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Ninth Circuit panel allows Slack securities claims to advance

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On September 20, a divided Ninth Circuit panel broke with nearly 50 years of precedent in holding that investors could challenge the accuracy of Slack's registration statement even if they may have purchased unregistered shares, solely because Slack had conducted a direct listing. The decision runs counter to decades of rulings on the question of which investors have standing to challenge a registration statement under the Securities Act of 1933.

On September 20, 2021, in *Pirani v. Slack Techs., Inc.*, No. 20-16419, a divided panel of the United States Court of Appeals for the Ninth Circuit affirmed the district court's denial of a motion to dismiss the securities case on standing grounds.

The panel ruled that the plaintiff had standing under Sections 11 and 12(a)(2) of the Securities Act of 1933 to challenge the accuracy of Slack's registration statement, even though the plaintiff could not allege that the shares he purchased were registered shares under that registration statement. The case is one of first impression, addressing whether in the unique circumstances of Slack's going public through a direct listing process, share purchasers—who did not know whether they purchased registered or unregistered shares—can assert claims under Sections 11 and 12 of the Securities Act. The controversial decision might well garner further appellate attention from the full Ninth Circuit or the Supreme Court. Its novel statutory construction underpinnings are inconsistent with decades of rulings from district and appellate courts throughout the country regarding the standing requirements of the Securities Act.

On June 20, 2019, Slack went public through a direct listing. A certain number of shares were registered under the registration statement Slack issued in connection with the direct listing process. Those registered shares became available for public sale at the same time as a number of *unregistered* shares, shares that were obtained and held by insiders pursuant to an exemption from registration. There was no lock-up period in connection with the direct listing, meaning that both registered and unregistered shares were sold to the public simultaneously. As a consequence, the purchasers in the secondary market, like the plaintiff, had no way to establish whether they purchased registered or unregistered shares.

The plaintiff purchased 250,000 Slack shares over several months. After multiple Slack service disruptions, Slack's share prices declined by more than one third from the direct listing price. On September 19, 2019, the plaintiff brought a putative class action lawsuit against Slack, its officers, directors, and certain venture capital investors in the company. The plaintiff alleged that Slack's registration statement was misleading because it did not alert purchasers to contractual risks that the company faced in the event of service disruptions, or to the risk posed by competition with Microsoft Teams.

Slack challenged whether the plaintiff had standing to sue because he could not sufficiently allege that his shares were registered under the allegedly misleading registration statement.

Section 11 of the Securities Act provides that "[i]n 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 mis-leading, **any person acquiring such security** … may" sue those

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responsible for the alleged misstatement. 15 U.S.C. § 77k(a) (emphasis added).

Section 12 of the Securities Act provides that "[a]ny person who … offers or sells a security … **by means of a prospectus** or oral communication, which includes an untrue statement of material fact or omits to state a material fact necessary in order to make the statements , … shall be liable … **to the person purchasing such security from him**, who may sue either at law or in equity in any court of competent jurisdiction … ." 15 U.S.C. § 77l(a)(2) (emphasis added).

The question presented as to both sections of the Act was whether someone who could *not* demonstrate that purchased shares were issued pursuant to the registration statement in question could still state a claim.

The panel, in a decision written by Judge Jane Restani from the Court of International Trade (sitting by designation) and joined by Chief Judge Sidney Thomas, affirmed the district court's holding that the plaintiff had standing, albeit for different reasons from those set forth by the district court. The district court had concluded that "such security" in the context of Slack's direct listing referred to "securities of the same nature," even though the district court acknowledged that over fifty years of decisions in other contexts had established that "such security" referred to securities registered under a specific registration statement. The majority of the panel ostensibly rejected the district court's view that the phrase "such security" could be given a different meaning in the context of a direct listing like Slack's and other contexts such as traditional IPOs or secondary offerings. Nevertheless, the majority held that unregistered Slack shares sold in the direct listing were "such securities" within the meaning of Section 11 because their public sale depended on the existence of an operative registration statement. Per the applicable New York Stock Exchange rule, a company *must* file a registration statement in order to engage in a direct listing. Therefore, the majority reasoned that because any person who acquired Slack shares through the direct listing could have done so only because there was an effective registration statement on file, "such security" was broad enough to encompass both registered and unregistered shares sold through Slack's direct listing process.

The panel noted, in a portion of the opinion that the dissent characterized as improper judicial policy-making, that interpreting Section 11 to apply only to registered shares offered in a direct listing context would all but eliminate Section 11 liability for misleading or false statements made in connection with a direct listing like Slack's. The panel characterized this as a loophole that would undermine the purpose of Section 11.

The panel also held that the plaintiff had standing to sue under Section 12. Consistent with its analysis of Section 11 liability, the panel found that the shares at issue in Slack's direct listing were all sold "by means of a prospectus" because the prospectus was part of the offering materials that permitted any shares to be sold to the public.

In dissent, Circuit Judge Eric Miller rejected the majority's reasoning, explaining that the plaintiff's inability to allege whether the shares were issued under the registration statement is outcome-determinative. As Judge Miller noted, every court of appeals that has considered the issue—albeit not in the direct listing context, like Slack's—has held that the phrase "such security" is limited to shares issued pursuant to the allegedly false or misleading registration agreement. As such, Judge Miller concluded that because the plaintiff could not show that he purchased shares issued under the registration statement, he lacked statutory standing, whether under Section 11 or Section 12.

While the panel's new construction of the term "such security" purports to reconcile and endorse the results in decades of decisions regarding the standing/tracing requirement under Sections 11 and 12 in other contexts, such as secondary offerings, it is plainly at odds with the meaning given that term in these long-standing precedents. As the dissent points out, there is no textual basis for the panel majority's construction of Section 11 and Section 12. To the extent the panel majority's decision is not overturned or gains traction in other circuits, direct listings that are structured like Slack's, without a lock-up and where registered and unregistered shares become simultaneously available for sale in the secondary market, will, like traditional IPOs, be subject to Section 11 and Section 12 class action litigation, rather than merely scienter-based class action litigation brought pursuant to Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

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