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Ninth Circuit's *Slack* Decision Forges New Ground For Securities Act Liability Related To Direct Listings

The decision appears to create a new rule for determining standing to bring Securities Act claims in the context of direct listings.

The *Slack* Direct Listing Decision

On September 20, 2021, the US Court of Appeals for the Ninth Circuit issued its highly anticipated decision in the *Pirani v. Slack* litigation concerning stockholders' ability to bring claims under the Securities Act of 1933 related to direct listings, the innovative "going public" alternative to the traditional IPO spearheaded by Latham & Watkins in recent years. In a published 2-1 opinion on this issue of first impression, the panel held over sharp dissent that even "unregistered shares sold in a direct listing" are actionable under Sections 11 and 12 of the Securities Act "because their public sale cannot occur without the only operative registration in existence." (Op. at 13.[1])

Slack Background

The question presented to the Ninth Circuit on interlocutory appeal was whether the named plaintiff (Fiyyaz Pirani) had standing to sue under Section 11 and Section 12(a)(2) of the Securities Act of 1933[2] relating to Slack Technologies, Inc.'s June 2019 direct listing. (Op. at 5.) In the direct listing as described by the Ninth Circuit, Slack's outstanding shares — both those registered pursuant to the Company's registration statement, and those unregistered in accordance with Rule 144 — were listed on the New York Stock Exchange (NYSE). (Op. at 6-7.) The direct listing was not underwritten, meaning that existing shareholders, such as employees and early-stage investors, were not subject to "lock ups" and could immediately sell their shares on the exchange. (*See id.*) Accordingly, on June 20, 2019, Slack went public on the NYSE through a direct listing, releasing 118 million registered shares and 165 million unregistered shares into the public market for purchase. (*Id.*) Pirani purchased 30,000 Slack shares on June 20, 2019, and another 220,000 shares over the ensuing months. (Op. at 7.) On September 19, 2019, Pirani brought a class action lawsuit against Slack, as well as its officers, directors, and venture capital fund investors, on behalf of himself and all other persons and entities who acquired Slack stock pursuant and/or traceable to Slack's registration statement and prospectus issued in connection with the direct listing. (Op. at 8.)

Slack moved the trial court to dismiss Pirani's complaint on grounds that he could not "trace" his shares to Slack's allegedly misleading registration statement, and therefore lacked statutory standing to sue under Section 11 and Section 12(a)(2) of the Securities Act. (Op. at 8.[3]) In essence, because both registered

and unregistered shares of Slack stock had been made available for purchase on the exchange beginning on June 20, 2019, and due to the way that stocks are traded today (*i.e.*, stockholders have a pro-rata interest in the "fungible bulk" of all the securities held by DTC that share the same CUSIP), Pirani was unable to allege facts establishing that he had purchased registered shares. Slack argued that this was fatal to Pirani's claim under the long line of cases to have considered such "tracing" requirements because he could not show that he had purchased "such securit[ies]" that were issued pursuant to the challenged registration statement.[4]

Concerned that adoption of Slack's argument would "obviate" the Securities Act's remedial penalties in the context of direct listings, on April 21, 2020, the district court denied Slack's motion to dismiss and adopted a broad interpretation of "such security" that had initially been contemplated but ultimately rejected by the Second Circuit in the seminal tracing case of *Barnes v. Osofsky*.[5] Specifically, the district court interpreted "such security" to mean all securities "of the same nature as that issued pursuant to the registration statement." *Pirani v. Slack Technologies, Inc., et al.*[6] As applied to direct listings, this interpretation meant that any holder of "a security of the same nature as that issued pursuant to the registration statement" has standing to sue under Section 11. *Id*. The district court also applied its "such security" holding to Pirani's Section 12(a)(2) claim, finding that Pirani had alleged sufficient facts to state a claim for "solicitation" liability against certain of Slack's directors and officers who had prepared and signed the offering materials, participated in Investor Day activities, and had personally sold shares, noting that it was a factual question best left for a jury. *Id.* at 383-85. On June 5, 2020, the district court certified its decision for interlocutory review; on July 23, 2021, the Ninth Circuit granted Slack's petition under 28 U.S.C. § 1292(b).

On September 21, 2021, the Ninth Circuit published its 2-1 decision affirming the district court's denial of Slack's motion to dismiss. The court discussed standing under Section 11 first, acknowledging at the outset that the Ninth Circuit had long defined "such security" to mean, "a security issued under a specific registration statement, not some later or earlier statement." (Op. at 11 (citations omitted).) However, the court attempted to distinguish these decisions because they arose in the context of "successive registrations, whereby a company issues a secondary offering to the public such that there are multiple registration statements under which a share may be registered, and other tracing challenges stemming from an IPO." (Op. at 12.[7]) Thus, characterizing the issue as one of first impression, the Ninth Circuit rejected both Slack's and the district court's interpretation of "such security" and conducted its own analysis of the statute's text and history as applied to direct listings. (Op. at 13-17.)

As to the relevant statutory text, the Ninth Circuit held that even "unregistered shares sold in a direct listing are 'such securities' within the meaning of Section 11 because their public sale cannot occur without the only operative registration in existence." (Op. at 13-14.) The Ninth Circuit did not explain how this interpretation is derived from the statutory text itself; instead, the Ninth Circuit pointed to certain characteristics of Slack's direct listing — most notably, that in the "direct listing, the same registration statement makes it possible to sell both registered and unregistered shares to the public." (Op. at 13.[8]) Significantly, in reaching this conclusion, the Ninth Circuit departed from earlier Ninth Circuit and other circuit court precedent limiting "such security" under Section 11 to mean "that the person must have purchased a security *issued under that, rather than some other, registration statement*."[9] At least for a direct listing, the court held, securities fall within the reach of Section 11 so long as they are *purchased* after the effectiveness date of a registration statement. (*See* Op. at 17.)

Notably, the Ninth Circuit rejected, in a footnote, an argument from Slack that its direct listing had actually involved two registration statements: a Form S-1 (the traditional registration statement) and a Form S-8 (registering sales of shares to employees through their compensation package). The court noted that

"[b]oth forms went into effect on the same day," that the "S-8 explicitly incorporates the S-1 by reference, meaning that any allegedly misleading statements in the S-1 are necessarily present in the S-8, and that these two forms are part of the same registration package." (Op. at 14 n.5.) In so doing, the court again acknowledged that where shares are issued under more than one "registration package" it presents "the same exact traceability conundrum as in past cases[.]" (*Id.*)

As to legislative intent, the Ninth Circuit echoed the district court's concern that adopting Slack's argument "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. . . . [and] would create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception." (Op. at 15-16.) In addition, the court pointed to Section 11's legislative history in support of its interpretation, citing the House Conference Report indicating that "the buyer of securities sold *upon a registration statement* including an untrue statement or omissions of materials fact" could sue, particularly because the "connection" between Pirani's purchase of the security and the registration statement was "clear." (*Id.*)

In a sharp dissent, Circuit Judge Miller wrote that he would have adopted Slack's argument, even it meant that no plaintiff could have standing to sue under the Securities Act relating to Slack's direct listing.[10] Judge Miller emphasized how the strict liability contemplated by the Securities Act is "strong medicine" which is "temper[ed]" by who can sue under it — particularly through the tracing requirement that has been developed and applied by various circuit courts over the previous five decades. (Op. at 22-23.) Judge Miller therefore would have applied that long line of precedent and dismissed Pirani's claim for lack of statutory standing, no matter that it was in the context of the novel direct listing instead of the traditional IPO. Judge Miller took issue with the majority's reliance on the rules of the NYSE as opposed to an analysis of the statutory text, and further stated that the same legislative history cited by the majority did not support their view. (Op. at 24-25.) Judge Miller noted the majority's policy concerns about the potential evasion of liability under Section 11, but stated they offered "no basis for changing the settled interpretation of the statutory text" because it should be left to Congress to update the laws to address unwanted consequences stemming from technological changes, and also because issuers involved in direct listings could still be held liable under the Exchange Act. (*See* Op. at 26.)

Conclusion

In a September 27, 2021 filing with the Ninth Circuit, Slack indicated its intent to petition the court for rehearing or rehearing en banc. Slack's petition is due on November 3, 2021. If the petition is denied, Slack could petition for writ of certiorari to the United States Supreme Court.

In the meantime, the panel's decision will be binding upon district courts in the Ninth Circuit in cases involving direct listings that are materially similar to Slack's direct listing. As the specifics of any given listing may be distinguishable from Slack's listing, practitioners should be attuned to ways in which the panel's decision can be distinguished. Indeed, the tracing "conundrum" is still alive and well, since the Ninth Circuit's decision goes out of its way to leave intact the plethora of case law fastidiously applying the tracing requirement to cases involving successive, or multiple, registration statements.

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Endnotes

[1] *Pirani v. Slack Technologies, Inc., et al.*, No. 20-16419, D.E. 54-1 (9th Cir. Sept. 20, 2021) (Restani, J.) ("Op.").

[2] 15 U.S.C. §§ 77k(a), 77*l*(a)(2)

[3] Section 11 states in relevant part: "In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring **such security** . . . may . . . sue . . . ." 15 U.S.C. § 77k (emphasis added). Meanwhile, Section 12(a)(2) provides that any person who "offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . shall be liable . . . to the person purchasing **such security** from him." 15 U.S.C. § 77*l*(a)(2) (emphasis added).

[4] *See, e.g.*, *Barnes v. Osofsky*, 373 F.3d 269 (2d Cir. 1967); *In re Century Aluminum Co. Sec. Litig.*, 729 F.3d 1104 (2013); *Krim v. PcOrder.com, Inc.*, 402 F.3d 489 (2005).

[5] 373 F.3d 269 (2d Cir. 1967)

[6] 445 F. Supp. 3d 367, 380-381 (N.D. Cal. Apr. 20, 2021)

[7] Citing *In re Century Aluminum Co. Securities Litigation*, 729 F.3d 1104, 1106 (9th Cir. 2013); *Lee v. Ernst & Young, LLP*, 294 F.3d 969, 972 (8th Cir. 2002); *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 491, 496–97 (5th Cir. 2005).

[8] In support of this proposition, the Ninth Circuit cited the following: *NYSE Listed Company Manual – Section 102.01B Footnote E*, NEW YORK STOCK EXCHANGE (Aug. 26, 2020), https://nyseguide.srorules.com/listed-company-manual; Order Granting Accelerated Approval of NYSE Proposed Rule Change Relating to Listing of Companies, Exchange Act Release No. 34-82627, 83 Fed. Reg. 5650, 5651 (Feb. 2, 2018); 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).

[9] *See, e.g.*, *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 (9th Cir. 1999).

[10] Latham & Watkins submitted an amicus brief on behalf of SIFMA and the U.S. Chamber that advocated for the same.