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Supreme Court confirms the scope of Section 11's tracing requirement

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In *Slack Technologies, LLC v. Pirani*, the Supreme Court confirmed that under Section 11 of the Securities Act of 1933 plaintiffs must "trace" their shares – that is, plead and prove that they were registered under the allegedly false or misleading registration statement at issue. The Court decisively resolved any uncertainty about whether unregistered shares could satisfy this requirement through some other connection to the registration statement, particularly in the context of direct listings.

On June 1, 2023, a unanimous Supreme Court held that plaintiffs suing under Section 11 of the Securities Act of 1933 (the Securities Act) must "trace" their shares to the specific registration statement that they allege was false or misleading, even when they acquired those shares in a direct listing.[1] The decision, *Slack Technologies, LLC v. Pirani*, settles a recent circuit split on tracing that developed from the Ninth Circuit's ruling in the case below. The *Slack* decision restores certainty to participants in the securities markets that Section 11 liability is limited to the shares sold under a given registration statement. Although the Supreme Court, in a footnote, reserved on the question of whether Section 12 of the Securities Act could be interpreted to extend more broadly, existing precedent provides a strong basis to limit potential liability under Section 12 in this and other ways.

Section 11's tracing requirement

Section 11 provides one of the two principal private causes of action under the Securities Act. It permits investors who acquired "such security" in a registered public offering to sue the issuer and certain other persons if "any part of the registration statement" contains a false or misleading statement or omission of material fact.[2] Prior to the *Slack* case, federal Courts of Appeals had uniformly held since the 1960s that this language requires plaintiffs to "trace" their shares—that is, to plead and prove that the shares they bought were registered under the registration statement over which they are suing.[3]

Direct listings

Direct listings are a relatively new mechanism for securities issuers to list their stock on an exchange for trading without going through an initial public offering (IPO).[4] In a traditional IPO, the issuer sells stock to underwriters, who then distribute it to the public at an offering price they set in consultation with the issuer, with the underwriters taking the risk of loss in the event that they cannot sell the offered stock at that price.[5] The underwriters typically require company employees and other early investors, who may hold pre-IPO, unregistered shares in the company, to enter into "lock-up agreements" that commit them not to sell these shares for a certain period following the offering.[6] In a direct listing, the issuer bypasses the underwriters and directly lists stock (either newly issued or pre-existing shares) on an exchange for trading at a price set by auction.[7] There are no underwriters and often no lock-up agreements in direct listings, and company employees and early investors can, subject to compliance with Securities and Exchange Commission rules, sell their unregistered shares alongside the registered shares offered in the direct listing.[8]

The *Slack* case

The *Slack* case arose from a 2019 direct listing on the New York Stock Exchange (NYSE) by Slack, "a technology company that offers a cloud-based collaboration and productivity platform."[9] The plaintiff, Fiyyaz Pirani, allegedly acquired shares in the offering and later sued the company and other defendants under the Securities Act, asserting that the registration statement contained misrepresentations and omissions.[10] Slack moved to dismiss, arguing that the plaintiff could not satisfy Section 11's tracing requirement. As relevant here, Slack argued that because it did not use underwriters for the sale of the shares and had no lock-up agreements, the plaintiff could not allege that the shares on which he was suing were registered pursuant to the challenged registration statement, as opposed to unregistered shares that were sold at the same time.[11] The district court, in a ruling of first impression, held that Section 11 does not require tracing in the context of direct listings, but certified its ruling so that Slack could immediately appeal.[12] Over a dissent, the Ninth Circuit affirmed, but on different reasoning. It concluded that Section 11 *does* impose a tracing requirement applicable to direct listings, but that this requirement can be satisfied even for unregistered shares, if they trade publicly *because of* a registration statement. The majority reasoned that because NYSE rules permit direct listings only if an effective registration statement is in place, any unregistered shares that were purchased on the NYSE still qualified as "such securit[ies]" within the scope of Section 11.[13]

The Supreme Court limits Section 11 liability to shares that are registered under the challenged registration statement

The Supreme Court granted certiorari to resolve the circuit split created by the Ninth Circuit,[14] and in a unanimous decision authored by Justice Gorsuch, vacated the Ninth Circuit's ruling. The Court began by acknowledging that the statutory term "such security" is unclear because there is no referent in Section 11 for the word "such."[15] But, the Court nevertheless determined that the language and structure of the Securities Act confirm the long-standing view that Section 11 covers only securities that are registered under the particular registration statement on which the plaintiff has sued. The Court explained that Section 11 itself uses the phrase "*the* registration statement" and ties damages to the value of the registered shares offered to the public, features that would be difficult to reconcile with an interpretation of Section 11 that allowed a plaintiff to sue on unregistered shares.[16] More broadly, the Court reasoned that the Securities Act generally "uses the word 'such' to narrow the law's focus," and that other provisions of the Act closely tie the scope of the registration requirement to the specific securities that are being sold and that are mentioned in the registration statement.[17] By contrast, the Court found that Mr. Pirani's alternative reading of the statute—that "such security" under Section 11 includes "other securities that bear some sort of minimal relationship to a defective registration statement"—was difficult to square with the statutory text and would yield uncertainties and indeterminate results.[18] The Court specifically rejected Mr. Pirani's policy argument that his interpretation, with its broader scope of liability, would better accomplish the Securities Act's remedial purpose, finding that it was equally possible that Congress had intended to keep the class of claims covered by Section 11 narrow, given the relatively few elements required for such claims.[19]

Taking this context together, the Court held that the "better reading" of Section 11 "requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement."[20] The Court vacated the Ninth Circuit's judgment and remanded for the Court of Appeals to determine, in the first instance, whether Mr. Pirani's complaint satisfies Section 11's tracing requirement as properly construed.[21]

Although Mr. Pirani had also asserted a claim under Section 12 of the Securities Act—the other principal private cause of action in that statute—the Supreme Court did not address the requirements of that claim. In a footnote, the Court explained that it did not need to reach the merits of the dispute over Section 12 because the parties and the Ninth Circuit had all agreed that the result under Section 12 followed from the analysis of the Section 11 claim.[22] The Court noted, however, that it did not "endorse the Ninth Circuit's apparent belief that §11 and §12 necessarily travel together," and "caution[ed]" that a difference in the language in the two provisions "warrants careful consideration."[23] The Court remanded the Section 12 issue for the court of appeals to consider in the first instance.

Key takeaways

For issuers, underwriters, auditors and other repeat participants in the securities markets, the Supreme Court's *Slack* decision represents a welcome return to uniformity. Although there had been little doubt about the scope of Section 11's tracing requirement prior to the Ninth Circuit's ruling in *Slack*, that decision raised the specter that courts might extend

Section 11 liability to unregistered shares, even in cases outside the context of direct listings, provided that those shares bore some difficult-to-define connection to an allegedly false or misleading registration statement. The Supreme Court's decision rules out that possibility. It further confirms that the parameters of Section 11's tracing requirement are not affected by the particular mechanism that an issuer uses to list its stock for trading. The Court's determination provides an additional measure of certainty regarding the scope of potential Section 11 liability, which will enable issuers—particularly those contemplating direct listings or other novel forms of securities offerings—to more accurately assess the attendant risks. While the Court's open-ended comment regarding the relationship between Section 11 and Section 12 will require further consideration on remand, existing Supreme Court and circuit court precedents provide defendants with strong grounds for limiting the scope of Section 12 claims[24]

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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1 *Slack Techs., LLC v. Pirani*, No. 22-200, 598 U.S. ___ (June 1, 2023).

2 15 U.S.C. § 77k(a).

3 *Slack Techs.*, No. 22-200, slip op. at 7 & n.2 (citing *Barnes v. Osofsky*, 373 F.2d 269, 272, 273 (2d Cir. 1967) and collecting cases).

4 *Id. at 3.*

5 *Id.* at 2.

6 *Id.* 2-3.

7 *See id.* at 3, 4.

8 *Id.*

9 *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367, 372 (N.D. Cal. 2020).

10 *Id.* at 372, 373-74.

[11] *Id.* at 378-79.

[12] *Id.* at 381; *see also Pirani v. Slack Techs., Inc.*, 13 F.4th 940, 945 (9th Cir. 2021).

[13] *Pirani*, 13 F.4th at 947-48, 949.

[14] *Slack Techs.*, No. 22-200, slip op. at 5.

[15] *Id.* at 6.

[16] *Id.* at 6-7.

[17] *Id.*

[18] *Id.* at 8.

[19] *Id.* at 9.

[20] *Id.*

[21] *Id.* at 9-10.

[22] *Id.* at 10 n.3.

[23] *Id.*

[24] *See, e.g., Gustafson v. Alloyd Co.*, 531 U.S. 561 (1995); *Pinter v. Dahl*, 486 U.S. 622 (1988).