



Securities Litigation ADVISORY ■

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Supreme Court Securities Law Roundup – The *Axon* Decision and Oral Argument in *Slack v. Pirani*

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Earlier this month, on April 14, 2023, the Supreme Court issued its decision in *Axon Enterprise, Inc. v. FTC, et al.* and the companion case, *SEC, et al. v. Cochran*, which authorized parties to bring constitutional challenges to the Federal Trade Commission's (FTC) and the Securities and Exchange Commission's (SEC) ability to pursue claims in their "home courts" before administrative law judges (ALJs).¹ A few days later on April 17, 2023, the Court heard oral argument in *Slack Technologies, LLC (f/k/a Slack Technologies, Inc.), et al., v. Pirani*, which will determine whether private plaintiffs who buy shares in so-called "direct listings" can bring claims under Sections 11 and 12(a)(2) of the Securities Act of 1933. Below, we outline the Court's ruling in the *Axon* and *Cochran* cases and assess the potential impact it could have. We also describe what we learned from the oral argument in *Slack* and what clues the argument provided for how the Court might ultimately rule in that case.

***Axon/Cochran* Decision**

The Supreme Court reached a unanimous decision in the *Axon* and *Cochran* appeals, holding that targets of enforcement actions brought by the FTC and SEC can file suit in federal district court challenging the constitutionality of the agency proceedings against them when the government has chosen to bring claims in an administrative proceeding before an ALJ. The government had taken the contrary position – namely, that any constitutional challenge to the use of the ALJs must first be made within the administrative proceeding itself. The government reasoned that only after the proceeding had run its course and resulted in an adverse determination against the person or entity at issue would those constitutional challenges be ripe to be heard by the court of appeals (as opposed to a district court).

The oral argument in the *Axon* and *Cochran* cases held on November 7, 2022 foreshadowed the Court's ultimate decision. One got a sense from the colloquy with the Court that the Court was not opposed to the notion of allowing parties to go straight to district court with so-called "structural" constitutional challenges.

¹ *Axon Enter., Inc. v. FTC*, 215 L. Ed. 2d 151, 2023 U.S. LEXIS 1500 (U.S. Apr. 14, 2023).

At oral argument, the Justices seemed primarily concerned about not opening the flood gates to all sorts of peripheral challenges that could be labeled as being “constitutional.” The Court’s ultimate ruling continues to reflect that concern. The opinion uses carefully crafted language to signal that only certain types of constitutional challenges will rise to the level of being “structural” and, as a result, be capable of being raised immediately in federal court.

For example, the opinion in *Axon* and *Cochran* describes the constitutional challenges that may be brought in federal court as being “fundamental, even existential” and in essence rising to the level of arguing that the agency as “currently structured [is] unconstitutional in much of their work.”² The opinion similarly refers to the type of constitutional challenge that may be heard by the district courts as “extraordinary,” “sweeping,” and “far-reaching.”³ In other words, under the Court’s decision, a party’s constitutional objection must rise to the level of saying in effect “the entire proceeding [is] unlawful” and causes a legal injury that is “independent” of whatever substantive ruling the ALJ might make against the defendant as to the particular claims at issue.⁴

The Court’s willingness to entertain immediate constitutional challenges was grounded in the fact that no later court can really “undo” the harm of being exposed to an unconstitutional proceeding if that proceeding has been allowed to take place. If the constitutional claim is so fundamental – the whole proceeding is illegitimate and is being led by an illegitimate decisionmaker – it is too late for the court of appeals to remedy that grievance because, by the time that challenge is heard, the proceeding has already happened and it cannot be undone.⁵ So, for these “structural” constitutional claims, the existing process of waiting until the end of the administrative proceedings to get access to the federal court system comes “too late to be meaningful.”⁶

It is important to note that the Court’s decision in *Axon* and *Cochran* did not decide whether the particular constitutional attacks made against the two agencies had merit. The decision only held that a district court had jurisdiction to hear those claims. The decision is nevertheless important because what the litigants wanted to do in those cases (and what they are now authorized to do) is to ask the district court to halt the administrative proceedings against them. In other words, they no longer have to endure the entire process and potentially wait years for their day in court. They can get their day in court on their own initiative and much earlier than would otherwise have been the case.

The impact of this decision to the SEC is harder to assess given that in recent years the SEC has largely avoided the use of ALJs in contested enforcement actions. Any ruling, however, that perpetuates the need for the SEC to act directly (as opposed to having the option of delegating to ALJs) could create a backlog and further delay the resolution of those administrative proceedings that still occur.

² *Id.* 159, 2023 U.S. LEXIS 1500, at *9.

³ *Id.* at 159, 162, 165, 2023 U.S. LEXIS 1500, at *10, *16-17, *24.

⁴ *Id.* at 160, 2023 U.S. LEXIS 1500, at *12.

⁵ *Id.* at 166, 2023 U.S. LEXIS 1400, at *27.

⁶ *Id.*

The question of whether litigants will be able to prevail on the particular constitutional challenges that Axon Enterprise and Cochran now have the right to assert could be decided in another appeal currently before the Supreme Court. The SEC has filed a petition for a writ of certiorari asking the Supreme Court to review a decision from the Fifth Circuit in which the court of appeals held that the SEC's use of ALJs was unconstitutional because, among other reasons, the ALJs are insufficiently accountable to the President, in violation of separation-of-powers principles.⁷ We are closely watching this appeal and will report on further developments should the Supreme Court grant certiorari.

***Slack v. Pirani* Oral Argument**

On April 17, 2023, the Supreme Court heard oral argument in the *Slack* case, which was the subject of a [prior advisory](#).⁸ This case is an appeal from the Ninth Circuit Court of Appeals, which deals with the question of whether claims may exist under Sections 11 and 12(a)(2) of the Securities Act of 1933 for shares made available for public sale in what is known as a "direct listing." Direct listings allow a company to "go public" without going through a traditional initial public offering (IPO) process. Unlike an IPO, new shares are not issued in a direct listing, but rather existing shares held by employees or early investors are made available for purchase by the public. In a direct listing, the filing of a registration statement is required, but both registered shares and unregistered shares (i.e., shares exempt from the registration requirement) may be made available for purchase by the public on the first day of trading.

Section 11 allows claims to be brought for false or misleading statements in a registration statement by "any person acquiring such security," and Section 12(a)(2) provides a cause of action against any person who offers or sells a security "by means of a [false or misleading] prospectus" that is part of the registration statement.⁹ The issue on appeal in *Slack* is whether the plaintiff must be able to plead and prove that he purchased shares registered under the registration statement that he challenges in order to bring these claims. Here, the plaintiff essentially conceded that he could not tell whether the shares he purchased in the Slack direct listing were registered or unregistered. The defendants have asked the Supreme Court to overrule the Ninth Circuit's decision that the plaintiff had standing to bring these 1933 Act claims, despite the fact that he cannot prove that he purchased any registered shares.

Oral argument for the *Slack* appeal provided several clues to how the Justices might ultimately rule on whether "tracing" of shares to the particular registration statement being challenged will be required for direct listings. Questions from the Court suggested that the Justices were not particularly interested in revisiting the existing body of case law that requires tracing for Section 11 claims, which arose in the context of traditional IPOs or when a company had multiple public offerings. Under that long-established authority, Section 11 claims can only be brought if the plaintiffs can show they purchased shares that were registered under the specific registration statement being challenged. The text of Section 11 has been interpreted uniformly by numerous circuits across the country over the years to require tracing, and the SEC has concurred in this majority view.

⁷ *SEC v. Jarkesy et al.*, No. 22-859 (petition for cert. filed Mar. 8, 2023).

⁸ No. 22-200 (petition for cert. granted by 143 S. Ct. 542 (U.S. Dec. 13, 2022)).

⁹ 15 U.S.C. § 77k(a)(1)-(2); 15 U.S.C. § 77l(a)(2).

The discussion at oral argument primarily focused on Section 12 and the fact that there is less case law addressing Section 12 claims. Certain Justices asked questions that indicated they perhaps felt ill-equipped to rule on Section 12 because of the lack of authority, or that they were weighing whether Sections 11 and 12 should necessarily be interpreted in the same manner because of the textual differences between the statutes. Several Justices also inquired why the Solicitor General did not file a brief to express the SEC's views on the scope of liability under Section 12, which underscored the frustration some Justices voiced about being asked to interpret the text of Section 12 in a vacuum.

The discussion at oral argument also signaled the possibility of the Court "splitting the baby" and deciding against the plaintiff on his Section 11 claims by holding that tracing is required, but not reaching the question of whether tracing is similarly required for Section 12. The Court could vacate and remand the Ninth Circuit's decision on Section 12 for further proceedings below, finding that it was error for the Ninth Circuit to assume without further analysis that Section 12 liability must be "consistent" with liability under Section 11. The Supreme Court could instruct that a separate analysis of Section 12 is required before coming to rest on the question of the scope of liability. This could include an assessment of whether the textual differences in Section 12 might lead to a different outcome.¹⁰ We will continue to monitor developments with this appeal and report on the Court's ultimate decision when issued.

¹⁰ *Pirani v. Slack Techs., Inc.*, 13 F.4th 940, 949 (9th Cir. 2021).

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