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Supreme Court Grants Review to Decide Who May Sue under Sections 11 and 12(a)(2) of the Securities Act

On December 13, 2022, the Supreme Court of the United States granted certiorari in *Slack Technologies, LLC v. Pirani*. The case presents the question whether Sections 11 and 12(a)(2) of the Securities Act of 1933 require plaintiffs to plead and prove that they bought shares registered under the registration statement they claim is misleading. A divided panel of the Ninth Circuit held that plaintiffs in a case arising out of a direct listing do not need to do so. Slack has argued that the Ninth Circuit's decision created a split with seven other courts of appeals. The Supreme Court is likely to hear argument in the spring and issue a decision by July.

Background

Federal securities law generally requires securities to be registered. There are several exemptions, including one for shares held by non-affiliates of a company for at least a year. Both registered and unregistered shares may not be sold on an exchange until the company has filed a registration statement under the Securities Act.

In 2018, the SEC approved direct listings of shares. A direct listing is different from a traditional initial public offering ("IPO") in several respects. In an IPO, a company files a registration statement to issue new shares. In a direct listing, the company files a registration statement to permit shareholders to sell their shares. Unlike in an IPO, where unregistered shares are "locked up" and cannot be sold on the exchange for a period of time, both registered and unregistered shares are immediately tradeable in a direct listing. Accordingly, it would be difficult for a shareholder to know whether a share purchased after a direct listing was registered or unregistered.

Defendant Slack Technologies, LLC, went public on the New York Stock Exchange ("NYSE") in 2019 through a direct listing. Slack filed a Form S-1 registration statement on April 26, 2019, which it amended three times in May of that year. On June 20, 2019, Slack filed a prospectus and began to sell Slack Class A common stock to the public. At the time of the direct listing, there were approximately 118 million registered shares and approximately 165 million unregistered shares.

Plaintiff Fiyaz Pirani purchased Slack shares on the NYSE on the day of the direct listing. He later sued Slack and other defendants under Sections 11 and 12(a)(2) of the Securities Act. Under Section 11, if "any part of the registration statement" is materially false or misleading, "any person acquiring such security" may generally sue certain individuals involved with the registration statement. Under Section 12(a)(2), if "a prospectus or oral communication" is materially false or misleading, a "person purchasing such security" may generally sue the person who offered or sold the security. Pirani did not allege that he purchased registered shares. He instead alleged only that he "purchased or otherwise acquired Slack common stock pursuant and/or traceable to the Offering Materials issued in connection with the Company's Offering."

Existing Case Law

For at least half a century, plaintiffs suing under Section 11 have been required to allege and prove that they purchased shares that were issued pursuant to the allegedly false or misleading registration statement. The leading decision is *Barnes v. Osofsky*, 373 F.3d 269 (2d Cir. 1967), in which Judge Friendly explained that only purchasers of newly registered shares could bring an action under Section 11. Other courts of appeals have similarly required plaintiffs to “trace” their shares to the allegedly false or misleading registration statement. All of those appellate decisions, however, arose in the context of successive registration statements, not direct listings.

Proceedings Below

Slack moved to dismiss on the ground that Pirani did not plead that the shares he purchased were registered under the allegedly misleading registration statement, as opposed to unregistered shares that entered the market around the same time. The district court denied the motion to dismiss in pertinent part, and a divided panel of the Ninth Circuit affirmed on September 20, 2021.

The majority held that, in the context of a direct listing, plaintiffs are not required to plead that they purchased shares registered under the allegedly false or misleading registration statement. The majority linked the unregistered shares to the registration statement because “the same registration statement makes it possible to sell both registered and unregistered shares to the public” under NYSE rules. The panel also expressed concern that Slack’s interpretation “would create a loophole large enough to undermine the purpose of Section 11” by “essentially eliminat[ing] Section 11 liability for misleading or false statements made in a registration statement in a direct listing for both registered and unregistered shares.” Accordingly, the panel declined to follow the decisions of other circuits, which require a plaintiff to allege that he purchased shares that were registered under the registration statement, because those cases involved successive registration statements, not direct listings.

Judge Eric Miller dissented. He explained that the words “such security” in the text of Section 11 referred to securities registered under the registration statement at issue, regardless of the context. He also observed that the panel’s decision split with “every court of appeals to consider the issue.”

Supreme Court Proceedings

Slack petitioned for certiorari. It argued that every other court of appeals to decide the question has held that plaintiffs must allege and prove that they bought shares registered under the allegedly misleading registration statement. The Supreme Court granted certiorari on December 13, 2022, to decide “[w]hether Sections 11 and 12(a)(2) of the Securities Act of 1933 require plaintiffs to plead and prove that they bought shares registered under the registration statement they claim is misleading.” Briefing is expected to conclude in March, and the case is likely to be argued in the spring. A decision is expected by July.

Implications

The Supreme Court’s decision will likely settle the question of whether purchasers of unregistered shares can pursue Section 11 and 12(a)(2) claims against companies that go public through a direct listing. The Court’s decision may also have broader implications for market participants and companies considering going public or issuing new publicly traded shares. A decision that Section 11 and 12(a)(2) plaintiffs must plead and prove that their shares are traceable to a specific registration statement could make it difficult for shareholders to pursue Securities Act claims against companies that go public through a direct listing. It could similarly make it difficult for shareholders to pursue claims arising out of secondary offerings, because shareholders may have difficulty pleading and proving that their shares are traceable to a new (misleading) registration statement and are not pre-existing shares from a prior offering. Such a ruling could incentivize direct listings and secondary offerings by reducing associated litigation exposure. Conversely, depending on the scope of the decision, an affirmance could lower the pleading standard for Securities Act claims and disincentivize direct listings or secondary offerings.

We will continue to monitor the case and provide further updates as it progresses through Supreme Court review.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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