

June 5, 2023

Supreme Court Limits Who May Sue Under Section 11 of the Securities Act

On June 1, 2023, the Supreme Court unanimously held in *Slack Technologies v. Pirani* that Section 11 of the Securities Act of 1933 requires plaintiffs to plead and prove that they bought shares registered under the registration statement they claim is materially misleading. The Supreme Court remanded the case to the Ninth Circuit to decide whether the plaintiff stated a claim under Section 11, as well as to interpret Section 12(a)(2) of the Securities Act in the first instance. The decision represents a significant limitation on the ability of purchasers of unregistered shares to pursue Section 11 claims against companies that go public through a direct listing, as well as in other contexts where registered and unregistered shares have become commingled. The decision nevertheless leaves open several important questions, including the level of factual detail necessary to plead traceability and the scope of liability under Section 12(a)(2).

Background

Federal securities law generally requires securities to be registered. There are several exemptions, including one for shares held by nonaffiliates 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.

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.

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.”

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.” 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 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 Decision

In a unanimous decision written by Justice Gorsuch, the Court vacated the judgment of the Ninth Circuit and remanded for further proceedings. The Court held that Section 11 requires plaintiffs to plead and prove that they bought shares registered under the registration statement they claim is materially misleading. The Court explained that, in context, the word “such” refers to a security registered under “the particular registration statement alleged to be misleading.” The Court relied on other uses of “such” in Section 11 and elsewhere in the Securities Act. The Court also found it significant that Section 11(e) “ties the maximum available recovery to the value of the registered shares alone” by capping damages against an underwriter at the “total price at which the securities underwritten by him and distributed to the public were offered to the public.” The Court further observed that Judge Friendly reached the same conclusion in *Barnes* and that every other court of appeals to address the question had agreed. Finally, the Court rejected Pirani’s policy arguments, noting that the Securities Act is “limited in scope.”

The Court did not address the meaning of Section 12. Because the Ninth Circuit viewed its interpretation of Section 12 as “‘follow[ing] from’ its analysis of [Pirani’s] §11 claim,” the Supreme Court remanded for the Ninth Circuit to decide that question “in the light of [the] holding today about the meaning of §11.” The Court “express[ed] no views about the proper interpretation of §12 or its application to this case.” The Court also declined to “endorse the Ninth Circuit’s apparent belief that §11 and §12 necessarily travel together, but instead caution[ed] that the two provisions contain distinct language that warrants careful consideration.”

Implications

The Supreme Court’s decision significantly limits the ability of purchasers of unregistered shares to pursue Section 11 claims against companies that go public through a direct listing. In so doing, the Court’s decision may incentivize direct listings by reducing associated litigation exposure.

The decision is also likely to have implications beyond direct listings. The same difficulties in pleading and proving traceability likely apply to shareholders who purchase shares after a lockup period expires or after there have been multiple offerings pursuant to multiple registration statements.

At the same time, the limited decision leaves open several important questions. One such question is how a plaintiff may plead and prove traceability, and in particular what amount of factual support is necessary to survive a motion to dismiss. Another unresolved question is the scope of Section 12 liability. Both issues are likely to be contested on remand in the Ninth Circuit and in other cases.

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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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