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# U.S. Supreme Court Adopts Narrow Reading of Liability Under the Securities Act of 1933

## Court Unanimously Holds That Only Shareholders Who Purchased Shares Directly Traceable To A Registration Statement Containing Alleged Misrepresentations May Pursue Section 11 Claims

### SUMMARY

On June 1, 2023, the U.S. Supreme Court held in *Slack Technologies, LLC, et al.* v. *Pirani*[1] that Section 11 of the Securities Act of 1933 (the "1933 Act"), which imposes strict liability on issuers for materially false or misleading registration statements, only applies to securities issued pursuant to the registration statement in question. In doing so, the Court rejected a decision by the U.S. Court of Appeals for the Ninth Circuit that Section 11 liability may also extend to other shares, and joined the majority of lower federal courts, including every Court of Appeals to consider the issue before the Ninth Circuit's opinion.

### BACKGROUND

Plaintiff Fiyyaz Pirani bought 30,000 shares of Slack Technologies, a technology company that offers an instant-messaging platform, on the day Slack conducted a direct listing on the New York Stock Exchange in 2019. He then purchased 220,000 additional Slack shares over the next few months. As part of its direct listing—a new process for listing shares that was approved by the SEC in 2018—Slack filed a registration statement indicating the specific number of registered shares it intended to offer to the public for purchase. Unlike an IPO, the direct listing did not use an underwriter or a lockup agreement, *i.e.*, an agreement prohibiting company insiders from selling their unregistered shares within a certain period of time after the direct listing. This meant that both registered and unregistered shares could be sold on the day of the direct

listing. More than half of the shares offered for purchase on the day of Slack's direct listing were unregistered.

When Slack's stock price later dropped, Pirani filed a class-action lawsuit in the U.S. District Court for the Northern District of California, alleging that Slack had violated Sections 11 and 12 of the 1933 Act by filing a materially misleading registration statement. Pirani did not allege that the shares he purchased were registered shares issued pursuant to the allegedly misleading registration statement.

Slack filed a motion to dismiss Pirani's complaint for failure to state a claim, arguing that Pirani could not pursue a Section 11 claim because he did not plead that the shares he purchased were issued pursuant to the allegedly misleading registration statement. The text of Section 11 states that, when a registration statement contains a material misstatement or omission, any individual who has acquired "such security" may bring suit.[2] For decades, lower federal courts had interpreted this to mean that liability only attaches when a buyer can trace the shares he purchased to the allegedly defective registration statement.[3]

The district court adopted a broader definition of "such security" due to the unique circumstance of a direct listing, in which both registered shares and shares exempted from registration simultaneously became available on the first day of trading, and denied Slack's motion.[4] A divided Ninth Circuit panel affirmed on interlocutory appeal, reasoning that Section 11's "tracing" requirement can be satisfied when unregistered shares are traded publicly because of a registration statement.[5]

## THE SUPREME COURT'S DECISION

The Supreme Court unanimously reversed the Ninth Circuit's decision, and held that the 1933 Act requires Pirani to plead and prove that he purchased securities registered under the allegedly misleading registration statement. Although the Court agreed that there was no "clear referent" defining what "such security" in the 1933 Act means, the Court determined based on various contextual indications that "such security" refers to a security issued pursuant to the allegedly misleading registration statement.[6] Therefore, liability "runs with the registered shares alone."[7] The Court stated that this was the "better reading" of the particular provision and rejected Pirani's characterization of the purpose of the 1933 Act.[8]

In contrast to the 1933 Act, which was the only provision under which Pirani chose to sue, the Court observed that liability under Section 10(b) of the Securities Exchange Act of 1934 applies to "the purchase or sale of 'any security,' whether registered or not." At the same time, that provision requires a plaintiff to prove various elements not required by Section 11, such as scienter on the part of the speaker of the alleged misstatement.[9]

## IMPLICATIONS

The Supreme Court's decision confirms that companies that choose to go public via direct listings of both registered and unregistered shares have stronger defenses against Section 11 liability than do companies

who go public via traditional IPOs. In order to plead standing, plaintiffs who purchased shares of a company that went public via a direct listing must engage in the extremely difficult (if not impossible) task of "tracing" their shares to those issued pursuant to the registration statement, even if those shares were purchased on the first day of an offering. Such a tracing analysis is unnecessary in the early days of an IPO when only registered shares are sold and unregistered shares are subject to a lockup period. As a result, plaintiffs face greater hurdles in pursuing Section 11 claims against direct listings, while companies may continue to use the flexibility of direct listings to afford their shareholders the convenience of selling their existing unregistered shares on a public exchange. Section 10(b) liability, however, still remains a possibility for registration statements issued as part of a direct listing. In addition, the Supreme Court declined to interpret Section 12 of the 1933 Act, "caution[ing] that the two provisions contain distinct language that warrants careful consideration."[10]

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## ENDNOTES

1 598 U.S. __, 2023 WL 3742580 (June 1, 2023).

2 15 U.S.C. § 77k(a).

3 In its opinion, the Court cited to Court of Appeals cases that adopted this narrow interpretation of Section 11. *See In re Ariad Pharms., Inc. Secs. Litig.*, 842 F.3d 744, 755-56 (1st Cir. 2016); *Rosenzweig* v. *Azurix Corp.*, 332 F.3d 854, 873 (5th Cir. 2003); *Lee* v. *Ernst & Young, LLP*, 294 F.3d 969, 976-77 (8th Cir. 2002); *Joseph* v. *Wiles*, 223 F.3d 1155, 1159 (10th Cir. 2000); *APA Excelsior III L.P.* v. *Premiere Techs., Inc.*, 476 F.3d 1261, 1271 (11th Cir. 2007).

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

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

6 *Slack Techs., LLC*, 2023 WL 3742580, at *5.

7 *Id.* at *6.

8 *Id.* The Court cited to its previous decision, *Herman & MacLean* v. *Huddleston*, 459 U.S. 375, 382 (1983), to emphasize that the 1933 Act is "limited in scope."

9 *Id.*

10 *Id.* at *6 n.3.

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