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Move Over IPOs: Unicorn Direct Listings May Be the New Mythical Beasts in Town

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MOVE OVER IPOS:
UNICORN DIRECT LISTINGS MAY BE THE NEW MYTHICAL BEASTS IN TOWN

*Tatum Sornborger**

ABSTRACT

Most people think of "going public" as an Initial Public Offering (IPO), but as IPOs have boomed and busted over the past decade, the direct listing has emerged as an unconventional but viable way to raise capital. The direct listing approach was uncovered by one rebellious "unicorn," a term used to describe privately held companies with valuations exceeding one billion dollars. By circumventing the traditional IPO process, Spotify prompted both the SEC and major stock exchanges to examine direct listings and promulgate rules for future offerings. Though these rules are still developing, companies now have a clear path to follow in Spotify's footsteps and forgo the traditional IPO.

The development of the direct listing is important not only because of the regulatory response, but also because of what it might reveal about the truth behind unicorn valuations. Many economists and industry professionals suspect that the reason behind several recent high-profile IPO failures may lie in excessively high valuations that do not correspond to reality. Many companies that went public through an IPO continue to trade well below their offering prices despite their private market success.

IPOs are still trending upward. But if unicorns continue to struggle to maintain massive pre-IPO valuations in the public markets, others may see the allure of the cost-saving and more transparent direct listing approach.

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INTRODUCTION

Spotify, with one unprecedented move, may go down in history as paving the way for a start-up financial rebellion.[1] In 2018, Spotify surprised the Securities and Exchange Commission (SEC) by rejecting the status quo through a decision not to launch an Initial Public Offering ("IPO"),[2] which, under the Securities Act of 1933 (the "Securities Act"),

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1. Rupa Briggs, *Direct listings: The IPOs of the new decade or a passing phase?*, WHITE & CASE (2020), https://www.whitecase.com/sites/default/files/2020-03/direct-listings-ipos-new-decade-or-passing-phase.pdf [https://perma.cc/2FGT-NGHT].

2. *Id.* An IPO is the first time an issuer offers securities to the general public. *See* SEC. & EXCH. COMM'N, SEC PUB. NO. 133 (2/13), INVESTOR BULLETIN: INVESTING IN AN IPO 1 (Feb. 25, 2013) [hereinafter SEC INVESTOR BULLETIN], https://www.sec.gov/investor/alerts/ipo-investorbulletin.pdf [https://perma.cc/T7V3-VTL7].

is a start-up's celebrated coming-out party.[3] Why did a company that was worth $20 billion decide to deviate from the accepted path and forgo its opportunity to be the next hot, new IPO? More importantly, what did they do instead? Is what they did legal, and did they really start a revolution? This Note will attempt to answer these questions by looking at Spotify's path and the path of other companies that have since followed suit. These companies, called "unicorns," have one important quality in common: their billion-dollar valuations.[4] The valuation of these companies puts them in an exclusive group, the "unicorn club."[5] This Note will discuss how certain companies make it to the club, and why some decide not to journey to the IPO promised land with the rest of the unicorn herd.

Imagine a CEO of a successful start-up, excited about the prospect of offering common stock of her billion-dollar company to the public. Then, this CEO begins to read newspaper headlines titled, "The Uber IPO Was Not a Failure, But IPOs in General Are a Mess"[6] and "Why IPO Investors Are Set Up for Failure."[7] The CEO starts to think that there has to be another way to stay successful without the risk of guests not showing up for her coming-out party. After all, she does not want a failed IPO.[8] Following in the footsteps of Spotify, the CEO skips the IPO, files a registration form with the SEC in accordance with the Securities Exchange Act of 1934 (the "Exchange Act") and the stock exchanges' new rules, and lists her company's common stock directly

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3. *See id.*

4. *See* Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 583 (2016). "Unicorn" was a term coined by Aileen Lee, the founder of Cowboy Ventures in 2013. *Id.* at 586.

5. *Id.* at 587; *see also* Aileen Lee, *Welcome to the Unicorn Club: Learning from Billion-Dollar Startups*, TECHCRUNCH (Nov. 2, 2013), https://techcrunch.com/2013/11/02/welcome-to-the-unicorn-club [https://perma.cc/UXH5-W8MJ].

6. Vitaliy Katsenelson, *The Uber IPO Was Not A Failure. But IPOs in General Are a Mess*, FORTUNE (June 6, 2019, 4:07 PM), https://fortune.com/2019/06/06/uber-ipo-success-or-failure [https://perma.cc/SFV6-6VL2].

7. Ross Gerber, *Why IPO Investors Are Set Up For Failure*, GERBER KAWASAKI BLOG (2017), https://gerberkawasaki.com/article/why-ipo-investors-are-set-up-for-failure [https://perma.cc/SFV6-6VL2].

8. When an IPO "fails," it essentially means that the company failed to make money after going public due to an inability to attract new investors. *See* Nicholas J. Price, *What Happens When Your IPO Fails?*, DILIGENTINSIGHTS (Nov. 13, 2019), https://insights.diligent.com/ipo/what-happens-when-your-ipo-fails [https://perma.cc/JL8N-T86G]. For example, Uber and Lyft "haven't done well after IPO." *Id.*

on a securities exchange without the help of underwriters. Like Spotify, this hypothetical company has thus rejected the IPO train and hopped on a new train: direct listing. In summary, this Note will dive into the inner workings of this revolution and analyze what it entails, which companies are rejecting the IPO model, how the regulatory scene is keeping up with this movement, and what it means for the financial start-up market.

Part I of this Note will discuss the rise of unicorns and how they get their $1 billion valuation. It will present common questions that many have already asked, such as whether this valuation is valid and if unicorns really exist, or if they are as mythical as their name suggests. Part II will briefly discuss recent IPO mishaps and how some unicorns have chosen to step away from IPOs in favor of direct listings, the unusual method undertaken by Spotify. Part II will then walk through the specific mechanics of a direct listing and discuss how the sudden use of direct listings over IPOs prompted a change in regulations to support their usage. Finally, Part III considers whether direct listings are here to stay, and why that might be.

I. PAPER UNICORNS: MYTHICAL NAME AND MYTHICAL VALUATIONS

Pinterest, WeWork, Uber, SpaceX, and Airbnb all have one thing in common:[9] They all, at one time or another, earned unicorn status. Once very rare, hence their mythical-creature-inspired namesake, unicorns have become increasingly common in today's technological start-up boom.[10] In 2019 alone, there were at least 50 new unicorns from a variety of industry sectors including fintech, fashion, biotech, and health.[11] As of December 2020, there were more than 500 unicorns around the world.[12] A large number of new unicorns are tech-based[13],

9. *See* James Chen, *Unicorn*, INVESTOPEDIA (Mar. 31, 2020), https://www.investopedia.com/terms/u/unicorn.asp [https://perma.cc/BZ95-TJSY].

10. *See* Fan, *supra* note 4, at 583.

11. Joanna Glasner, *Unicorn Class of 2019: Richer, More Autonomous, and More American*, CRUNCHBASE NEWS (June 12, 2019), https://news.crunchbase.com/news/unicorn-class-of-2019-richer-more-autonomous-and-more-american [https://perma.cc/GSR5-EZ4L].

12. *The Complete List of Unicorn Companies*, CBINSIGHTS (Dec. 2020), https://www.cbinsights.com/research-unicorn-companies [https://perma.cc/R3FP-RR3E]. This website is continuously updated to reflect the most recent data, with

and many, if not most, are U.S. based companies.[14] These companies typically earn their unicorn status between four and seven years of operation.[15] However, a few companies have recently reached that status in only two years.[16] Some scholars believe that this has more to do with valuation methodology than genuine success.[17]

So, why do venture investors and entrepreneurs care if companies reach this billion-dollar mark? First, from a logical standpoint, as venture-capital-supported start-ups continue to grow in size, larger "exit options" are needed to deliver returns.[18] Second, others seem to suggest that a fervent desire to reach the billion-dollar mark is born not just out of monetary motivations.[19] Steve Butterfield, Slack's CEO, admitted that while the number appears arbitrary, for him and for others, it "does makes a big difference psychologically."[20] According to Butterfield, "[o]ne billion is better than $800 million because it's the psychological threshold for potential customers, employees, and the press."[21] The desire for large valuations, unfortunately, does not automatically make them trustworthy, rather, some financial experts argue that many valuations are unreliable and based on calculations that are neither accurate nor indicative of future success.[22] These same scholars imply that these seemingly successful companies are nothing more than "paper unicorns."[23] But how did Butterfield, investors, and employees even get to the $1 billion number, notwithstanding its potential inaccuracy?

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numbers growing every month. *See id.* If the company is priced over $10 billion, it is called a "decacorn" and if it is priced over $100 billion it is called a "hectocorn." *Id.*

13. *See id.*

14. *See* Gene Teare, *Monthly Funding Recap October 2020: 14 New Unicorns Are Born And Funding Holds Steady*, CRUNCHBASE NEWS (Nov. 9, 2020), https://news.crunchbase.com/news/monthly-funding-recap-october [https://perma.cc/V4NT-5KZ6].

15. *Id.*

16. *See id.*

17. *See infra* Part II.

18. *See* Gary Spencer, *Developments in Banking & Financial Law: 2015*, 35 REV. BANKING & FIN. L. 47, 55 (2015) [hereinafter *Developments*]. These "exit options" are usually in the form of an IPO. *See id.*

19. Erin Griffith & Dan Primack, *The Age of Unicorns*, FORTUNE (Jan. 22, 2015), https://fortune.com/2015/01/22/the-age-of-unicorns [https://perma.cc/L87R-GJ7Q].

20. *Id.*

21. *Id.*

22. *See Developments*, *supra* note 18, at 47.

23. *Id.* at 48. These scholars use the term "paper unicorns" to refer to unicorns that have not had a liquidity event, such as an IPO, where initial investors are able to cash out some or all of their shares. *See id.* IPOs are the most common of such events, but

A. INTRODUCTION TO VALUATIONS

"Value" is defined differently depending on the legal context in which it is applied.[24] The classical definition of "value" is the price that a willing buyer and a willing seller settle on using "reasonable knowledge of relevant facts."[25] This price is not set by the market, a price that is called "market value," but is arranged by two willing parties in an arm's-length transaction.[26] It presumes that both the seller and the buyer arrive at a price through fair and reasonable negotiations.[27] Furthermore, the price is determined based on the parties' knowledge of the asset and the presumption that they are acting in their own interests free from external pressures.[28]

This classical approach to valuation is used by many sources of authority such as the Internal Revenue Service (IRS) and the SEC.[29] But as a general method, publicly held companies are typically valued by multiplying the number of shares by their share price.[30] Current stock prices and available number of shares are found on databases such as

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others include direct acquisitions by other corporations or private equity firms. *See id.* at n.8.

24. SHANNON P. PRATT & ALINA V. NICULITA, THE LAWYER'S BUSINESS VALUATION HANDBOOK 1 (2d ed. 2010). For example, financial reporting yields different results than investment value or acquisition value. *See generally id.*

25. Treas. Reg. § 25.2512-1 (as amended in 1992). The Internal Revenue Code uses the term "value" throughout its provisions. *See, e.g.*, I.R.C. § 2031 (2018). The IRS has also released various publications emphasizing its classical approach to the term. *See* IRS, Publication 561 (02/2020), Determining the Value of Donated Property (Feb. 2020), https://www.irs.gov/publications/p561 [https://perma.cc/ZWS6-ZZDX].

26. PRATT & NICULITA, *supra* note 24, at 1. "Market Value" and "Fair Market Value" are two different terms where the former refers to the value that is decided by the market whereas the latter should represent the asset's true worth based on certain conditions described above. *See id.*

27. *See* Treas. Reg., §§ 20.2031-1(b), 25.2512-1 (1992).

28. *See* James Chen, *Fair Market Value (FMV)*, INVESTOPEDIA (Feb. 21, 2020) [hereinafter *Fair Market Value*], https://www.investopedia.com/terms/f/fairmarketvalue.asp [https://perma.cc/99ND-8UCA].

29. Sources of authority include statutory law, administrative rules, court directions, and IRS authority. PRATT & NICULITA, *supra* note 24, at 13–14. Federal statutes that contain valuation methods or material relating to valuation include the International Revenue Code, U.S. Bankruptcy Code, and the Securities and Exchange Acts. *Id.*

30. *See Developments*, *supra* note 18, at 49.

Google Finance.[31] Once these numbers are acquired, they are analyzed under conditions such as earnings, growth rates, and the volatility of the stock compared with the overall market: all publicly available information.[32] This is why accurate financial statements are extremely important. Potential and current investors need accurate data to analyze a company's performance so that they can make an informed decision on whether to invest.[33] Because of the need for accurate financial data, both Congress and the SEC have increased regulations in an attempt to bolster the reliability of audited financials.[34] Additionally, other public trading platforms, such as the New York Stock Exchange (NYSE), offer their own manuals that impose requirements for companies to disclose information that may materially affect the market for their securities.[35] These disclosures, in turn, affect the stock prices and valuations of the companies.[36]

For private companies, valuation can be boiled down to the "present worth of future benefits."[37] But what exactly does this mean when private companies have little financial history and no public oversight? A private company derives its valuation not based on the for-value transaction expressed in the classical definition of value; rather, its value is based on projections of what the company should be worth in

31. *Private Company Valuation*, CORP. FIN. INST. (2019), https://corporatefinanceinstitute.com/resources/knowledge/valuation/private-company-valuation [https://perma.cc/FP6Z-VW5W]. The value of the public company is called "market capitalization." *Id.*

32. *Developments*, *supra* note 18, at 49 (citing Kathleen Pender, *Are Unicorn Valuations Part Fantasy?*, S.F. CHRON. (May 13, 2015), http://www.sfchronicle.com/business/article/Are-unicorn-valuations-part-fantasy-6261937.php [https://perma.cc/X93U-WEV5].

33. *See id.*

34. *See* HOWARD M. FRIEDMAN, PUBLICLY HELD CORPORATIONS: A LAWYER'S GUIDE 69 (1st ed. 2011). These regulations have been implemented both in the accounting and corporate professions. *See id.* at 68–70. For example, in 2002, after a series of corporate scandals, Congress enacted the Sarbanes–Oxley Act. *Id.* at 70. Additionally, the Securities Exchange Act § 13(b)(2) increased obligations on public companies to file periodic reports with the SEC. *See id.* These obligations specifically require companies to maintain records that are accurate as well as maintain measures to ensure that internal accounting functions have a level of oversight in order to improve accountability and accuracy. *See id.*

35. N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL § 202.05 (2020) [hereinafter, NYSE LISTED COMPANY MANUAL], https://nyse.wolterskluwer.cloud/listed-company-manual [https://perma.cc/D4CQ-PGDQ].

36. *Id.*

37. PRATT & NICULITA, *supra* note 24, at 45.

the future.[38] Before their public market debut, privately-held companies are usually valued using one of three dominant approaches: Comparable Company Analysis ("CCA"),[39] the Discounted Cash Flow ("DCF") method,[40] or the First Chicago method.[41] These methods, while different, have one thing in common: They are based on predictions using the limited data available to the public.[42] Predictions, after all, are expectations that may or may not come true. As discussed in Part III, these faulty predictions may be the reason why many recent IPOs are failing.

So, how are these companies raising money to boost their valuation? Private companies usually raise capital through private funding which occurs in "large, late-stage growth equity rounds."[43]

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38. *Id.*

39. The CCA Method involves comparing similar companies that are assumed to have similar numbers to the target valuation. *See* James Chen, *Comparable Company Analysis (CCA)*, INVESTOPEDIA (Mar. 19, 2020), https://www.investopedia.com/terms/c/comparable-company-analysis-cca.asp [https://perma.cc/66QL-G7C6]. Essentially it is a method of "comparing" a similar company with more available data to the company being valued. *See id.*

40. The DCF method involves not only comparing the average growth rates of similar companies, like the CCA method, but it also involves discounting a future forecast of a company's free cash flow to today's value. See *What is a DCF Model?*, CORP. FIN. INST. (2020), https://corporatefinanceinstitute.com/resources/knowledge/modeling/dcf-model-training-free-guide [https://perma.cc/Y8B4-4KJF]. "Free Cash Flow" is cash that is available based on projections of the firm's operating expenses, taxes, and revenue. *See id.*

41. The First Chicago method involves taking the above methods and viewing them through a lens of scenarios: best-case, base-case (the most likely outcome), and worst-case scenarios. *See First Chicago Method*, THE BUS. PROFESSOR (Mar. 10, 2015), https://thebusinessprofessor.com/lesson/first-chicago-valuation-method [https://perma.cc/XU6W-6PY4]. Each of these scenarios is assigned a probability and the ultimate number is achieved by taking the weighted average of the three. *See id.*

42. *See* Stanley J. Block, *The Liquidity Discount in Valuing Privately Owned Companies*, 17 J. APPLIED FIN. 33, 33 (Fall 2007).

43. Christopher T. Holding et al., *Private IPOs and Unicorns May Trigger More H-S-R Act Filings*, GOODWIN PROCTER (July 28, 2015), https://www.goodwinlaw.com/publications/2015/07/07_28_15-private-ipos-and-unicorns-may-trigger-more-hsr-act-filings [https://perma.cc/8USG-5CZ9]. These large late-stage rounds are typical for unicorns who presumably want to get that large valuation number. *See Alex Wilhelm*, How Unicorns Have Helped Venture Capital Get Later, and Bigger, TECHCRUNCH (Oct. 22, 2020, 12:10 PM), https://techcrunch.com/2020/10/22/how-unicorns-helped-venture-capital-get-later-and-bigger [https://perma.cc/XY8Z-J368]. The success of

These private-stage rounds are characterized by investors receiving preferred stock from the company, rather than the common stock sold in an IPO.[44] Essentially, the price of this stock is largely based on negotiations between an investor and the company's management.[45] These negotiations, plus the added safeguards for venture investors, such as senior liquidation preferences, have led to "generous investment capital" before the acronym "IPO" is even whispered.[46] These money raising rounds have been described as "private IPOs."[47] Private IPOs do not necessarily mean that the company will forgo traditional IPOs after enticing early-round investors. However, they enable unicorns to directly list on a stock exchange rather than continue on with the IPO process.[48]

Are these pre-IPO negotiations the same negotiations referred to in the classic definition of "value," where a willing buyer and willing seller come to an agreement on the price? In a classic fair market value sense, the buyer wants the lowest price and the seller wants the highest price.[49] Interestingly, in the pre-IPO context, a late stage investor may not have these same interests,[50] and therefore may not meet this typical buyer-seller understanding.[51] Specifically, a late stage investor uses an IPO to procure an efficient exit that makes money,[52] meaning that a buyer

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these rounds may be a reason why unicorns are comfortable putting off their ultimate IPO. *See id.*

44. Barry Kramer et al., *The Terms Behind the Unicorn Valuations*, FENWICK & WEST (Mar. 31, 2015), https://assets.fenwick.com/legacy/FenwickDocuments/The-Terms-Behind-the-Unicorn-Valuations.pdf [https://perma.cc/WR9L-5U4V].

45. *Developments*, *supra* note 18, at 50.

46. *See id.* at 51.

47. Holding et al., *supra* note 43.

48. Amy Fontinelle, *IPO vs. Staying Private: What's the Difference?*, INVESTOPEDIA (July 8, 2019), https://www.investopedia.com/articles/investing/102915/ipo-vs-staying-private-pros-and-cons-each-model.asp [https://perma.cc/US88-KJ27].

49. *See Fair Market Value*, *supra* note 28.

50. *See* Flavia Richardson, *The New Valuation Guidelines for Venture Capital and Private Equity*, MEDIUM (Apr. 8, 2019), https://medium.com/@flaviarichardso/the-new-valuation-guidelines-for-venture-capital-and-private-equity-9e857153ed96 [https://perma.cc/PYU2-SVE8].

51. Different stages of funding involve different considerations. *See* Nathan Reiff, *Series A, B, C Funding: How It Works*, INVESTOPEDIA (Mar. 15, 2020), https://www.investopedia.com/articles/personal-finance/102015/series-b-c-funding-what-it-all-means-and-how-it-works.asp [https://perma.cc/E4PU-J69U].

52. *See* Adam Hayes, *Exit Strategy*, INVESTOPEDIA (Mar. 26, 2020), https://www.investopedia.com/terms/e/exitstrategy.asp [https://perma.cc/S5P2-NQLA]. IPOs are a type of "exit strategy" for existing investors. *Id.* An "exit strategy" is broadly

wants a high valuation, not a low one.[53] Perhaps this is a reason why the valuation of private companies often misses the mark–there is no opposing interest forcing the valuation to reach equilibrium. Instead, an investor wants the valuation of the company to be high and therefore does not want the lowest price desired by a typical buyer.[54]

B. THE ROLE OF INSTITUTIONAL INVESTORS IN VALUATIONS

Usually, investors are able to break into the "black box" of private companies by investing through big mutual fund companies like BlackRock.[55] This means that public investors can have a piece of the pie—"baked" into their portfolios by a mutual fund—even before an IPO occurs (and they may not even know it).[56] However, even these big mutual fund companies may inaccurately value the assets.[57] Essentially, by aggressively investing in unicorns, mutual fund companies only add to the unicorn's nebulous valuation.[58] For example, one of the ways in which the valuations are misguided is that these mutual fund companies are using a price that is calculated following new financing rounds, or new rounds of share issuing, without distinguishing different types of shares.[59] This indicates that underlying differences in shares with differing investor values may be treated as indistinguishable when

defined as a "conscious plan to dispose of an investment in a business venture or financial asset." *Id.* Examples of exit strategies include IPOs, management buy-outs, and strategic acquisitions. *Id.* Every exit strategy requires a business valuation in order to determine a sale price. *See id.* The purpose of an IPO, as well as other types of exit strategies, is typically to limit losses. *See id.* Therefore, the investor's interest is to "exit" the company by selling shares of the private corporation to the public. *See id.*

53. *See* Kate Clark, *Late-Stage Valuations Have Increased Nearly 20% in 2018*, PITCHBOOK (May 8, 2018), https://pitchbook.com/news/articles/late-stage-valuations-have-increased-nearly-20-in-2018 [https://perma.cc/SM2D-2D5Y].

54. *See* Andrew Sorkin, *How Valuable Is a Unicorn? Maybe Not as Much as It Claims to Be*, N.Y. TIMES (Oct. 16, 2017), https://www.nytimes.com/2017/10/16/business/how-valuable-is-a-unicorn-maybe-not-as-much-as-it-claims-to-be.html [https://perma.cc/WY5Y-YLSL].

55. *See id.* These mutual fund companies are examples of "institutional investor[s]." James Chen, *Institutional Investor*, INVESTOPEDIA (Mar. 20, 2020), https://www.investopedia.com/terms/i/institutionalinvestor.asp [https://perma.cc/K3M3-XH7A].

56. *See* Sorkin, *supra* note 54.

57. *Id.*

58. *See id.*

59. *See id.*

calculating the final valuation.[60] Instead, these companies assume that "all shares are as valuable as the most recently issued preferred shares."[61] But in reality, some share classes are promised "valuation-inflating terms," such as return guarantees, vetoes over slumping IPO prices, and seniority to other investors.[62]

C. THE COMPANY CAN PERFORM ITS OWN VALUATION INFLATION

Inflating valuation numbers may be easier than one might think.[63] While some investors are promised a specific valuation price, other investors might unknowingly make up the difference if that valuation price is not realized after the company goes public.[64] Essentially, if there is a difference between a company's numbers and their IPO goal, all they need to do is issue more shares to make up the difference.[65] The common shareholders are unknowingly paying for this difference.[66]

Despite the problems that are arising with valuation mistakes, regulation laws have barely knocked on the door of the unicorn club.[67] Even the SEC's definition of "value" for private companies seems unhelpful.[68] Section 2(a)(41)(B) of the Investment Company Act

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60. *See id.*

61. Will Gornall & Ilya A. Strebulaev, *Squaring Venture Capital Valuations with Reality*, 135 J. FIN. ECON. 120, 120 (2020). Private companies backed by venture-capitalists usually create a new class of equity every one to two years as they raise money. *Id.* at 2. On average, a unicorn has eight share classes, each owned by different groups of people such as employees, mutual funds, strategic investors, and founders. *Id.* at 2–3.

62. *See id.* at 1.

63. *See, e.g.*, Alex Morrell, *Nearly Half of Tech "Unicorns" Rely on Tricky Math to Land Imaginary Valuations*, BUS. INSIDER (Aug. 2, 2017, 5:45 PM), https://www.businessinsider.com/study-nearly-half-of-tech-unicorns-overstate-their-valuations-2017-8 [https://perma.cc/JV9N-C2ZL].

64. Sorkin, *supra* note 54. For example, in 2015, Appdynamics issued a Series F round where certain investors would receive a 20% bonus if the IPO fell in price. *Id.* In other companies, some investors are promised twice their money back if the company is sold, thereby enticing investors to purchase more. *See id.* Claims like these are common and are used to entice investors and increase valuations. *See id.* Sorkin notes, however, that the professors who pointed out these instances do not believe these claims are meant to manipulate investors, even though that may be the outcome. *Id.*

65. *Id.*

66. *Id.*

67. *See* Fan, *supra* note 4, at 585.

68. *See* Chris B. Murphey, *How to Value Private Companies*, INVESTOPEDIA (May 14, 2020), https://www.investopedia.com/articles/fundamental-analysis/11/valuing-

dictates that securities without readily available market estimates, are to be valued at "fair value as determined by the Board of the Directors."[69] Still, these directors are likely using the valuation methods described above. Therefore, the fair value price is still based on fuzzy predictions.[70]

As previously mentioned, most of this mismatch arises from a unicorn's private status, meaning that it is subject to decreased scrutiny relative to a publicly held company.[71] Therefore, investors of private companies are looking at numbers contrived from projections created without sufficient historical data.[72] Because potential "future profits" are weighted more heavily than historical data for a private company,[73] one New York Times writer suggests that the average unicorn is worth "half of the headline price tag" of its valuation.[74] Furthermore, if promises to certain classes are considered,[75] almost half of all U.S. unicorns would fall below the billion-dollar threshold, thus forgoing their "club" status.[76]

D. FROM VALUATIONS TO IPOS

Once these private companies have valuation numbers, most prepare for an IPO hoping that their projected numbers will match the listed price on the stock exchange.[77] How does the company go public in order to sell common stock? First, transactions must be registered with

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private-companies.asp [https://perma.cc/QX55-W4Y9]. For a list of valuation cases, see *Recent SEC Mispricing Cases: Best Practices in Valuation*, HOULIHAN CAP. (Dec. 20, 2019), https://www.houlihancapital.com/recent-sec-mispricing-cases-best-practices-in-valuation [https://perma.cc/A8YY-G9DU].

69. 15 U.S.C. § 80a-2(a)(41)(B).

70. *See* Fan, *supra* note 4, at 583–84.

71. *See Developments*, *supra* note 18, at 48–49.

72. *Id.* at 52–53. For example, public companies must disclose detailed earnings and revenue trends. *Id.*

73. *Id.* at 53 (emphasis omitted).

74. Sorkin, *supra* note 54.

75. *See* Gornall & Strebulaev, *supra* note 61, at 122.

76. *Id.*

77. *See generally id.* In a traditional IPO, the company would have retained an underwriter for the offering. *See* SEC INVESTOR BULLETIN, *supra* note 2, at 2. An underwriter is an investment bank that manages and sells the IPO for the company. *Id.*

the SEC for a company to offer or sell shares.[78] To register an offering, the company files a registration statement with the SEC through Form S-1 or Form F-1 (for foreign issuers).[79] The Securities Act imposes standards on companies or persons engaged in the offer or sale of securities to protect future investors by ensuring that investors are provided with accurate information.[80] For instance, a company must include a "prospectus" as part of its registration statement.[81] The prospectus is "the offering document describing the company, the IPO terms, and other information that an investor may use when deciding to invest."[82] The SEC will use this registration statement and the included prospectus to monitor a company's compliance with disclosure requirements and other securities law obligations.[83] After appropriate registration, the company may list shares on an exchange to begin publicly selling shares.[84]

Companies rely on underwriters, which are sometimes banks, not only in preparation for the IPO but also to help sell shares to the public once the IPO launches.[85] As with the registration requirements, IPOs and underwriters are also governed by the Securities Act.[86] Section 2(a)(11) of the Securities Act defines "underwriter" as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking."[87] Underwriters play an integral role in the IPO process.[88] Their role is

78. MARC I. STEINBERG, UNDERSTANDING SECURITIES LAWS 125 (7th ed. 2018). The registration process is governed by the Securities Act of 1933. *See id.*

79. See Will Kenton, *SEC S-1 Definition*, INVESTOPEDIA (Mar. 19, 2020), https://www.investopedia.com/terms/s/sec-form-s-1.asp [https://perma.cc/Q535-2UBH]; *see also* Securities Act of 1933, 15 U.S.C. § 77f; 15 U.S.C § 78l.

80. *See* STEINBERG, *supra* note 78, at 125.

81. *See* Form S-1 available at https://www.sec.gov/files/forms-1.pdf [https://perma.cc/8ZHB-XTX7].

82. SEC INVESTOR BULLETIN, *supra* note 2, at 1.

83. *See id.*

84. 15 U.S.C. § 77e.

85. Allana Akhtar & Jennifer Ortakales Dawkins, *Asana just said it's doing a direct listing—here's how they work and why more companies are thinking outside the box when it comes to going public*, BUS. INSIDER (Feb. 4, 2020, 12:13 PM), https://www.businessinsider.com/the-difference-between-a-direct-listing-and-an-ipo-2019-6 [https://perma.cc/THQ3-QDUU].

86. 15 U.S.C. §§ 77a–77aa.

87. 15 U.S.C. § 77b(11).

88. *See* STEINBERG, *supra* note 78, at 189–90.

perhaps why the majority of the cost of an IPO is underwriter fees.[89] Therefore, because the underwriter fee is connected to the overall IPO price, both the company and the underwriters have an interest in establishing a higher priced offering.[90] Therefore, because of the conflicted interests of the underwriters and the company, the SEC warns potential investors that "the offering price may bear little relationship to the trading price of the securities, and it is not uncommon for the closing price of the shares shortly after the IPO to be well above or below the offering price."[91]

Finally, together with an IPO, a company going public must apply to list shares on a stock exchange such as the NYSE or NASDAQ.[92] These stock exchanges have their own listing and valuation rules that the company will have to follow.[93] Changes to these rules have become necessary as more companies deviate from the IPO path.

II. MOVE OVER IPOS, DIRECT LISTINGS HAVE ARRIVED

A. UNICORN IPO FAILURES SET THE STAGE

2019 was not kind to unicorns.[94] Nearly half of all companies that went public in 2019 were trading below their offer prices by the end of the year, meaning that investors were losing hundreds of millions of

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89. *See* Brent J. Horton, *Spotify's Direct Listing: Is it a Recipe for Gatekeeper Failure?* 72 SMU L. REV. 177, 185 (2019). A "large IPO" is typically an offering greater than $301 million. *Id.* Other fees include the SEC registration fee, the listing fee, printing costs, legal fees, and auditor fees. *Id.* Overall, the average cost of a large IPO is over $44 million. *Id.*

90. *See* SEC INVESTOR BULLETIN, *supra* note 2, at 4. The underwriters would get more compensation and the company has the possibility of raising more capital. *See id.*

91. *Id.* at 4–5. An IPO "fails" when the closing price falls well below the offering price. Katsenelson, *supra* note 6.

92. *See* SEC INVESTOR BULLETIN, *supra* note 2, at 2.

93. *See* NYSE LISTED COMPANY MANUAL, *supra* note 35, at § 102 *et seq.* NASDAQ is currently awaiting approval from the SEC for a rule addressing direct listings and valuations. *See infra* Part III.

94. Ben Winck, *The IPO Market is Rebelling Against Many of 2019's Money-Losing Unicorns. Here's What's Scaring Investors Away—And What It Means for the Future*, MKTS. INSIDER (Oct. 2, 2019, 2:16 PM), https://markets.businessinsider.com/news/stocks/ipo-market-outlook-trends-why-investors-rebelling-against-unicorns-implications-2019-9-1028570687 [https://perma.cc/7LKC-S3JG].

dollars, sometimes in a single day.[95] The SEC, seeing these trends, tried to stop the bleeding through repeated warnings.[96] For example, Mary Jo White, a former SEC chair, warned private companies in a speech in Silicon Valley that "being a private company comes with serious obligations to investors and the markets."[97] However, because of the regulatory framework's current focus on public valuations, there is only so much that the SEC can do to protect investors from a misguided valuation.[98]

Peloton's IPO was one of the biggest failures of 2019, following Uber, Lyft, and Endeavor in the line of "high-profile IPO flops."[99] Uber shares also fell on the first day of its IPO, with more than a 7% loss (compared to Peloton's 11%).[100] Interestingly, despite these high-profile failures, 211 companies went public in 2019.[101] Some market critics have suggested that, despite big-name IPO failures, IPOs continue to trend because the overall approach to what an IPO means has changed.[102] Specifically, companies are going public as "a path to

95. *See id.*

96. *See* Nicolas Morgan & Brian Kaewert, *Private Companies: Beware of SEC Scrutiny*, CFO (Apr. 22, 2019), https://www.cfo.com/fraud/2019/04/private-companies-beware-of-sec-scrutiny [https://perma.cc/4V7X-W7FC].

97. *Id.*

98. *See id.* One way in which the SEC has tried to protect potential investors is by pursuing private companies through fraud-related enforcement actions. *See id.* Investors, too, can use this approach to protect themselves. *See id.* For example, before Lyft was publicly traded, investors filed two class actions alleging that Lyft's disclosures were "overhyped". *Id.* Many investors point to these lawsuits as evidence of Lyft's IPO faux pas. *See id.* Additionally, private companies often rely on Regulation D of the Securities Act, which requires Form D filings. *See* 17 C.F.R § 230.506(b) (2015).

99. Theron Mohamed, *Peloton Is the Latest in a Line of IPO Flops and Failures This Year. Here Are 5 of the Biggest*, MKTS. INSIDER (Sept. 27, 2019, 12:06 PM), https://markets.businessinsider.com/news/stocks/peloton-joins-uber-lyft-wework-ipo-flops-and-failures-2019-9-1028560037 [https://perma.cc/GA3C-KDS6]. Peloton was privately valued at $4 billion in August 2018 and was seeking a public valuation of about $8 billion. *Id.* It debuted as the third-worst unicorn IPO, losing 11% of its share price on the first day of trading. *Id.* However, after a dip in mid-2020, Peloton is now trading at over four times its IPO price. *See Peloton Interactive*, THE MOTLEY FOOL (last visited Dec. 19, 2020), https://www.fool.com/quote/nasdaq/peloton-interactive/pton [https://perma.cc/QN2M-TJVD].

100. *Id.*

101. Maureen Farrell, *2019: The Year of IPO Disappointment*, WALL ST. J. (Dec 29, 2019, 5:30 AM), https://www.wsj.com/articles/2019-the-year-of-ipo-disappointment-11577615400 [https://perma.cc/62G2-QAVB].

102. *See id.*

profitability" rather than going public <u>because</u> of their profitability.[103] However, it should be noted that there are still many companies (that are not unicorns) that are continuing to see success after an IPO.[104] Critics caution, however, that the trends today are very reminiscent of the dot-com bubble of the 2000s.[105] So, are recent unicorn IPO failures a sign that a "unicorn bubble" is about to pop?[106]

The next section of this Note will discuss what some prominent unicorns have done to escape this apparent IPO bubble and achieve the success that only an IPO could once deliver, all while retaining their unicorn status.

B. DIRECT LISTINGS OR PRIVATE IPOS: THE CURRENT REBELLION TACTIC

Presumably because IPOs are no longer the only option, companies are staying private longer[107] or choosing to go public in a different way.[108] As hinted at the beginning of this Note, some unicorns have

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103. *Id.*

104. *Id.*

105. *Id.*

106. *See* Les Brorsen, *Looking Behind the Declining Number of Public Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 18, 2017), https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/ [https://perma.cc/A4RN-ZMNT]. IPOs peaked in the 1990s, but despite a decline, they are raising more money now than ever before due to the extension of the private financing stage. *Id.* It is important to note that this same article predicted a rebound in 2017-2018. *Id.* This may have been the case, but the number of IPOs does not indicate their success. *See id.*

107. The average age of companies going public is 8, with tech companies waiting on average until age 13. *See* Kate Rooney, *This Year's IPO Class is the Least Profitable of Any Year Since the Tech Bubble*, CNBC (Sept. 18, 2019, 7:32 AM), https://www.cnbc.com/2019/09/18/this-years-ipo-class-is-the-least-profitable-of-any-year-since-the-tech-bubble.html [https://perma.cc/5G74-BQ8Q]. According to one Harvard article, the age of companies completing an IPO has steadily increased, from six years in the years from 1996-2000, to eight years in the early 2000s, and then up to 10 years after the financial crisis. *See* David F. Larcker, Brian Tayan & Edward Watts, *Cashing It In: Private-Company Exchanges and Employee Stock Sales Prior to IPO*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 9, 2018), https://corpgov.law.harvard.edu/2018/10/09/cashing-it-in-private-company-exchanges-and-employee-stock-sales-prior-to-ipo [https://perma.cc/3R4E-U82X].

108. *See infra* Section II.C.

decided to go public without an IPO backing.[109] Spotify was the first to lead a growing herd, followed by Slack.[110] Both of these unicorns—and this Note predicts more to come—decided to skip "middleman" underwriters in favor of a direct listing.[111]

Knowing that they were breaking new ground, Spotify's prospectus contained the following warning:

> [T]he listing of our ordinary shares on the NYSE without underwriters is a novel method for commencing public trading in our ordinary shares, and consequently, the trading volume and price of our ordinary shares may be more volatile than if our ordinary shares were initially listed in connection with an underwritten initial public offering."[112]

Recognizing the uniqueness of this move, Spotify hoped to stay within the boundaries of the securities laws, while also warning investors of unrecognized problems.[113] Spotify recognized that with a direct listing, its shareholders could resell their shares on the NYSE immediately.[114] However, as mentioned below, many of these shareholders still needed to comply with Rule 144,[115] which requires that a minimum of sixth months to a year, depending on the type of company, must elapse in order for the issuer or an affiliate of the issuer to resell shares.[116] Spotify made sure to register shares held by affiliated

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109. *See supra* Part I.

110. *See supra* Part I.

111. *See* Akhtar & Dawkins, *supra* note 85. Importantly, without an IPO, employees and early investors are not mandated to wait to sell their shares when the company goes public, in what is known as the "lock-up" period. *Id.*

112. Spotify Tech. S.A., Registration Statement (Form F-1) (Feb. 28, 2018) [hereinafter Spotify Prospectus], https://www.sec.gov/Archives/edgar/data/1639920/000119312518063434/d494294df1.htm#rom494294_4 [https://perma.cc/DL4N-VEAQ].

113. *See* LATHAM & WATKINS, *Spotify Case Study: Structuring and Executing a Direct Listing* 3 (2018) [hereinafter *Spotify Case Study*], https://www.lw.com/thoughtLeadership/spotify-case-study-structuring-executing-direct-listing [https://perma.cc/84X4-LKE8].

114. *See id.* at 1-2. Traditionally, shareholders would be unable to resell their shares on a securities exchange without an IPO, after which, they would be restricted from selling those shares immediately because of the "lock-up" or "lock-in" period discussed above. *See What is a Lock-up Period?*, CORP. FIN. INST. (2020), https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/lock-up-period [https://perma.cc/GJ4Y-M5XU].

115. 17 C.F.R. § 230.144 (2020)

116. *See Spotify Case Study*, *supra* note 113, at 4.

issuers who did not meet the requirements of Rule 144.[117] Those that had already held shares for at least a year were able to escape registration under the rule.[118]

Additionally, unlike an IPO, no set amount of shares were sold to the public, and shares were not allocated at a set public price.[119] Instead, prospective buyers would place an order with someone of their choosing at a price of their choosing; this price was based on what they believed to be suitable.[120] Again, this price is different than the typical price set by a willing buyer and seller, as found in the classic fair market value model.[121] Therefore, every order contributed to the price rather than the price being based on a previously arranged value set by the initial buyer and seller.[122]

A direct listing is essentially where a company lets investors buy its stock without hiring banks to analyze, demand, and set an IPO price.[123] Essentially, this allows the companies to delay going public through rounds of venture group investments.[124] Then, one or two large investors, like Fidelity and, enter the mix to help with final steps.[125] In the direct listing model, current investors can sell their shares on a stock exchange directly without the help of underwriters (who are needed in an IPO).[126] Because the prices of these directly listed stocks are not informed by underwriters, they are, instead, established by private-market transactions that utilize previously discussed valuation

117. *Id.*
118. *Id.*
119. *Id.* at 2.
120. *Id.*
121. *See Fair Market Value*, *supra* note 28.
122. *Id.*
123. Matt Levine, *Unicorns Take Different Paths to Being Public*, BLOOMBERG (Mar. 27, 2018), https://www.bloomberg.com/opinion/articles/2018-03-27/unicorns-take-different-paths-to-being-public [https://perma.cc/6XV9-SLE3].
124. *See* Sergey Chernenko, Josh Lerner & Yao Zeng, *Mutual Funds as Venture Capitalists? Evidence From Unicorns* 1 (Harv. Bus. Sch., Working Paper No. 18-037, 2017), https://www.hbs.edu/faculty/Publication%20Files/18-037_9e4595dd-5d56-408d-addb-57c395ed760a.pdf [https://perma.cc/MT67-N6BJ].
125. *See id.* at 26–27.
126. Levine, *supra* note 123.

methods.[127] Therefore, without the stabilizing influence of a bank and big mutual-fund shareholders, the stock price can be highly volatile.[128]

As a reminder, the final price listed on the stock exchange was established by the valuation work done when raising money from investors in the private stage.[129] This means that "the late-stage private investors now are doing the job that the post-IPO public investors used to do."[130] Rather than paying bankers to spearhead an IPO, unicorns pay them to set up the direct listing.[131] Overall, unicorns are still saving money because they are not paying banks to market the company to investors in the public sphere.[132]

Furthermore, shareholders, rather than the banks, bear many of the costs of the direct listing.[133] In traditional IPOs, an underwriter (generally a bank) does not charge the company fees when they sell the stock.[134] Instead, they get an "underwriting discount," which means they purchase the stock from the company at a lower price and then sell it at a higher price.[135] Everyone who sells shares is paying that "discount" to the bankers, meaning that shareholders pay around half of the bankers' fees.[136] In a direct listing, however, the company bears the cost of all the bankers' fees because those shares sold don't have to then cover the discounted shares given to bankers.[137] Some of these new costs are different, though, since the company should still educate investors, rather than rely on investors' general knowledge.[138] For example, as it prepared for its direct listing, Spotify educated prospective investors through what it called "Investor Day."[139] Importantly, despite bearing all

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127. *See Private Company Valuation*, *supra* note 31.

128. Maureen Farrell & Ana Rivas, *The IPO Shortcut: A Direct Listing*, WALL ST. J. (Sept. 29, 2020, 4:05 PM), https://www.wsj.com/articles/the-ipo-shortcut-a-direct-listing-11560976972 [https://perma.cc/AD8J-8FJP].

129. Levine, *supra* note 123.

130. *Id.*

131. Akhtar & Dawkins, *supra* note 85. According to this article, banks can charge 2-8% of the total capital raised when helping companies raise money. *Id.*

132. *See id.*

133. Levine, *supra* note 123.

134. *See id.*

135. *See id.*

136. *See id.*

137. *See id.*

138. *See id.*

139. *See Spotify Case Study*, *supra* note 113 at 5. Investor Day included presentations from Spotify's leadership team that were publicly streamed and accessible around the world. *Id.* The Investor Day also qualified as a "road show," as far as the

of the costs, by using a direct listing, unicorns still pay a fraction of what they had to pay underwriters in a typical IPO.[140]

C. THE BENEFACTORS OF IPOS AND DIRECT LISTINGS

Traditional IPOs and direct listings also differ in a very important way: the recipient of the ultimate benefit.[141] In a traditional IPO, the issuer is selling the securities itself in order to raise capital for the company.[142] The primary issuance to shareholders is recorded on the company's balance sheet as stockholders' equity.[143] Furthermore, outside of these IPO-derived shareholders, many existing shareholders[144] are subject to what is called a "lock-up period," a contractual period of time set by the company's underwriters.[145] This contractually-defined period prevents company insiders, employees, and other private investors from selling their stock before the period lapses.[146] Importantly, even if this lock-up period was not defined, company

SEC was concerned, and therefore needed to meet the requirements of § 10(b) of the Securities Act. *Id.*; *see also* 17 C.F.R. § 230.433(D)(8) (2020) and accompanying note. Spotify's publicly filed registration statement needed to include a "red herring" prospectus as required by the SEC. See *Spotify Case Study*, *supra* note 113, at 5. Spotify complied with this requirement by explaining that the price range, a necessary element of this prospectus, would be determined by recent private transactions. *See id.*

140. *See* Farrell & Rivas, *supra* note 128.

141. For a full comparison, see *A Current Guide to Direct Listings*, GIBSON DUNN (Dec. 3, 2019), https://www.gibsondunn.com/a-current-guide-to-direct-listings [https://perma.cc/5DCH-54FH].

142. *See* Jason Fernando & Julius Mansa, *Initial Public Offering (IPO)*, INVESTOPEDIA (Nov. 24, 2020), https://www.investopedia.com/terms/i/ipo.asp [https://perma.cc/2GCG-UQMU]. Essentially, the issuer gets direct access to investor funding by selling stock to the public and raising capital. *See id.*

143. *Id.*

144. *See A Current Guide to Direct Listings*, *supra* note 141, at 3. Existing shareholders include company insiders. *See id.*

145. *Id.*

146. *See* Amy Fontinelle, *How Long Is an IPO Lock-Up Period?*, INVESTOPEDIA (Jan. 7, 2019), https://www.investopedia.com/ask/answer/12/ipo-lockup-period.asp [https://perma.cc/Y6ZK-4MY7]. The purpose of these lock-up periods is to stop early investors from flooding the market with their shares, leading to a decrease in stock price. *See id.*

insiders would still be prevented from selling their stock unless the designated time, established by Rule 144, had passed.[147]

Comparatively, in direct listings, the issuer is not receiving the same immediate benefit of capital gain through selling public shares; rather, existing shareholders are receiving the immediate benefit of selling their own stock.[148] These shareholders especially benefit because they are not confined to the lock-up period typically seen in an IPO.[149] However, direct listings still must comply with other obligations set by regulators, including the SEC and the stock exchanges themselves.[150]

D. DIRECT LISTINGS ARE STILL ON A REGULATOR'S LEASH

In September 2019, SEC Chairman Jay Clayton indicated that the SEC does not mind when companies go public through a direct listing as opposed to a traditional offering.[151] Following this announcement, in October, the SEC held discussions on other alternatives to IPOs, which included more conversations about direct listings.[152] This came in the wake of more and more Silicon Valley investors and advisers pushing for direct listings over IPOs.[153] The SEC appears to be on board with the transition.[154] A Latham and Watkins partner in attendance at this discussion suggested that because "the SEC's mandate is to have as many public companies as possible," facilitating an easier path for direct listings is a logical step for the SEC to take.[155] This apparent thaw in

147. *See* SEC. & EXCH. COMM'N, RULE 144: SELLING RESTRICTED AND CONTROL SECURITIES (Jan. 16, 2013), https://www.sec.gov/reportspubs/investorpublications/investorpubsrule144htm.html. It is also important to recognize that the contractually defined lock-up period created by the IPO underwriters varies depending on their specific agreement. *See* Jason Fernando, *Lock-up Agreement*, INVESTOPEDIA (Oct. 8, 2019), https://www.investopedia.com/terms/l/lockup.asp.

148. *See A Current Guide to Direct Listings*, *supra* note 141, at 2.

149. *See id.* Because a direct listing bypasses the use of underwriters, it also bypasses the lock-up period that goes along with them. *See id.*

150. *See infra* Section II.D.

151. Dave Michaels, *SEC's Clayton Says SEC Doesn't Judge Direct Listings*, WALL ST. J. (Sept. 19, 2019, 12:28 PM), https://www.wsj.com/articles/secs-clayton-says-sec-doesnt-judge-direct-listings-11568904829 [https://perma.cc/3PE5-XDEZ].

152. Miles Kruppa, *SEC Opens Debate on Finding Alternatives to IPOs*, FIN. TIMES (Oct. 17, 2019), https://www.ft.com/content/d9e59d5e-efcd-11e9-ad1e-4367d8281195 [https://perma.cc/Z7UA-323A].

153. *See id.*

154. *See id.*

155. *Id.*

attitude towards direct listings, however, is very different from the original sentiment of caution the SEC expressed when Spotify made the decision to begin the process in 2017;[156] essentially, the SEC's acceptance has been slow. Additionally, along with Spotify, the NYSE also had to seek a rule change from the SEC, but its path towards acceptance began earlier.[157]

The NYSE has "eased its rules" regarding listing requirements of private companies in the past few years in order to compete with NASDAQ, the original "go-to exchange for direct listings."[158] Nasdaq has been the major venue for small companies who have traditionally utilized the direct listing method.[159] The Nasdaq private market allows companies to privately trade their shares to institutional investors who wish to buy into private companies at a discounted price.[160] However, over the past decade, these same investors urged small companies to then register their shares for public trading after purchasing the shares on the private market.[161] Thus, after the filing and approval of disclosures with the SEC, the companies would start to trade their stock on an exchange.[162] Spotify essentially wanted to do this too, but on a much larger scale, since it was a much larger company.[163]

E. THE NYSE AND NASDAQ STEP IN TO HELP

As mentioned in the previous section, Spotify's unprecedented direct listing prompted the NYSE and the SEC to step forward and

156. Maureen Farrell & Alexander Osipovich, *Bankers Begone! Spotify to Get Clearance for an "Underwriter-Less" IPO*, WALL ST. J. (Dec. 21, 2017, 5:33 PM), https://www.wsj.com/articles/bankers-begone-spotify-to-get-clearance-for-an-underwriter-less-ipo-1513852210 [https://perma.cc/PWR2-QMAB].

157. *See id.*

158. *Id.*

159. 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 [https://perma.cc/N78Q-J53S].

160. *See id.*

161. *See id.*

162. *See id.*

163. *See id.*; *see also* Marc D. Jaffe, Greg Rodgers, & Horacio Gutierrez, *Spotify Case Study: Structuring and Executing a Direct Listing*, HARV. L. SCH. F. ON CORP. GOVERNANCE (July 5, 2018), https://corpgov.law.harvard.edu/2018/07/05/spotify-case-study-structuring-and-executing-a-direct-listing [https://perma.cc/388W-RJLN].

scramble to create regulations.[164] On February 2, 2018, the SEC approved the NYSE's proposal to permit direct listings on the NYSE, so long as the company also filed a resale registration statement pursuant to the Securities Act.[165] Before official approval was granted, like Nasdaq, the NYSE had used its discretion to permit certain smaller direct listings on a case-by-case basis.[166] Specifically, the direct listing method is permitted in Section 102.01B, footnote (E) of the NYSE Listed Company Manual.[167] The original footnote, before the 2019 proposed rule, said that the NYSE would approve the listing of private companies not previously registered with the SEC if the company could show "a $100 million aggregate market value of publicly held shares."[168] The company must also show the value of these shares based on: (1) an independent third-party valuation; and (2) the company's most recent trading price for privately sold stock.[169]

Now, with the approved rule, the NYSE modified its Listing Company Manual to better allow companies to list on the Exchange without prior registration and with little private market-price history.[170] Specifically, the NYSE proposed two changes to footnote (E) of the Listed Company Manual.[171] The first proposal was that the NYSE would have the ability to determine that the company had met its market value of publicly-held shares even if there was no recent private exchange trading to observe.[172] To do this, the company would have to provide a recent valuation that would indicate that the company had met the

164. *See supra* Section II.D.

165. *SEC Approves NYSE Rules to Facilitate Direct Listings*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM (Feb. 8, 2018) [hereinafter *SEC Approves NYSE Rules*], https://www.skadden.com/insights/publications/2018/02/sec-approves-nyse-rules-to-facilitate-direct [https://perma.cc/7VFU-YV4Y].

166. *See id.*

167. *See* NYSE LISTED COMPANY MANUAL, *supra* note 35, at § 102.01B n.E.

168. *Spotify Case Study*, *supra* note 113, at 6.

169. *See* Notice of Filing of Amendment and Order Granting Accelerated Approval of Proposed Rule Change to Amend Section 102.01B of the NYSE Listed Company Manual, Exchange Act Release No. 82627, 83 Fed. Reg. 5650 (Feb. 2, 2018) [hereinafter Notice of Approved Rule].

170. *Id.* at 5650. The SEC Rule refers to this private exchange as a "Private Placement Market." *Id.* Section 102.01B footnote (E) of the NYSE Listed Company Manual also discusses specific factors that must be adhered to when relying on a Private Placement Market Price. *See id.* at 5651–52.

171. *Id.* at 5651.

172. *Id.*

market value of publicly-held shares of at least $250 million.[173] This would make it easier for clearly qualified companies (such as unicorns) to list without showing both a valuation statement from a third party as well as recent transactions from a private market, steps that the original rule required.[174] Because of this new rule, the company could use a financial advisor to work with the NYSE's designated market maker to determine the opening price.[175]

The second rule change established more criteria to ensure that the valuation agent is "independent" for purposes of footnote (E).[176] For example, the valuation agent cannot have provided any investment banking services to the listing company within 12 months of the submitted valuation.[177] Additionally, the NYSE had proposed to amend rules regarding the initial listing procedures of companies that do not have recent trading on a private exchange or market; this, too, was approved.[178] In essence, in an attempt to regulate the shadowy valuations occurring behind closed doors, this new rule focuses on the valuation methods used by private companies that are attempting to list

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173. *See* Notice of Filing of Proposed Rule Change To Amend Section 102.01B of the NYSE Listed Company Manual, Exchange Act Release No. 80933, 82 Fed. Reg. 28200, 28201, 28203 (June 20, 2017) [hereinafter Original Notice] (describing changes to § 102.01B n.E of the NYSE Listed Company Manual).

174. *See* Notice of Approved Rule, *supra* note 169, at 5651 (explaining that the original NYSE Listed Company Manual required a valuation of $100 million, but the new rule requires a valuation of $250 million). The NYSE said that this "will give a significant degree of comfort that the market value of the company's shares will meet the [$100 million] standard upon commencement of trading on the Exchange." *Id.* at 5652. In other words, the NYSE believes that it is highly unlikely that a company with a valuation of this amount would also fail to meet the normal $100 million requirement upon listing. *Id.* at 5652 n.23.

175. Nicolas Grabar, David Lopez & Andrea Basham, *A Look Under the Hood of Spotify's Direct Listing*, HARV. L. SCH. F. on CORP. GOVERNANCE (Apr. 26, 2018), https://corpgov.law.harvard.edu/2018/04/26/a-look-under-the-hood-of-spotifys-direct-listing [https://perma.cc/G8HX-SX8Z]. For example, Spotify's financial advisor was Morgan Stanley. *See id.* The prospectus itself stated that the opening price would be influenced by Morgan Stanley's "understanding of the ownership of our outstanding ordinary shares and pre-listing selling and buying interest in our ordinary shares that it becomes aware of from potential investors and holders." Spotify Prospectus, *supra* note 112, at 180.

176. *See* Notice of Approved Rule, *supra* note 169, at 5652.

177. *See* Original Notice, *supra* note 173, at 28202 (discussing § 102.01B n.E of the NYSE Listed Company Manual).

178. *See* Notice of Approved Rule, *supra* note 169, at 5652.

shares through direct listings and mandates that valuations must be performed by competent agents.[179]

Importantly, in addition to the footnote (E) changes, the approved rule also requires a filing of a resale registration statement under the Exchange Act, subject to review by the SEC.[180] Therefore, the company must consider liability provisions under the Securities Act as well as the Exchange Act.[181] This dual consideration requires that the direct listing regulatory process "unfold as if there is an IPO even when there is not."[182] The proposed rule, after a variety of iterations, was approved on an accelerated basis.[183]

The NYSE did not stop with this first rule related to direct listings, which was largely limited to the reselling of securities by existing shareholders.[184] Rather, the NYSE attempted to further ease the path towards direct listing with another proposal made in December 2019.[185] This proposed rule would allow for "primary direct listings," with which a company, could itself list and sell its own shares on the NYSE on the first day of trading.[186] Essentially, with this newer proposal, direct listing would not be limited to "shareholder direct floor listings" such as Spotify's, where only existing shareholders could resell their shares; instead, an issuer would be able to sell newly issued primary shares on its own behalf.[187] After some road blocks, including a stay of the SEC's

179. *See SEC Approves NYSE Rules*, *supra* note 165.

180. Andrew Brady, Phyllis Korff & Michael Zeidel, *New NYSE Rules for Non-IPO Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 24, 2018), https://corpgov.law.harvard.edu/2018/02/24/new-nyse-rules-for-non-ipo-listings [https://perma.cc/Q4UR-DVEN].

181. *See id.*

182. Grabar, Lopez & Basham, *supra* note 175.

183. *See* Cydney Posner, *It takes a unicorn? SEC approves NYSE rule change to facilitate direct listings*, COOLEY (Feb. 23, 2018), https://cooleypubco.com/2018/02/23/it-takes-a-unicorn-sec-approves-nyse-rule-change-to-facilitate-direct-listings [https://perma.cc/QYT4-JR8N]. For example, one of the early iterations of the proposal would have allowed a company to list immediately after filing a registration statement without any Securities Act registration. *See* Notice of Approved Rule, *supra* note 169, at 5651 n.11.

184. See Peter D. Hutcheon, *Direct Listings on the New York Stock Exchange: "Undertaking" Underwriting*, NAT'L. L. REV. (Sept. 2, 2020), https://www.natlawreview.com/article/direct-listing-new-york-stock-exchange-undertaking-underwriting [https://perma.cc/T26C-2UK8].

185. *See id.*

186. *See id.*

187. *See id.* In order to qualify for a Primary Direct Floor Listing, the company must either "sell $100 million in market value of shares in the opening auction on the first

initial approval from August 2020, the rule was finally approved again in December 2020.[188] As a result of the NYSE's efforts, companies can now more fully engage in the direct listing process as long as they have filed an effective registration statement with the SEC.[189]

The NYSE was not the only exchange platform to realize that direct listings needed assistance.[190] Nasdaq also submitted a proposed rule in February 2019 that was approved by the SEC shortly thereafter.[191] Specifically, Nasdaq's new rule clarifies the role of financial advisors in direct listings, explains how Nasdaq will calculate the price requirements for the listing, and requires that the direct listing is accompanied by a registration statement under the Securities Act, only for the purpose of allowing existing shareholders to resell shares.[192] Nasdaq also submitted an extension of these rules in a new proposal in August 2019.[193] This extension further defines a price-based initial listing requirement and provides alternatives to private placement market trading history for valuation.[194]

Both Nasdaq rules look almost identical to the NYSE's approved rule.[195] The NYSE, however, had to go through three different amendments in order for the SEC to finally approve its rule.[196] Coming in second has its advantages. The SEC granted accelerated approval to

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day of trading"; or, at the time of listing, have freely tradeable shares with a market value of at least $250 million, "calculated using a price per share that is equal to the lowest price in the price range set by the company in the Securities Act Registration Statement." *Id.*

188. Brian Hecht, Mark D. Wood & Mark J. Reyes, *SEC Again Approves NYSE's Direct Listing Rules*, NAT'L L. REV. (Jan 8, 2021), https://www.natlawreview.com/article/sec-again-approves-nyse-s-direct-listing-rules [https://perma.cc/3V6J-GYVS].

189. *See id.*

190. *See* Notice of Approved Rule, *supra* note 169, at 5653.

191. *See SEC Extends Review Period for Nasdaq Direct Listing Proposal*, J.D. SUPRA (Oct. 24, 2019), https://www.jdsupra.com/legalnews/sec-extends-review-period-for-nasdaq-86585 [https://perma.cc/9KTN-3TAY].

192. *Id.*

193. Notice of Filing of Proposed Rule Change, Exchange Act Release No. 86792, 84 Fed. Reg. 171 (Aug. 28, 2019) [hereinafter Notice of Proposed Nasdaq Rule].

194. *See id*. at 46582.

195. *Compare* Notice of Approved Rule, *supra* note 169, *with* Notice of Proposed Nasdaq Rule, *supra* note 193.

196. *See* Notice of Approved Rule, *supra* note 169, at 5650.

Nasdaq's proposed rule on December 3, 2019.[197] Additionally, Nasdaq has once again attempted to follow in NYSE's footsteps with their own proposal for primary direct listings.[198] Nasdaq's proposal, filed on December 22, 2020, is "'virtually identical' to that of the NYSE."[199] If it follows the previous accelerated approval process, Nasdaq's approval should be imminent.

Importantly for both exchanges, as soon as a company has listed securities, the company is subject to reporting requirements, such as reports that must be filed with the SEC, as well as corporate governance requirements.[200] Therefore, choosing a direct listing over an IPO does not mean that a company avoids the SEC altogether.[201] The next section will discuss these requirements by looking directly at Spotify's path.

F. THE PACK LEADERS: THE SPOTIFY AND SLACK APPROACH

Heeding the words of their financial and legal advisers, Spotify approached the process of its direct listing carefully.[202] Specifically, Spotify implemented procedures similar to an IPO.[203] First, in order to start the process of a direct listing, Spotify registered its shares with the SEC using Form F-1.[204] Form F-1 is similar to a Form S-1, but is specifically for foreign issuers.[205] Both forms are required under the Securities Act.[206] However, because Spotify was not selling new shares or coordinating existing shareholders, Form F-1 acted not as a traditional registration statement, but rather as a <u>resale</u> registration statement.[207] Companies need to be careful when using Form F-1 in this way because, depending on timing, the SEC may consider the resale of shares a "distribution," something that Spotify feared would happen.[208]

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197. *See* Order Granting Accelerated Approval of a Proposed Rule Change, Exchange Act Release No. 87648, 84 Fed. Reg. 67308 (Dec. 3, 2019).

198. Hecht, Wood & Reyes, *supra* note 188.

199. *Id.*

200. *See* 15 U.S.C. § 78l (Exchange Act § 12(b)).

201. *See infra* Section II.F.

202. *See generally Spotify Case Study*, *supra* note 113.

203. *See id.* at 3.

204. *Id.*

205. Adam Hayes, *SEC Form F-1*, INVESTOPEDIA (June 9, 2020), https://www.investopedia.com/terms/s/sec-form-f-1.asp [https://perma.cc/U9FM-8FZY].

206. 17 C.F.R. § 239.31 (2020).

207. *Spotify Case Study*, *supra* note 113, at 3.

208. *Id.* at 7.

Resale registration statements are normally filed using a Form S-3 or Form F-3.[209] Filing with these forms was not possible for Spotify, since a company can only use these forms if that company has already been subject to the reporting requirements of the Securities Act for 12 months.[210] Therefore, Spotify needed to rely on Form F-1 instead.[211]

However, in order to make sure that existing shareholders could in fact resell their shares (and not experience the traditional lock-up period found in an IPO),[212] Spotify needed to either register all of its securities or qualify for a Rule 144 exemption.[213] Rule 144 allows securities to be traded on a secondary market.[214] In order to avoid becoming a "distribution" in the eyes of the SEC, the shares must be held for the period of time determined by Rule 144.[215] Spotify explained as such in their February 2018 prospectus under the "Shares Eligible for Future Sale" section.[216]

Furthermore, in a "pure direct listing", a company only needs to comply with the Exchange Act, since the Securities Act is used for the resale of shares.[217] This was not the case for Spotify.[218] In order for Spotify to successfully complete an approved listing, its Form F-1 needed to contain information that complied with the Exchange Act <u>and</u>

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209. 17 C.F.R. § 239.13 (2020); 17 C.F.R. § 239.33 (2020).

210. *Spotify Case Study*, *supra* note 113, at 10 n.7.

211. *Id.* Spotify submitted its prospectus and its 2018 first quarter financial statements. *See id.* Spotify essentially found a way around the impossibility of submitting a Form F-3 since it did not meet Form F-3s 12-month Exchange Act reporting requirement. *See id.* F-1, in contrast to F-3, is a Securities Act form rather than an Exchange Act form. *Id.* Registering with the SEC through Form F-1 allowed existing shareholders to resell their shares registered on the registration statement. *See id.* at 3.

212. Akhtar & Dawkins, *supra* note 85.

213. *See* 17 C.F.R. § 230.144 (2020); *see Spotify Case Study*, *supra* note 113, at 4. According to Rule 144, a registration statement must be effective for a period of 90 days. *See* 17 C.F.R. § 230.144 (2020). Not only must the registration statement remain open for 90 days, but a shareholder must have held his shares for at least six months before selling them under Rule 144. *See id.*

214. *See* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 468 (2017).

215. *See* 17 C.F.R. § 230.144 (2020); *see also Spotify Case Study*, *supra* note 113, at 7.

216. Spotify Prospectus, *supra* note 112, at 168.

217. Horton, *supra* note 89, at 190–91.

218. *Id.* at 191; *see Spotify Case Study*, *supra* note 113, at 4.

the Securities Act.[219] For instance, the prospectus needed to include a price range of the anticipated sale price on the front page pursuant to Item 501(b)(3) of Regulation S-K.[220] This disclosure was not possible for Spotify since the company was not offering any new shares (since it was only reselling existing shares) or playing a role in pricing new shares as it would in an IPO.[221] Therefore, Spotify relied on a statement warning potential investors that the price would be based on the buy and sell orders collected by the NYSE.[222] In an effort towards compliance and transparency, Spotify included some numbers from recent private transactions.[223]

Finally, Spotify's prospectus needed to include a "Plan of Distribution" section.[224] To do this, Spotify again clarified, in detail, the NYSE's role by defining it as the "designated market maker" whereby the NYSE would open the shares for trading and facilitate an orderly market for Spotify's shares "without coordination with Spotify."[225] However, current regulatory laws did not overtly permit this novel approach; this is why, as described in Section II.E., Spotify's journey towards a direct listing had to parallel the NYSE's attempt to allow such a move.[226]

G. THE SEC'S REVIEW PROCESS

How, though, did Spotify make sure that the SEC would accept this novel approach thereby ensuring its success? On December 18, 2017, Spotify decided to rely on the SEC's confidential review process by submitting a draft registration statement.[227] A few months later, Spotify publicly filed the registration statement as well as a brief statement

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219. *See* Horton, *supra* note 89, at 182 tbl.1.

220. *Spotify Case Study*, *supra* note 113, at 4.

221. *Id.*

222. *See id.*; *see also* Spotify Prospectus, *supra* note 112, at 1–7.

223. *Spotify Case Study*, *supra* note 113, at 4; Spotify Prospectus, *supra* note 112, at 8. In their February 2018 prospectus, Spotify warned that no public market for ordinary shares existed, but that the ordinary shares had a history of trading in private transactions. *See* Spotify Prospectus, *supra* note 112, at 8. After this warning, they proceeded to list the low and high sales price for ordinary shares for private transactions that took place in the preceding three months. *See id.*

224. *Spotify Case Study*, *supra* note 113, at 5; 17 C.F.R. § 229.508 (2020).

225. *See Spotify Case Study*, *supra* note 113, at 5.

226. *See* NYSE LISTED COMPANY MANUAL, *supra* note 35, at § 102.01B n.E.

227. Grabar et al., *supra* note 175.

using Form 8-A in order to register under the Exchange Act.[228] Because Spotify submitted Form F-1 as a resale registration statement rather than just the typical registration statement called for by the Exchange Act, the SEC had to analyze what this would mean.[229]

First, the Commission had to decide if this resale statement was actually an "offering."[230] If it was, the next question would be "whether such offering . . . would constitute a "distribution" for purposes of Regulation M of the Exchange Act," especially given Spotify's Investor Day and other educational initiatives.[231] Regulation M is the SEC's "anti-manipulation rule that limits the market activity of distribution participants."[232] The open question of whether Spotify's resale statement was, in fact, defined as an "offering" prompted Spotify to seek a no-action letter from the SEC.[233] In this no-action letter, "the SEC Staff agreed . . . that it would not recommend enforcement action against Spotify . . . if the restrict[ion] period . . . commenced five business days . . . prior to the commencement of trading."[234] However, like a typical no-action letter, the SEC made sure to clarify that the letter only applied to enforcement and did not represent any legal conclusions regarding securities laws.[235] But, despite the lack of legal precedent, Spotify had accomplished its goal; it had successfully gone public without an IPO.

228. *Id.*

229. *Spotify Case Study*, *supra* note 113, at 7.

230. *Id.*

231. *Id.* at 7, 11 n.13. Regulation M prohibits distribution participants such as security holders and issuers from bidding, purchasing, or inducing a person to bid or purchase during a specified time period. *See id.*

232. *Spotify's Direct Listing–A Look Under the Hood: Alert Memorandum*, CLEARY GOTTLIEB (Apr. 17, 2018), https://www.clearygottlieb.com/-/media/files/alert-memos-2018/spotifys-direct-listing--a-look-under-the-hood.pdf [https://perma.cc/NL78-93RM].

233. *Spotify Case Study*, *supra* note 113, at 7.

234. *Id.*

235. Spotify Tech. S.A., SEC Staff No-Action Letter (Mar. 23, 2018), https://www.sec.gov/divisions/marketreg/mr-noaction/2018/spotify-technology-032318-regm.pdf [https://perma.cc/433P-U3U8].

H. SLACK CLOSELY FOLLOWS

With Spotify successfully paving the way, Slack, another tech unicorn, now knew how to satisfy SEC requirements.[236] Learning from Spotify, the very first sentence of Slack's prospectus clarifies that it "relates to the registration of the resale" of its shares.[237] The next sentence goes on to say that the resale by the Registered Stockholders is not being underwritten by an investment bank.[238] Additionally, paralleling Spotify, Slack finished its prospectus's opening page by informing readers that the stock price will be determined by the buy and sell orders collected by the NYSE.[239] Essentially, Slack knew what to do to please not only the SEC but also the NYSE, successfully following in Spotify's footsteps.[240]

III. THE FUTURE OF DIRECT LISTINGS

A. WHICH UNICORN COULD BE NEXT?

Perhaps in the next year we will see other unicorn companies following the same path as Spotify and Slack. For example, WeWork may be one of the likely candidates for just such a move, especially given its failed IPO attempt.[241] After all, a direct listing is a way to cut

236. Maureen Farrell, *Slack Plans to Follow Spotify on Unconventional IPO Route*, WALL ST. J. (Jan. 11, 2019), https://www.wsj.com/articles/slack-planning-to-pursue-direct-listing-11547202723 [https://perma.cc/86VQ-2APB].

237. Slack Tech., Inc., Registration Statement (Form F-1) (Apr. 26, 2019).

238. *Id.*

239. *Id.* Slack described two categories of common stock: Class A and Class B, which only differ with regards to voting rights and conversion rights. *See id.* Class A stock, however, did not have any history of private trading and so the price had to be determined by the NYSE as mentioned above. *See id.* Class B, though, had a range of high and low sale prices per share of which Slack could disclose. *See id.*

240. *Compare id.*, *with* Spotify Prospectus, *supra* note 112.

241. *See* Ben Ashwell, *"WeWork" is a transformational moment, says OTC Markets' Paltrowitz,* IRMAGAZINE (Nov. 1, 2019), https://www.irmagazine.com/small-cap/wework-transformational-moment-says-otc-markets-paltrowitz [https://perma.cc/2YVQ-W4MC].

some of the costs of a traditional IPO,[242] and after the events of 2019, WeWork is in need of as many cost-cutting initiatives it can find.[243]

An indicator that WeWork might be heading towards a direct listing is the fact that WeWork "shelved its IPO at the last minute due to a lack of investor interest."[244] WeWork originally filed for the IPO in December 2018[245] and filed an official prospectus in August 2019, indicating its plan for an IPO.[246] The prospectus even contained a section devoted to underwriters employed by WeWork at the time.[247] However, following a wave of negative publicity in 2019 and the impact of pandemic conditions on the market in 2020, I predict that WeWork will likely abandon this approach and join the direct listing pack when the market rebounds. This theory seems to be supported by the fact that in September 2019, WeWork officially requested the SEC withdraw its IPO prospectus.[248] This move may be the biggest indicator that a direct listing for the company is in the making.

Comparatively, another unicorn, Airbnb,[249] once seemed like a perfect candidate for a direct listing.[250] Airbnb originally disclosed in 2019 that it planned to go public in 2020.[251] Many market insiders

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242. *See supra* Section II.B.

243. *See* Nicholas Jasinki, *WeWork Is Dropping Its Plan for an IPO*, BARRON'S (Sept. 30, 2019, 11:27 AM), https://www.barrons.com/articles/wework-asks-the-sec-to-withdraw-its-ipo-prospectus-51569857248 [https://perma.cc/9XRH-NEUC].

244. Mohamed, *supra* note 99.

245. *WeWork Files for Confidential IPO*, PYMNTS (Apr. 29, 2019), https://www.pymnts.com/news/ipo/2019/wework-files-initial-public-offering [https://perma.cc/6DK2-6SND].

246. The We Company, Registration Statement (Form S-1) (Aug. 14, 2019).

247. *Id.* at 237.

248. *See* Jasinki, *supra* note 243.

249. Airbnb joined the Unicorn Club in 2011 and is now currently valued at $18 billion dollars as of Sept. 13, 2020. *See The Global Unicorn Club*, CBINSIGHTS (Oct. 7, 2020), https://www.cbinsights.com/research-unicorn-companies [https://perma.cc/FN3J-HYVC].

250. *See* Ben Winck, *Airbnb reportedly opts for direct listing over traditional IPO ahead of 2020 market debut*, MARKETS INSIDER (Oct. 1, 2019, 9:15 AM), https://markets.businessinsider.com/news/stocks/airbnb-picks-direct-listing-over-ipo-2020-market-debut-report-2019-10-1028567322 [https://perma.cc/XT5X-87GS].

251. *See* Airbnb, *Airbnb Announces Intention to Become a Publicly-Traded Company During 2020*, AIRBNB NEWS (Sept. 19, 2019), https://news.airbnb.com/airbnb-announces-intention-to-become-a-publicly-traded-company-during-2020 [https://perma.cc/V5NC-QMJX]; *see also* Olivia Carville & Sonali Basak, *Airbnb Leans Toward Direct Listing Over Traditional IPO*, BLOOMBERG (Oct. 1, 2019),

suspected that Airbnb might opt for a direct listing, mirroring Spotify's success.[252] However, after months of silence, Airbnb finally announced a confidential submission of a draft registration statement to the SEC in August 2020.[253] Draft statements usually signal a pending IPO.[254] This came as a surprise to many, since the announcement occurred during the pandemic when the economy remained extremely uncertain.[255] However, because the stock market is experiencing record highs despite continued pandemic fears,[256] Airbnb may have felt confident that it would share in the market's success.

Despite market uncertainty and the opportunity to join the direct listing herd, Airbnb recently went public through a traditional IPO in December 2020.[257] Even though Airbnb's IPO seemed like a success initially,[258] Airbnb faced falling stock prices with shares down 25% just a week after debuting.[259] In retrospect, looking at these falling numbers,

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https://www.bloomberg.com/news/articles/2019-10-01/airbnb-is-planning-for-direct-listing-instead-of-traditional-ipo [https://perma.cc/9ZQ2-7HRF].

252. Levi Sumagaysay, *Airbnb files for IPO that was "hard to imagine" just a few months ago*, MARKETWATCH (Aug. 22, 2020), https://www.marketwatch.com/story/airbnb-files-for-initial-public-offering-11597870063 [https://perma.cc/FZZ9-4374].

253. *Airbnb Announces Confidential Submission of Draft Registration Statement*, AIRBNB (Aug. 19, 2020), https://news.airbnb.com/airbnb-announces-confidential-submission-of-draft-registration-statement [https://perma.cc/SW33-4TSZ].

254. *See* LATHAM & WATKINS, U.S. IPO GUIDE 6 (July 31, 2020), https://www.lw.com/thoughtLeadership/lw-us-ipo-guide [https://perma.cc/L2Q4-PCYK].

255. *See* Sumagaysay, *supra* note 252.

256. *See* Barbara Friedberg, *Why the Market is Booming and the Economy is Struggling*, U.S. NEWS (Sept. 15, 2020), https://money.usnews.com/investing/stock-market-news/articles/why-the-market-is-booming-and-the-economy-is-struggling [https://perma.cc/F92F-GGPC]. The article refers to the "Fed Model" which describes the interest rates and federal monetary policy set by the Federal Reserve. *Id.* The Fed is meant to control inflation and maintain stability during volatile times. *Id.* Many believe that it is this model that allows the market to remain stable even if the economy is suffering. *See id.* Of course, these same people still warn that the future remains unknown regardless of government help and a booming market. *See id.*

257. *See* Adam Uzialko, *U.S. SEC Expands the "IPO On-Ramp" Provision of the JOBS Act*, BUS. NEWS DAILY (July 11, 2017), https://www.businessnewsdaily.com/10074-sec-jobs-act-ipo-confidential-registration.html [https://perma.cc/95BW-32YX].

258. See Keith Noonan, *Why I didn't go All In On the Airbnb IPO*, THE MOTLEY FOOL (Dec 20, 2020), https://www.fool.com/investing/2020/12/20/why-i-didnt-go-all-in-on-the-airbnb-ipo [https://perma.cc/PB7U-H6L4]. Like this Note, the article is skeptical of overblown tech company valuation numbers. *See id.*

259. See Johnathan Ponciano, *Airbnb Stock Down 25% Since IPO, Three Billionaire Cofounders Lose $5 Billion In 3 Trading Days*, FORBES (Dec. 15, 2020),

it is surprising that Airbnb went through with an IPO after witnessing companies like Uber experience this same downfall.[260] Furthermore, it is even more surprising that Airbnb chose to go public as a company that makes money off of travel, especially since it was "net-harmed by Covid."[261] I am simply arguing that perhaps Airbnb could have avoided the price drop following the IPO if it had used a direct listing. If anything, Airbnb could have at least saved on underwriting fees. Why not play it safe in an unsafe and unstable world? Perhaps Airbnb's experience is another indicator to still-private unicorns that direct listings may be the better option.

Regardless of Airbnb's choice to toe the usual party line, I firmly believe that Spotify has left a legacy that other companies will utilize. After all, even if bigger unicorns do not ultimately decide to use the direct listing method, smaller unicorns may still find it appealing—a trend that seems to have already begun.[262] For example, after confidentially filing an S-1 statement with the SEC, Asana, a workplace productivity platform, announced its plan for a direct listing in February 2020.[263] More than half a year later, Asana officially listed shares on the NYSE in September 2020.[264] Asana was the brain child of Facebook's co-founder Dustin Moskovitz and his business partner, Justin Rosenstein.[265] Asana's successful direct listing resulted in a $5.5 billion

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https://www.forbes.com/sites/jonathanponciano/2020/12/15/airbnb-down-25-since-ipo-three-billionaire-cofounders-lose-5-billion-in-3-trading-days/?sh=238ef6ab2065 [https://perma.cc/3BGF-QXY5].

260. *See* Katsenelson, *supra* note 6 and accompanying text.

261. *See* Alex Wilhelm, *How the Pandemic Drove the IPO Wave We See Today*, TECHCRUNCH (Nov. 21, 2020), https://techcrunch.com/2020/11/21/how-the-pandemic-drove-the-ipo-wave-we-see-today [https://perma.cc/HF8H-89GM].

262. *See* Lucas Matney, *Asana Files to Go Public Via Direct Listing*, TECHCRUNCH (Feb. 3, 2020), https://techcrunch.com/2020/02/03/asana-files-to-go-public-says-it-will-do-so-via-a-trendy-direct-listing [https://perma.cc/ZSJ9-FWR3].

263. *See id.*

264. *See* John Swartz, *The Asana non-IPO: 5 Things to Know About Direct Listings of Facebook co-founder's Software Company*, MARKETWATCH (Sept. 30, 2020), https://www.marketwatch.com/story/5-things-you-need-to-know-about-asanas-direct-listing-2020-09-15 [https://perma.cc/2GCF-QFJY]; *see also Collaboration Software Unicorn Asana Selects September 30 for NYSE Direct Listing Date*, RENAISSANCE CAP. (Sept. 9, 2020), https://www.renaissancecapital.com/IPO-Center/News/70963/Collaboration-software-unicorn-Asana-selects-September-30-for-NYSE-direct [https://perma.cc/AZ77-93MA].

265. *See* Matney, *supra* note 262.

valuation,[266] a higher number than expected.[267] While Asana is technically a unicorn, it is a much smaller company than Spotify and Slack.[268] Nonetheless, I predict that even if older and larger unicorns like Airbnb and WeWork get cold feet, Asana will pave the way for a younger herd of unicorns looking for potential money-saving options.[269] One way or another, direct listings are here to stay.

B. IS IT REALLY A REVOLUTION?

All in all, unicorns are probably the only species that would be able to survive the direct listing process.[270] By using their brand name recognition, private-investor support, and capital, unicorns are able to forgo an IPO and opt for a direct listing.[271] The bigger question remains, however, whether unicorns themselves will survive, given growing concern over their valuation methods.[272]

As more and more unicorn IPOs fail to meet expectations, public markets will perhaps realize that at times, the "private valuations of billion-dollar start-ups have missed the mark."[273] As mentioned in Part I, unconstrained hypergrowth of these companies on private markets can lead to extreme overvaluations and disappointed investors.[274] Simply put, massive private valuations are not matching public markets, and the financial world is catching on.[275] This Note suggests that scrutiny of these companies will continue to grow as investors become even more wary of companies with extreme valuations.

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266. Bloomberg, *Asana Valued at $5.5 billion After Direct Listing Debut*, L.A. TIMES (Sept. 30, 2020), https://www.latimes.com/business/story/2020-09-30/asana-direct-listing [https://perma.cc/LL48-FRY6].

267. *See* Swartz, *supra* note 264. According to the article, Asana's market valuation was predicted to range from $3.7 billion to $4.3 billion after its direct listing. *Id.*

268. *Id.* Asana was valued at $1.5 billion as of 2018, during which it raised $50 million through Series E funding. *See The Complete List of Unicorn Companies*, *supra* note 12.

269. *See* Akhtar & Dawkins, *supra* note 85.

270. *See id.*

271. *See id.*

272. *See supra* Section I.C.

273. Steve Kovach, *This Year's Disappointing IPO Class Is Causing a "Reckoning" Among Private Investors*, CNBC (Sept. 30, 2019), https://www.cnbc.com/2019/09/30/new-ipos-face-reckoning-over-lofty-private-valuations.html [https://perma.cc/H977-N8DN].

274. *Id.*

275. *Id.*

I believe that the SEC is correctly attempting to promote the success of these unicorns through each subsequent rule approval, allowing for an easier direct listing path for future issuers. With increasingly flexible regulations, it seems probable that many unicorns will utilize the direct listing approach in an effort to bypass underwriter fees and decrease the probability of an unsuccessful IPO. As Spotify's CFO Barry McCarthy has stated, companies simply do not want to deal with the "shenanigans" of the traditional IPO.[276]

C. Recent Unprecedented Factors

However, these events preceded the global turmoil unleashed by COVID-19. Due to the pandemic, the attractiveness of direct listings seems to have diminished given the rising number of IPOs this year.[277] This makes sense considering that current market volatility and general uncertainty make the direct listing an uncertain proposition at best especially given its novelty. On the other hand, because some unicorns are still experiencing less than successful IPOs despite their continued prominence,[278] companies could be pushed to the direct listing alternative. After all, as this Note discusses,[279] direct listings offer lower costs and a way out with some hope of a financial return for existing shareholders. As the public health crisis continues through 2021, only time will tell if companies like WeWork will join the 2020 IPO boom[280] or enter the market through a direct listing.

Conclusion

This Note suggests that direct listings, like unicorns, may exit the mythical realm and become a very real presence in the financial world.

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276. *See* Mark Baker, *Direct Listings: The Future According to Goldman Sachs*, EUROMONEY (Oct. 16, 2019), https://www.euromoney.com/article/b1hm1tkx86xrzy/direct-listings-the-future-according-to-goldman-sachs [https://perma.cc/EF64-UHUR].

277. *See* Teare, *supra* note 14.

278. *See* Noonan, *supra* note 258.

279. *See supra* Part II.

280. *See* Ciara Linnane, *IPO Market is Headed for Busiest Third Quarter Since the Dot-com Years*, MARKETWATCH (Sept. 29, 2020, 1:17 PM), https://www.marketwatch.com/story/ipo-market-is-headed-for-busiest-third-quarter-since-the-dotcom-years-and-theres-lots-more-to-come-2020-09-28 [https://perma.cc/7XC7-RYQG].

This prediction seems especially strong in light of recent companies either shelving their IPO plans altogether[281] or experiencing falling share prices after a traditional IPO.[282] The SEC, the NYSE, and Nasdaq have all taken steps to allow for ease in using the direct listing method, which seemingly supports the theory that more companies may choose direct listings over IPOs. However, only time will tell if companies will indeed follow in Spotify and Slack's footsteps, or if high valuations coupled with the attractions and comforts of the traditional IPO will convince rising companies to stick with underwriters.

281. *See* Jasinki, *supra* note 243.
282. *See* Ponciano, *supra* note 259.