Articles + Publications | December 1, 2021

Divided Ninth Circ. Opens Floodgates for Direct Listing Investors to Assert Section 11 Claim

WRITTEN BY

Jay A. Dubow | Robert L. Hickok | Bianca DiBella

In a matter of first impression, a U.S. Court of Appeals for the Ninth Circuit panel in *Pirani v. Slack Technologies,* 13 F.4th 940 (9th Cir. 2021), wrestled with its own prior holding that a plaintiff bringing a claim under Section 11 of the Securities Act of 1933 must have purchased a security issued under a specific registration statement and its concern that, in a direct listing, it may be impossible for any plaintiff to ever know, or prove, that the shares he purchased were among the shares formally registered through the company's registration statement as opposed to other unregistered shares. In deciding that an investor purchasing through a direct listing could establish standing under Section 11, the Ninth Circuit departs from past precedent and abandons the previously strict tracing requirement courts have historically interpreted under Section 11.

Section 11 of the Securities Act of 1933

Section 11 establishes a private cause of action that exists only for persons "acquiring such security" sold through the registration statement which contains false or misleading information. To prevail on a Section 11 claim, a plaintiff must establish that a defendant is a signer of a registration statement or a director of the issuer or an underwriter for the offering, the plaintiff purchased the registered securities, and any part of the registration statement for the offering contained an untrue statement of a material fact or omitted a material fact necessary to make the statements not misleading. There is no requirement of scienter (intent), reliance, or causation. Accordingly, Section 11 broadly imposes strict liability on an issuer, its directors and officers for any material, untrue statement of fact, or omission in the registration statement.

But Section 11's requirement that only persons who "acquired such security" may bring a claim limits standing to those investors who purchased securities that were issued *under that registration statement*. For example, an investor who cannot determine whether the stock purchased was registered through the registration statement at issue or through an earlier (or later) registration of identical stock would not be able to maintain a Section 11 claim because that investor would be unable to trace his stock to the allegedly misleading registration statement.

The Ninth Circuit Expands Prior Precedent

In *Pirani v. Slack Technologies,* plaintiff Pirani purchased Slack common stock on the day of Slack's "direct listing," a new form of offering introduced by the New York Stock Exchange in 2018 and later approved by the

SEC. A direct listing allows a company to enter the public market without using underwriters or issuing any new shares—as in an IPO—but rather by permitting all existing shareholders to sell their unregistered shares directly in the public offering simultaneously with the company's own newly registered shares. In Slack's direct listing, it issued 118 million registered shares and 165 million existing unregistered shares, and purchasers on the open market did not know whether their specific shares acquired were previously registered or unregistered.

Departing from precedent, the Ninth Circuit's 2-1 panel found that even the plaintiff's unregistered shares sold in a direct listing were "such securities" within the meaning of Section 11 "because their public sale cannot occur without the only operative registration in existence." In other words, the sale of both the registered and unregistered shares must have emanated from the registration statement because it is the only way Slack could accomplish its direct listing. The majority opinion, authored by Judge Jane Restani, did not cite to any cases, noting that this was a "case of first impression." Instead, the panel relied on the perceived policy consequences of "interpreting Section 11 to apply only to registered shares in a direct listing context" which "would essentially eliminate Section 11 liability for misleading or false statements made in a registration stating in a direct listing for both registered and unregistered shares."

The dissent, authored by Judge Eric Miller, criticized this reasoning as neither "new" nor "particularly concerning" because other avenues—like Section 10(b) of the Securities Exchange Act—are available for issuers to be held accountable for misleading registration statements and because such policy concerns are better suited for Congress, not the Court, to decide. Judge Miller, citing a collection of federal cases, including from the Ninth Circuit, also could not ignore the well-established precedent that "such security" under Section 11 has historically been interpreted to mean the shares that were *actually registered* pursuant to the specific registration statement at issue.

But the *Slack* decision is not yet the Ninth Circuit's final word. On Nov. 3, Slack filed a petition for panel rehearing and petition for rehearing en banc. Shortly thereafter, on Nov. 15, the Cato Institute, former SEC Commissioner Joseph A. Grundfest, the Securities Industry and Financial Markets Association, the Chamber of Commerce of the United States of America, and the National Venture Capital Association filed amicus briefs. As of the date of publication, the court has not issued a decision on the petition for rehearing.

The Future of Section 11 Cases Based on Direct Listings

The Ninth Circuit's decision means that companies will be subject to Section 11 liability even if the company decides to go public through a direct listing. In other words, choosing to forego the classic IPO model, with a registration statement, does not also forego the risks associated with a potential Section 11 lawsuit. The *Slack* decision may signal courts'—at least in the Ninth Circuit—willingness to relax Section 11 tracing requirements, making it easier to bring a Section 11 claim in the secondary offering context. Though given the sharp contrast between the majority and dissent, this issue will likely be hotly debated amongst the various circuits and federal district courts, with the possibility of Supreme Court intervention should a circuit split arise. Certainly, given the company's petition for rehearing, and various amicus briefs filed in support, the Ninth Circuit may (or may not) issue a superseding opinion. And to further complicate matters, under the Supreme Court's decision in *Cyan v. Beaver County Employees Retirement Fund*, Section 11 claims can be brought in state court, which may also lead to conflicting state court decisions.

However, even if this decision stands, *Slack* presented only one registration statement, unlike other "direct listing" cases where multiple registration statements make traceability even more challenging. Perhaps in a multi-registration statement scenario, a federal court would be inclined to narrow the Ninth Circuit's holding in *Slack* because the need to trace shares to a particular registration statement would be even more difficult, indeed, near impossible. In any event, Miller's fierce dissent provides guidance for future defendants to challenge such claims regardless of whether one or multiple registration statements are present.

RELATED INDUSTRIES + PRACTICES

- Business Litigation
- Securities Investigations + Enforcement
- White Collar Litigation + Investigations