

Divided Ninth Circuit Finds Securities Act Standing for Purchasers in Slack’s Direct Listing

September 30, 2021

On September 20, 2021, a divided panel of the U.S. Court of Appeals for the Ninth Circuit affirmed a novel district court ruling that permitted investors to bring Section 11 claims based on purchases in a direct listing notwithstanding their inability to trace their purchases to the registration statement.¹

Before the district court’s decision in *Slack*, which found “good reason” for dispensing with Section 11’s tracing requirement in the context of direct listings, it had been assumed that such claims would be difficult to pursue because many shares in a direct listing may be sold without using a registration statement. The Ninth Circuit’s affirmance of that ruling on potentially broader grounds – departing from the well-established understanding of Section 11 by finding the tracing requirement satisfied for all shares purchased in a direct listing because those securities could not be sold “without the only operative registration in existence” – casts further doubt on that assumption.

If not reversed and followed by other courts, the decision may therefore make it easier for plaintiffs to bring Section 11 claims in connection with direct listings and potentially other types of offering structures.

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¹ *Pirani v. Slack Techs., Inc.*, No. 20-16419, 2021 WL 4258835 (9th Cir. Sept. 20, 2021). For a discussion of the prior district court decision, see Cleary Gottlieb’s April 30, 2020 [Alert Memorandum](#).



Background

Slack's Direct Listing. On June 20, 2019, Slack went public through a direct listing in which it filed a registration statement so that shares already held by insiders and certain early investors could begin to trade publicly.

The direct listing mechanism had been introduced in 2018 by the New York Stock Exchange ("NYSE") and later approved by the Securities and Exchange Commission ("SEC"). Unlike a traditional initial public offering ("IPO"), which generally offers new (so-called primary) shares to the public to raise capital, a direct listing (as originally formulated)² does not include new shares but rather permits only insiders and certain early investors to sell their outstanding shares to the public (a so-called secondary offering).

In connection with its direct listing, Slack filed a registration statement that applied to "up to 118,429,640" shares offered for resale to the public, and noted that 164,932,646 shares were available for resale and exempt from registration pursuant to SEC Rule 144.

Plaintiff's Allegations. Plaintiff Fiyyaz Pirani brought a class action against Slack and certain officers and directors on September 19, 2019, on behalf of himself and others who acquired Slack stock during the direct listing. The complaint raised claims under Sections 11, 12(a)(2), and 15 of the Securities Act of 1933, alleging that class members suffered losses to the value of their purchased shares as a result of misstatements or omissions in the registration statement, including statements regarding service outages, scalability and purported key benefits, growth strategy, and competition.

Defendants' Motion to Dismiss. Defendants moved to dismiss the action on the grounds that Plaintiff did not have statutory standing to sue under Sections 11 and 12(a)(2) because he could not trace his shares back to a registration statement, that Section 11 damages could not be established in the case of a direct listing because

it did not involve a public offering price, and that Plaintiff lacked standing under the privity requirement of Section 12. Defendants further argued that Plaintiff failed to plead that any statement was false or misleading.

District Court's Decision. On April 21, 2020, the district court for the Northern District of California granted in part and denied in part Defendants' motion to dismiss.

The district court held that Plaintiff had standing to sue under Section 11 based on his purchase of shares in a direct listing in which shares registered under the Securities Act became available on the first day simultaneously with shares exempted from registration.³ Under the text of Section 11, a claim for material misstatements or omissions in a registration statement for a security can only be brought by "any person acquiring such security."⁴ In the first case interpreting this language, Judge Henry Friendly, writing for the Second Circuit, weighed two possible readings of the phrase: a narrower reading, "acquiring a security issued pursuant to the registration statement"; and a broader reading, "acquiring a security of the same nature as that issued pursuant to the registration statement."⁵ The Second Circuit, and subsequent courts, adopted the narrower reading that plaintiffs must "trace their shares back to the relevant offering" in order to plead statutory standing under Section 11, meaning plaintiffs must either have "purchased shares in the offering made under the misleading registration statement," or purchased shares in the aftermarket "provided they can trace their shares back to the relevant offering."⁶ But Judge Friendly concluded in dicta that the broader reading, which would permit a person to bring a claim concerning a security "of the same nature as that issued pursuant to the registration statement," "would not be such a violent departure from the words that a court could not

² A subsequent NYSE rule now permits a direct listing to include primary shares although no direct listing to date has done so.

³ *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 380 (N.D. Cal. 2020).

⁴ 15 U.S.C. § 77k.

⁵ *Pirani*, 455 F. Supp. 3d at 377 (quoting *Barnes v. Osofsky*, 373 F.2d 269, 271 (2d Cir. 1967)).

⁶ *Id.* at 378.

properly adopt it if there would good reason for doing so.”⁷

The district court here found that the broader reading was warranted in the context of a direct listing where the securities purchased, even if unregistered, were “of the same nature” as those issued pursuant to the registration statement. In reaching this conclusion, the district court noted that Defendants’ cited case law imposing a tracing requirement involved successive stock offerings, not simultaneous offerings as in a direct listing, and it warned that imposing a narrow tracing requirement would “completely obviate the remedial penalties” of the Securities Act.⁸

Defendants sought an interlocutory appeal, which the district court granted based on its view that the standing issue was “one of first impression on which fair-minded jurists might disagree.”⁹

The Ninth Circuit’s Decision

In a decision issued on September 20, 2021, a divided panel of the Ninth Circuit affirmed the district court’s decision, albeit with different reasoning.

Majority Opinion. Writing for the majority, Judge Jane A. Restani, sitting by designation from the Court of International Trade, declined to adopt the district court’s broad interpretation of Section 11 that would dispense with the tracing requirement in the context of a direct listing. Instead, the majority held that unregistered shares sold in a direct listing qualify as “such securities” within the meaning of Section 11

because “their public sale cannot occur without the only operative registration in existence.”¹⁰

In reaching this conclusion, the majority relied on the statutory language of Section 11, which creates liability based on the registration statement “when such part became effective;”¹¹ the NYSE rule that requires a company to file a registration statement in order to engage in a direct listing and only permits companies to “list their common equity securities on the Exchange *at the time of effectiveness* of a registration statement filed solely for the purpose of allowing existing shareholders to sell their shares;”¹² and the SEC’s order adopting the NYSE rule, which interpreted the registration statement referenced in the NYSE rule to constitute an effective registration statement filed pursuant to the Securities Act.¹³ Viewing these provisions together, the majority found that Slack’s shares offered in its direct listing, whether unregistered or registered, were immediately sold to the public on the exchange “at the time of the effectiveness” of the registration statement and when “the registration statement became effective” because “the same registration statement makes it possible to sell both registered and unregistered shares to the public.”¹⁴ Therefore, it reasoned, “[a]ny person who acquired Slack shares through its direct listing could do so only because of the effectiveness of its registration statement” and, as a result, all shares sold in the direct listing, both those registered and those freely tradable under SEC Rule 144, qualified as “such securities.”¹⁵

The majority also referenced the legislative history of Section 11 to support its conclusion. It emphasized language from a House Conference Report that

⁷ *Id.* at 377 (quoting *Barnes*, 373 F.2d at 271).

⁸ *Pirani*, 455 F. Supp. 3d at 380-81 (quoting *E.E.O.C. v. Com. Office Prod. Co.*, 486 U.S. 107, 120 (1988)). The district court also held that Plaintiff had satisfied his burden of pleading damages under Section 11 because the challenge to the damages calculation was an affirmative defense. It further held that Plaintiff had adequately alleged an active solicitation theory to support statutory standing under Section 12(a)(2).

⁹ *Pirani v. Slack Techs., Inc.*, 2020 WL 7061035, at *2 (N.D. Cal. June 5, 2020).

¹⁰ *Pirani*, 2021 WL 4258835, at *5.

¹¹ *Id.* at *6 (quoting 15 U.S.C. § 77k).

¹² *Id.* at *5 (quoting NYSE, Section 102.01B, Footnote E) (emphasis added).

¹³ *Id.* (citing Order Approving a Proposed Rule Change To Modify the Provisions Relating to Direct Listings, Exchange Act Release No. 34-90768, 85 Fed. Reg. 85,807, 85,808 n.15 (Dec. 22, 2020)).

¹⁴ *Id.*

¹⁵ *Id.*

described Sections 11 and 12 as “entitl[ing] the buyer of securities sold *upon a registration statement* including an untrue statement or omission of material fact, to sue for recovery,” and noted that “it is the essence of fairness to insist upon the assumption of responsibility for the making of these statements” when the “connection between the statements made and the purchase of the security is clear[.]”¹⁶ The Ninth Circuit found that the connection between the purchase of the securities and the registration statement in the direct listing was clear because the registered and unregistered Slack shares sold in the direct listing were sold “upon a registrations statement” as they could only be sold to the public at the time of the effectiveness of the registration statement.

The majority rejected Slack’s argument that past cases in the Ninth Circuit and other circuit courts had limited the meaning of “such security” in Section 11 to only registered shares. It took the same approach as the district court in distinguishing those cases as involving successive offerings under different registration statements, rather than direct listings involving only a single registration statement.¹⁷

Finally, the majority stated that a contrary holding requiring strict tracing to bring Section 11 claims in the context of a direct listing would “create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception.”¹⁸ It reasoned that because a direct listing does not have a lock-up period in which a purchaser knows if they purchased a registered or unregistered share,¹⁹ “interpreting Section 11 to apply only to registered shares in a direct listing context would essentially

eliminate Section 11 liability for misleading or false statements made in a registration statement in a direct listing for both registered and unregistered share.”²⁰ It therefore expressed the concern that companies would forego the traditional IPO in favor of a direct listing in order to avoid the risk of Section 11, and that companies would be “incentivized to file overly optimistic registration statements accompanying their direct listings in order to increase their share price, knowing that they would face no shareholder liability under Section 11.”²¹

Dissenting Opinion. Judge Eric D. Miller dissented, finding that Plaintiff’s failure to prove his shares were issued under the registration statement is “outcome-determinative.”²² The dissent characterized the majority’s opinion as being driven by the concern that “it would be bad policy for a section 11 action to be unavailable when a company goes public through a direct listing.”²³

The dissent began by stating that the language of Section 11 was ambiguous as to what sort of security a plaintiff must purchase in order to demonstrate standing, but that Judge Friendly’s decision in *Barnes*, and every court of appeals to have considered the issue, has adopted the narrow interpretation of the language “such security” to mean “a security issued pursuant to the registration statement,” which he viewed as the “more natural” interpretation of the text.²⁴ This reading, the dissent explained, was consistent with the strict liability standard imposed by Sections 11 and 12, which is “strong medicine” and which these “statute[s] temper[] it by limiting the class of plaintiffs who can sue.”²⁵

¹⁶ *Id.* (quoting H.R. Rep. No. 73-85, at 9-10 (1933) (Conf. Rep.)).

¹⁷ *See id.* at *6 (citing *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104, 1106 (9th Cir. 2013) (successive offering); *Lee v. Ernst & Young, LLP*, 294 F.3d 969, 976 (8th Cir. 2002) (same); *Barnes*, 373 F.2d at 273 (same)).

¹⁸ *Id.*

¹⁹ Lock-up periods, in which holders of outstanding shares not included in the offering agree with the underwriters not to sell their shares during a specified period (generally 180 days) even if those shares are freely tradable under SEC Rule 144, are not part of a direct listing because there are no

underwriters.

²⁰ *Pirani*, 2021 WL 4258835, at *6.

²¹ *Id.* The Ninth Circuit also affirmed the district court’s holding that there was Section 12(a)(2) standing to the extent it paralleled Section 11 standing.

²² *Id.* at *8.

²³ *Id.* at *10.

²⁴ *Id.*

²⁵ *Id.* at *9.

The dissent further rejected the majority’s reading and reliance on the NYSE rule as having no basis in the statutory text. Section 11, the dissent explained, gave standing to those purchasing securities issued “pursuant to the registration statement,” and the majority had not suggested that the unregistered shares were issued under the registration statement.²⁶ The dissent similarly concluded that the House Conference Report’s phrase “securities sold upon a registration statement” could only refer to registered securities.

Finally, the dissent rejected the majority’s distinction between successive offerings and direct listings, explaining that the cases involving successive offerings interpreted the statutory text to impose the requirement that plaintiffs are required to trace their purchases to the registration statement and that the mechanism of a direct listing was not dissimilar.²⁷

Key Takeaways

The Ninth Circuit’s divided decision in *Slack* is significant because it affirms plaintiffs’ ability to bring Section 11 claims concerning direct listings, notwithstanding the prior decades-old understanding of Section 11’s tracing requirement under which it was assumed that such claims would not be viable. Thus, when deciding whether to pursue a direct listing, companies, as well as their officers and directors, should consider the risk that they may face future Section 11 securities fraud liability, regardless of whether the plaintiffs will be able to show that they purchased registered shares.

At the same time, the decision also raises the question whether issuers in other types of offering structures can also be subject to Section 11 liability, even if the relevant registration statement does not apply to all shares. For example, the tracing requirement could be eliminated from situations in which the underwriters permit shares to be released early from the lock-up period because those shares are freely tradable without registration and thus do not require successive registration statements.

Finally, the decision appears to rest on the incorrect premise that because a direct listing could not have occurred under the NYSE rule without a registration

statement, all shares sold in the direct listing—both those registered and those freely tradable under SEC Rule 144—had a “but for” relationship to the registration statement. But the fact that the registration statement requirement reflects an exchange listing policy should not have *any* bearing on the interpretation of Section 11 of the Securities Act, a statute that applies irrespective of exchange listing. Rather, for purposes of the Securities Act, shares held by non-affiliate holders free to sell under SEC Rule 144 would be freely tradable at the time of the direct listing without regard to any registration statement. Because of this fundamental misunderstanding, fueled by the policy-driven nature of the majority’s ruling, it is possible the decision could be reversed on review or rejected by other courts.

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²⁶ *Id.* at *10.

²⁷ For the same reason, the dissent concluded that Plaintiff lacked standing under Section 12(a)(2).