in the United States.[200] Spotify acknowledged this in its F-1:

> We are organized under the laws of Luxembourg and a substantial amount of our assets are not located in the United States. It may be difficult for you to obtain or enforce judgments or bring original actions against us or the members of our board of directors in the United States.[201]

As the company pointed out, even if investors did bring an action against it for a violation, which would be difficult because of the remoteness of jurisdiction, any resolution attempted to protect the investors' interests would be difficult to seize upon. "[T]he opportunity to expropriate minority shareholders will be highest when managers' control of a firm cannot be challenged internally."[202]

In addition, foreign issuers are more likely than domestic issuers to have concentrated ownership.[203] The CEO of Spotify owns twenty-four percent of the company.[204] As mentioned above,

199. John C. Coffee, Jr., *The Spotify Listing: Can an "Underwriter-less" IPO Attract Other Unicorns?*, COLUM. L. SCH. BLUE SKY BLOG (Jan. 16, 2018), http://clsbluesky.law.columbia.edu/2018/01/16/the-spotify-listing-can-an-underwriter-less-ipo-attract-other-unicorns/.

200. Shnitser, *supra* note 79, at 1644.

201. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018).

202. Craig Doidge et al., *Private Benefits of Control, Ownership, and the Crosslisting Decision*, 64 J. FIN. 425, 432 (2009).

203. Shnitser, *supra* note 79, at 1660.

204. Coffee, *supra* note 199.

some conflict of interest rules do not apply to directors or executives, and shareholders going forward have little protection against the CEO, who, without any sort of lock-up, could sell a substantial number of shares over a short period of time. Further, research by other legal writers has shown that from 2000 to 2008, the SEC "brought enforcement actions against [foreign issuers] at a rate lower than the rate for domestic issuers . . . ."[205] Each of these factors together provides justification for requiring more disclosures from a company like Spotify.

Despite these risks, Spotify's direct listing has encouraged Slack to pursue its own direct listing, and Airbnb may follow the same path.[206] To accommodate Spotify, the NYSE hastily adopted rules to allow for direct listings, as it had previously allowed private listing by private companies interested in allowing their existing shareholders liquidity only "on a case-by-case basis[.]"[207] Nasdaq, ever in competition with the NYSE for new companies interesting in listing on a national exchange, and historically the favored exchange among technology companies[208], has since adopted its own set of rules to allow for direct listings[209]. Like the NYSE, Nasdaq previously allowed companies to list shares without conducting a concurrent IPO.[210]

Just as Slack's choice to conduct a direct listing after Spotify paved the path indicates that Spotify's choice may have immediate impacts on the market and future issuers, Nasdaq's adoption of direct listing rules signals that more companies may be interested

205. Shnitser, *supra* note 79, at 1693.

206. Theodore Schleifer, *Airbnb and Slack are Considering Untraditional IPOs that Box Out Bankers Like Spotify Did*, RECODE (Dec. 10, 2018, 12:46 PM), https://www.recode.net/2018/12/10/18129880/airbnb-postmates-slack-direct-listing-ipo.

207. Andrew Brady, Phyllis Korff & Michael Zeidel, *New NYSE Rules for Non-IPO Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Feb. 24, 2018), https://corpgov.law.harvard.edu/2018/02/24/new-nyse-rules-for-non-ipo-listings/.

208. Eric Newcomer, *Uber Picks New York Stock Exchange for Its Mega IPO*, Bloomberg (Mar. 21, 2019), https://www.bloomberg.com/news/articles/2019-03-21/uber-is-said-to-pick-new-york-stock-exchange-for-2019-mega-ipo (explaining that "many technology giants, including Alphabet Inc.'s Google, Microsoft Corp. and Apple Inc. trade on the Nasdaq, which was once the dominant exchange for tech upstarts going public").

209. Catherine M. Clarkin, Robert W. Downes & James M. Shea Jr., *Updated Nasdaq Requirements for Direct Listings*, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (Mar. 18, 2019), https://corpgov.law.harvard.edu/2019/03/18/updated-nasdaq-requirements-for-direct-listings/.

210. *Id.*

in direct listings. Whether the two direct listings are followed by a third, or a fourth—and on—is an open question, but early indications clearly suggest direct listings may gain traction.

VI. POSSIBLE SOLUTIONS—DISCLOSURES AND GUN JUMPING

Unsurprisingly, the solution for preventing harm to investors is to require more disclosures and apply gun-jumping rules to direct listings by foreign private issuers.

The tradeoff for accessing the capital of the public markets is the requirement to provide disclosures and risk liability if those disclosures are inaccurate. After Spotify's example, other companies may come to see direct listings as a viable way to avoid some of the disclosure requirements required of U.S. companies issuing shares in an IPO. Securities laws and regulations should be amended to prevent foreign private issuers conducting direct listings from bypassing the more extensive disclosures demanded of domestic corporations conducting IPOs.

In many ways, the direct listing itself does not allow significantly less robust disclosures. As explained, a registration statement prepared in accordance with Form F-1 is very similar to a Form S-1, and investors reviewing the Spotify F-1 saw most of the same material they would see in an S-1. Rather, the most important change to the regulations should come after the listing. Foreign Private Issuers not subject to disclosure requirements under foreign law should be required under U.S. law to provide interim disclosures with the same frequency and information as local issuers. Similarly, foreign private issuers should be required to provide event-based disclosures after the same occurrences as local companies are required to file.

In Spotify's case, the company has essentially conducted its post-direct listing disclosures with the same frequency and, to a great degree, the same disclosures as other public companies that do not qualify as foreign private issuers. In its first year, the company filed interim reports after each successive three-month period. Spotify has also provided reports for other current events on Form 6-K, including disclosures of earnings releases and departures of key executives.[211] However, because of the relaxed disclosures, there may be some events that would typically be disclosed by local issuers, which Spotify has chosen not to disclose. Without the mandated disclosures, it is difficult to know, and investors may not have material information they should have.

Of course, we do not want to regulate foreign private issuers too much. My argument is for stricter disclosure requirements when a foreign private issuer lists shares only on a U.S. exchange. This will not affect many companies. "The United States benefits from foreign private issuers listing on domestic exchanges. And, U.S. investors find it easier to invest in shares of foreign companies if they are listed in the United States,"[212] allowing U.S. investors to share in the growth of international companies. Many of the recent changes to eliminate burdensome disclosures are effective tradeoffs that eliminate tedious and duplicative disclosures for the issuer while refraining from subjecting investors to a high risk of losing access to material information.[213] But there is an important, though elusive, line between encouraging a strong market and protecting investors.

Next, companies in Spotify's position—foreign private issuers registering shares via direct listing only—should be required to abide by the rules similar to gun-jumping rules that restrict communications during the period before and during the registration process. Specifically, such companies should be required to abide by quiet-period rules and prohibitions against executives discussing the upcoming offering in the pre-filing period.

211. *See, e.g.*, Spotify Tech. S.A., *Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 Under the Securities Exchange Act of 1934* (Form 6-K) (Filed Sep. 13, 2018); Spotify Tech. S.A., *Report of Foreign Private Issuer Pursuant to Rule 13a-16 or 15d-16 Under the Securities Exchange Act of 1934* (Form 6-K) (Filed Feb. 6, 2019).

212. Woo, *supra* note 162.

213. On March 22, 2019, the SEC published highly anticipated final rules to implement FAST Act disclosure changes, which included allowing companies to exclude portions of the management discussion and analysis, if those portions were included in a prior filing, redacting confidential information associated with material agreements, and eliminating the requirement to provide attachments or schedules to exhibits if the schedules or attachments contain non-material information. *FAST Act Modernization and Simplification of Regulation S-K*, 17 C.F.R. §§ 229, 230, 232, 239, 240, 249, 270, 274 & 275 (https://www.sec.gov/rules/final/2019/33-10618.pdf). These changes are intended to reduce "the costs and burdens on registrants while continuing to provide all material information to investors." *Id.*

For Spotify, rules that accomplished the same general purpose as gun-jumping rules may not have made a significant difference. Such rules would have prevented the company's executives from discussing the upcoming listing prior to the time it became effective, unless those communications were appropriately recorded and disclosed under exceptions, like a free writing prospectus. But there has been no clear evidence that the Spotify executives discussed the offering widely or artificially pumped up the stock price by generating more interest than is allowed with typical IPOs. Still, the concern is that other foreign private issuers may be less inclined to observe the rules required only when shares are being offered or sold.[214] Rules patterned after gun-jumping rules would introduce a reasonable restriction that minimizes the risk investors face without significantly constricting interest in direct listings.

VII. CONCLUSION

In summary, Spotify's direct listing garnered a lot of attention as a potential game changer and rightfully so, it appears, considering that Slack, a second, large private company, has filed for its own direct listing. This new pattern may encourage more companies to list their shares on the public market and allow corporations to avoid expensive underwriting commissions and, if the process is adopted widely and efficiencies are developed over time, onerous fees as well.

A careful examination of the foreign private issuer qualifications, direct listing and cross-listing practices, and the regular IPO process suggest that such a transition from IPOs to standalone direct listings could harm investors, particularly when conducted by foreign private issuers not subject to local disclosure rules. Other adjustments to IPO rules were made with the JOBS Act in 2009, and the results of easing disclosure requirements and bypassing gun-jumping rules did not, at least in the short term, proportionately motivate the public market or prompt a substantial increase in IPOs.[215] In the aggregate, investors have not been harmed by the Spotify direct listing so far. But if the speculations of

214. *See* Securities Act of 1933 § 5, 15 U.S.C. § 77e(a) (2012).
215. *See generally* Scott, *supra* note 7.

some observers and analysts prove prescient, a broader trend away from IPOs could harm investors, because other companies that follow Spotify's pattern may not be as well prepared for a direct listing, as willing to provide interim disclosures as frequently, or may choose less thorough disclosures if they are not mandated. The purpose of securities laws is to protect investors and encourage confidence in public markets while stimulating capital formation.[216] If direct listings become more than a surprising phenomenon, regulators and policymakers are at risk of allowing capital formation to dominate and neglecting investor protection.

Instead, foreign private issuers that choose the direct listing route should be required to provide disclosures as if they were conducting an IPO, especially ongoing disclosures in the months and years after the direct listing. In addition, companies like Spotify should be required to adhere to the same gun-jumping rules with which companies conducting an IPO must comply. By instituting these changes, regulators and policymakers may restrict capital formation for a small number of startups that share characteristics with Spotify while ensuring the thrust of securities laws remains investor protection.

Tayler Tanner[*]

216. *Id.*

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