



## Securities Litigation ADVISORY ■

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### Supreme Court to Decide Whether the 1933 Act's Strict Liability Provisions Apply to Direct Listings

by [Susan Hurd](#)

On December 13, 2022, the U.S. Supreme Court agreed to hear an appeal from the Ninth Circuit Court of Appeals regarding whether claims exist under Sections 11 and 12(a)(2) of the Securities Act of 1933 for shares issued under the rule allowing companies to make shares available to the public through what is known as a "direct listing."<sup>1</sup> Direct listings allow a company to "go public" without going through a traditional initial public offering (IPO) process. Unlike an IPO, which involves the issuance of new shares, in a direct listing, existing shares held by employees or other investors are made available for purchase by the public. In a direct listing, a registration statement is filed with the SEC, but both registered and unregistered shares may be available for purchase by the public on the first day of trading.

#### ***Decision on appeal***

The Ninth Circuit agreed to review the lower court's decision to deny in part the defendants' motion to dismiss based on the contention that the plaintiff lacked standing to pursue 1933 Act claims.<sup>2</sup> The defendants argued that the plaintiff could not bring such claims because he was unable to prove the shares he bought were registered under the allegedly misleading registration statement that he challenged. The Ninth Circuit affirmed the lower court's conclusion that Sections 11 and 12(a)(2) could apply when an investor purchased shares via a direct listing, even though that investor may not be able to determine whether the investor bought registered shares.<sup>3</sup>

The two statutes on which the plaintiff sought to rely provide (1) a cause of action for false or misleading statements made in a registration statement that can be brought by "any person acquiring such security"

<sup>1</sup> *Slack Technologies, LLC (f/k/a Slack Technologies, Inc.), et al., v. Pirani*, No. 22-200 (December 13, 2022).

<sup>2</sup> *Pirani v. Slack Technologies, Inc.*, 13 F.4th 940, 943 (9th Cir. 2021).

<sup>3</sup> *Id.*

(Section 11)<sup>4</sup> and (2) a cause of action against any person who offers or sells a security by means of a false or misleading prospectus (which is a part of the registration statement) that can be brought by “the person purchasing such security” (Section 12(a)(2)).<sup>5</sup> The Ninth Circuit determined that a plaintiff’s standing to bring these claims should turn on whether the shares purchased qualify as “such security” as that phrase is used in these two provisions.

The court of appeals based its decision that a plaintiff need not prove receipt of registered shares in the direct listing context on the notion that the shares at issue “could not have been purchased without the issuance of [the company’s] registration statement, thus demarking these shares, whether registered or unregistered, as ‘such security’ under Sections 11 and 12[.]”<sup>6</sup> Accordingly, “[a]ny person who acquired … shares through [the] direct listing could do so only because of the effectiveness of [the] registration statement” the company was required to file.<sup>7</sup> The court explained that “tracing” problems posed no obstacle here because there was only one registration statement that had been filed and, thus, all of the “shares sold in this direct listing, whether labeled as registered or unregistered, can be traced to that one registration.”<sup>8</sup>

The Ninth Circuit rejected the defendants’ argument that Section 11 had previously been interpreted (for example, in cases involving successive registration statements) as requiring the plaintiff to prove the purchase of registered shares pursuant to the particular registration being challenged.<sup>9</sup> The court of appeals refused to extend this reasoning to direct listings because, in its view, this would create a “loophole” that “would essentially eliminate [any] Section 11 liability” for both registered or unregistered shares in direct listings.<sup>10</sup>

The Ninth Circuit’s analysis of potential Section 12 liability was consistent with the analysis it applied to Section 11. The court reasoned that a share bought in a direct listing, whether registered or unregistered, qualified as “such security” under Section 12 because “the prospectus was part of the offering materials (i.e., the registration statement and prospectus) that permitted the shares to be sold to the public.”<sup>11</sup> Thus, the plaintiff had standing under Section 12(a)(2) because all of the company’s shares “in this direct listing were sold ‘by means of a prospectus.’”<sup>12</sup>

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<sup>4</sup> 15 U.S.C. § 77(k)(a)(1)-(2).

<sup>5</sup> 15 U.S.C. § 77l(a)(2).

<sup>6</sup> *Pirani*, 13 F.4th at 943.

<sup>7</sup> *Id.* at 947.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.* at 948.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 949.

<sup>12</sup> *Id.*

### ***Analysis of the issues before the Supreme Court***

The federal securities laws at issue in the appeal are viewed as “strict liability” provisions, which counsels in favor of allowing a more limited class of individuals/entities to bring such claims. The plaintiff is, in effect, asking the Supreme Court to sanction an expansion of potential liability under these provisions, which would seem to be a “hard sell” for the Court as currently configured.

The plaintiff also faces challenges on appeal in defending the logic embraced by the lower courts as to why direct listings should be treated differently from successive registrations. This is particularly true when one considers the fact that prior decisions on successive registrations all turned on the same language in Section 11 analyzed by the Ninth Circuit, which had been consistently interpreted over the years to require shares to have been issued under the particular registration statement being challenged.

Also, while Section 12 has the phrase “such security” in common with Section 11, the text of Section 12 also expressly requires the security to be offered or sold “by means of a prospectus[,]” which would seem to limit such claims to registered securities. In other words, by referencing materials that relate to an offering of registered securities, the text of Section 12 would seem to suggest that the ability to bring such a claim is limited to registered shares. As the dissenting opinion before the Ninth Circuit observed, “[e]ven if the filing of the registration statement determines *when* an unregistered security can be offered to the public in a direct listing, the registration statement does not apply to the unregistered security and therefore is not the means through which it is offered or sold.”<sup>13</sup>

We will continue to report on further developments regarding this appeal.

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<sup>13</sup> *Id.* at 954 (Miller, J., dissenting).

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