

Supreme Court Adopts Strict Section 11 Tracing Requirement in Slack’s Direct Listing

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On June 1, 2023, in a unanimous decision by Justice Gorsuch, the Supreme Court reversed a decision by the Ninth Circuit that allowed investors to bring claims under Section 11 of the Securities Act based on a direct listing, notwithstanding their inability to trace their purchases to the registration statement.¹

Before the Ninth Circuit’s ruling in *Slack*, circuit courts had uniformly interpreted Section 11 as imposing a strict “tracing” requirement, under which plaintiffs are required to show that they purchased shares registered under the registration statement containing the alleged misstatement. In *Slack*, however, the Ninth Circuit relaxed this rule given the difficulty determining whether securities purchased in a direct listing were registered or not, holding that it was enough for plaintiffs to show that the purchase could not occur without the issuance of the relevant registration statement.

In a succinct decision, the Supreme Court rejected the Ninth Circuit’s conclusion, holding that the “better” reading of Section 11 is that “the securities held by the plaintiff must be traceable to the particular registration statement alleged to be false or misleading.” The decision thus reaffirms that the tracing requirement will limit investors’ ability to bring Section 11 claims in the context of direct listings and other types of offerings. Interestingly, however, a footnote in the decision leaves open the question whether Section 12(a)(2) claims are similarly limited, given that section’s “distinct language.”

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¹ For a discussion of the prior Ninth Circuit decision, see Cleary Gottlieb’s September 30, 2021 [Alert Memorandum](#).



Background

Slack’s Direct Listing. In 2019, the instant messaging company Slack went public through a direct listing on the New York Stock Exchange, in which 118 million registered shares and 165 million unregistered shares were offered for resale by their holders.² A direct listing, through which a company’s shares are sold “publicly on [an] exchange without an IPO,” affords “shareholders (whether investors, employees, or others) the convenience of being able to sell their existing shares on a public exchange.”³

In contrast, in a traditional IPO, a company typically “goes public [by] issu[ing] new shares pursuant to a registration statement” in order to “rais[e] capital.”⁴ Although in an IPO “early investors and employees [in a company] may own preexisting shares,” underwriters typically “require insiders to consent to a ‘lockup agreement’—a commitment to hold their unregistered shares for a period of time before selling them on the new public market”—allowing investors during the lockup period to know that they purchased newly issued shares.⁵

Plaintiff’s Allegations. On June 20, 2019, the day of Slack’s direct listing, Plaintiff Fiyaz Pirani bought 30,000 shares.⁶ Pirani subsequently brought a class action suit against Slack in the Northern District of California on behalf of investors who acquired Slack stock during its direct listing. The complaint asserted claims under Sections 11, 12(a)(2) and 15 of the Securities Act, alleging that the registration statement contained a variety of misstatements regarding service outages, scalability, growth strategy, and competition.

Defendants’ Motion to Dismiss and the District Court’s Decision. Defendants moved to dismiss the action for failure to state a claim. Among other things, Defendants argued that Plaintiff did not have statutory standing to sue in light of the then well-established authority (beginning with a seminal Second Circuit decision by Judge Henry Friendly, a former Cleary partner) requiring plaintiffs to trace their shares back to the allegedly misleading registration statement. This authority interpreted the text of Section 11—which provides that a claim for misstatements in a registration statement for a security can only be brought by a “person acquiring such security”—as limiting standing to those “acquiring a security issued pursuant to the registration statement.”⁷

On April 21, 2020, the district court denied in part Defendants’ motion to dismiss. In relevant part, the district court held that Pirani had standing to sue under Section 11 notwithstanding his inability to trace his purchases to shares registered under the registration statement.⁸ While the district court acknowledged that other courts had uniformly held that the text of Section 11 imposes a strict tracing requirement, it found “good reason” to adopt a broader reading 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.⁹ In reaching this conclusion, the district court warned that imposing a narrow tracing requirement would “completely obviate the remedial penalties” of the Securities Act in the context of direct listings.¹⁰

² *Slack Techs., LLC v. Pirani*, No. 22-200, 2023 WL 3742580, at *3-4 (U.S. June 1, 2023).

³ *Id.*

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at *4; *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 374 (N.D. Cal. 2020).

⁷ *Barnes v. Osofsky*, 373 F.2d 269, 271 (2d Cir. 1967).

⁸ *Pirani*, 445 F. Supp. 3d at 380.

⁹ *Pirani*, 445 F. Supp. 3d at 377 (quoting *Barnes*, 373 F.2d at 271). In adopting this test, the district court cited Judge Friendly’s decision in *Barnes*, where he adopted a strict tracing requirement but acknowledged that a broader reading of the statute allowing a plaintiff to bring a claim if its securities were “of the same nature” as those issued under a registration statement “would not be such a violent departure from the words that a court could not properly adopt if there were good reason for doing so.”

¹⁰ *Pirani*, 445 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 adequately alleged statutory standing under Section 12(a)(2).

Defendants sought an interlocutory appeal, which was granted.¹¹

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. The majority 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. Rather, it 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” and therefore “all of Slack’s shares sold in this direct listing, whether labeled as registered or unregistered, can be traced to that one registration.”¹²

The majority also stated that a contrary holding requiring strict tracing in the context of a direct listing would “create a loophole large enough to undermine the purpose of Section 11[.]”¹³ It reasoned that because a direct listing does not have a lock-up period, which would enable a purchaser to know if they purchased a registered share, “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 shares.”¹⁴

Finally, the Ninth Circuit also affirmed the district court’s holding that there was Section 12(a)(2) standing, stating that provision’s standing requirements largely paralleled Section 11 standing.

Judge Eric D. Miller wrote a dissenting opinion, which 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.”¹⁵ He stated that every court of appeals to have considered the issue had 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.¹⁶

The Supreme Court’s Decision

On June 1, 2023, in an opinion authored by Justice Gorsuch, a unanimous Supreme Court reversed the Ninth Circuit, holding Section 11 “requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement.”¹⁷

Interpreting the text of Section 11(a), the Court first asked, “Does the term ‘such security’ refer to a security issued pursuant to the allegedly misleading registration statement? Or can the term also sometimes encompass a security that was not issued pursuant to the allegedly misleading registration statement?”¹⁸ Observing that the statute did not make reference to what “‘such security’ means[.]” the Court looked to “contextual clues.”¹⁹

The Court noted that Section 11(a) “imposes liability for false statements or misleading omissions in ‘the registration statement[.]’” highlighting the statute’s use of “the definite article to reference the particular registration statement alleged to be misleading[.]”²⁰ Therefore, the Court reasoned, the text “suggest[s] the plaintiff must ‘acquire such security’ under that document’s terms.”²¹

The Court also held that Section 11 “repeatedly uses the word ‘such’ to narrow the law’s focus” to the registration statement.²² This was also true in “[o]ther provisions in the 1933 Act.”²³ For example, another

¹¹ *Pirani v. SlackTechs., Inc.*, 2020 WL 7061035, at *2 (N.D. Cal. June 5, 2020).

¹² *Pirani v. SlackTechs., Inc.*, 13 F.4th 940, 947 (9th Cir. 2021).

¹³ *Id.*

¹⁴ *Pirani*, 13 F.4th at 948.

¹⁵ *Id.* at 953.

¹⁶ *Id.* at 952.

¹⁷ *SlackTechs., LLC*, 2023 WL 3742580 at *6.

¹⁸ *Id.* at *4.

¹⁹ *Id.* at *5.

²⁰ *Id.*

²¹ *Id.* (alterations omitted).

²² *Id.*

²³ *Id.*

“clue[]” was found in Section 11(e), which “ties the maximum available recovery to the value of the registered shares alone.”²⁴ The Court concluded that it would “make[] little sense” for Section 11(a) to “extend[] beyond . . . presumably available damages.”²⁵

Based on this analysis, the Court adopted Judge Friendly’s “narrower reading” of Section 11 to require a plaintiff to trace its shares to the registration statement, noting that “every court of appeals to consider the issue has reached the same conclusion[,]” and that “[u]ntil this decision, even the Ninth Circuit seemed to take the same view.”²⁶

The Court also found unconvincing Pirani’s policy argument that a “broader reading” of the statutory language would “better accomplish the purpose of the 1933 Act” by “expand[ing] liability for falsehoods and misleading omissions.”²⁷ Acknowledging that “Congress could have been clearer[,]” the Court stated that it does not “presume that any result consistent with one party’s account of the statute’s overarching goal must be the law,” and further cautioned that this reading of the statute’s overall aim was not “obvious.”²⁸ Rather, the Court pointed to the Securities Act’s strict liability for misstatements or omissions in the registration statement in comparison to the Exchange Act’s scienter requirement for ongoing disclosures, and observed it was “equally possible that Congress sought a balanced liability regime that allows a narrow class of claims to proceed on lesser proof but requires a higher standard of proof to sustain a broader set of claims.”²⁹

Finally, while the Court explicitly declined to reach the merits of the parties’ related dispute over the proper interpretation of statutory standing under Section 12(a)(2), it vacated the Ninth Circuit’s judgment as to that claim, remanding it for reconsideration. In doing so, the Court stated in a footnote that it “express[ed] no views about the proper interpretation of [Section] 12[,]” but it made clear that it did not “endorse the

Ninth Circuit’s apparent belief” that Section 11 and Section 12 “necessarily travel together.” Instead, it “caution[ed] that the two provisions contain distinct language that warrants careful consideration.”³⁰

Key Takeaways

The Supreme Court’s unanimous decision in *Slack* reaffirms the prior decades-old understanding of Section 11’s tracing requirement, which will impose a significant barrier to plaintiffs pursuing Section 11 claims concerning direct listings. Under this ruling, plaintiffs must plead plausible facts in their complaint showing that they purchased registered shares prior to receiving the benefit of discovery.

The Supreme Court’s ruling will also have implications for investors seeking to bring Section 11 claims for other types of offerings where strict tracing is difficult. For example, plaintiffs may face difficulties tracing their shares to a particular registration statement in the context of other offerings not made through underwriters, such as at-the-market offerings.

At the same time, the decision leaves open the possibility of approaching statutory standing under Section 12(a)(2) differently. That said, the language of that provision contains specific reference to the “security” sold “by means of” the allegedly misleading prospectus, likely creating an even clearer tracing requirement than Section 11.³¹

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²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at *6.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at n.3.

³¹ 15 U.S.C. § 77L.