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Client Alert
Commentary

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Supreme Court *Slack* Decision Confirms Narrow Interpretation of Section 11 Claims

The unanimous opinion requires shareholder plaintiffs to plead and prove that they purchased shares traceable to an allegedly false or misleading registration statement.

On June 1, 2023, the US Supreme Court issued its much-anticipated decision in *Slack Technologies LLC v. Pirani*.[1] The key issue in the case was the extent to which shareholders who purchase shares from a direct listing — an innovative alternative to traditional underwritten public offerings — can pursue claims under Section 11 of the Securities Act of 1933. (Latham & Watkins has been involved in the majority of direct listings to date, including representing Spotify in the first direct listing.)

In a unanimous opinion authored by Justice Neil Gorsuch, the Court held that Section 11 of the Securities Act "requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement." In other words, Section 11 plaintiffs must be able to prove they purchased registered shares in an offering, rather than unregistered shares.

The Court declined to reach the question whether claims under Section 12 of the Act are similarly limited.

Background: The Ninth Circuit Creates a Circuit Split

In June 2019, Slack Technologies, Inc. went public via a direct listing. As described by the Court, Slack's outstanding shares — both those registered pursuant to the company's registration statement, and those not subject to registration but held by early investors and employees — were listed on the New York Stock Exchange (NYSE). The direct listing was not underwritten, and existing stockholders were therefore immediately able to sell their shares on the exchange because the stockholders were not subject to any contractual lock-up agreements such as those typically imposed by underwriters.

As part of the direct listing process, Slack registered 118 million shares for sale by certain shareholders, which were available to purchase at the start of trading. At the same time, an additional 165 million unregistered shares were also immediately available for purchase from other existing shareholders, pursuant to SEC Rule 144 under the Securities Act. Fiyyaz Pirani purchased 30,000 Slack shares on the initial listing date and another 220,000 shares over the ensuing months. Three months after the direct listing, Pirani brought a class action lawsuit against Slack and its officers, directors, and venture capital fund investors.

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Slack moved to dismiss Pirani's complaint because he could not trace his shares to Slack's allegedly misleading registration statement. In essence, Pirani was unable to allege facts establishing that he had purchased registered shares, as opposed to unregistered shares not subject to Section 11 or 12, because both registered and unregistered shares of Slack stock had traded on the initial listing date.

The district court denied Slack's motion but certified its decision for interlocutory appeal to the Ninth Circuit. In a 2-1 decision, a panel of the Ninth Circuit affirmed. The dissent argued that Sections 11 and 12 require plaintiffs to plead and prove that they purchased shares under a materially misleading registration statement, which Pirani had not done. Slack petitioned for certiorari; the Supreme Court granted the petition in December 2022 and heard argument in April 2023.[2]

The *Slack* Decision: Contextual Clues

The Court's decision focuses on the text of Section 11, which "authorizes an individual to sue for a material misstatement or omission in a registration statement when he has acquired 'such security.'"[3] The key question, the Court explained, was: "Does the term 'such security' refer to a security issued pursuant to the allegedly misleading registration statement?" (as Slack argued), "Or can the term also sometimes encompass a security that was not issued pursuant to the allegedly misleading registration statement?" (as Pirani argued).

To answer that question, the Court turned to a textualist approach, including the use of a 1931 dictionary definition of the word "such," noting that "there is no clear referent" in the statutory text "telling us what 'such security' means." The Court then turned to a broader analysis of statutory "context or circumstances." The Court concluded that "context provides several clues" for answering the question presented, all of which pointed in favor of Slack's reading of Section 11. For example, Section 11(a) refers to "*the* registration statement," which "seems to suggest the plaintiff must 'acquire such security' under that document's terms." And Section 11(a) uses "such" multiple times to "narrow the law's focus," suggesting that "when it comes to 'such security,' the law speaks to a security registered under the particular registration statement alleged to contain a falsehood or misleading omission." Likewise, other provisions of the Securities Act (including Sections 5 and 6) "follow suit" by narrowing the focus of the Act, and make the broader reading "hard to square" with the text of the statute, because "adopting that reading would give the registration statement effect (in the sense of creating liability) for securities that are not 'specified' in the registration statement 'as proposed to be offered.'" Finally, the Court noted that Section 11(e)'s cap on the damages against an underwriter in a Section 11 suit "to the 'total price at which the securities underwritten by him and distributed to the public were offered to the public'" would make no sense under Pirani's reading, "for if § 11(a) liability extended beyond registered shares presumably available damages would too."

Collectively, all of those contextual clues led the Court to conclude that "Slack's reading of the law is the better one." And the Court noted that its holding was consistent with a long line of cases requiring tracing, dating back more than 50 years to the Second Circuit case of *Barnes v. Osofsky*.[4]

By contrast, the Court identified significant problems with Pirani's position. For example, the Court noted that Pirani "does not explain what the limits of his rule would be, how we might derive them from §11, or how any of this can be squared with the various contextual clues we have encountered suggesting that liability runs with registered shares alone." And although the Court acknowledged that Congress could have drafted Section 11(a) to more precisely limit liability to claims with traceable shares, that possibility did not prove Pirani's argument. Indeed, Pirani's argument only demonstrated that Congress could have drafted Section 11(a) to reference "any security" as opposed to "such

security." As the Court explained: "That Congress could have been clearer, no one disputes. But none of this proves it adopted anything like the rule Mr. Pirani proposes."

At the end of the day, the Court noted, "Congress remains free to revise the securities laws at any time, whether to address the rise of direct listings or any other development." But the Court's role was limited to "discerning and applying the law as we find it."

The Court therefore held that Section 11(a) "requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement." The Court vacated the Ninth Circuit's decision on the Section 11 claim and remanded to the court of appeals to decide "whether Mr. Pirani's pleadings can satisfy § 11(a) as properly construed."

In a significant footnote at the end of its opinion, the Court declined to reach the parties' arguments about the scope of claims under Section 12. The Ninth Circuit had permitted the Section 12 claim to proceed, holding that the Section 12 claim "follow[ed] from" its application of Section 11. The Court declined to express a view "about the proper interpretation of § 12 or its application to this case." Nor did it "endorse the Ninth Circuit's apparent belief that § 11 and § 12 necessarily travel together, but instead, caution that the two provisions contain distinct language that warrants careful consideration."

***Slack*'s Limits and Implications**

The Supreme Court's decision resolves the split of authority created by the Ninth Circuit's interpretation of Section 11, making clear that it "requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement."

A number of questions regarding Securities Act liability and litigation remain open, however. For example, while the traceability requirement is now clear, the particular facts a Section 11 plaintiff must *plead* with respect to tracing in order to survive a motion to dismiss, as well as what a plaintiff must ultimately *prove* to prevail on a Section 11 claim, will be for the lower courts to decide. Future litigation may likely focus on the extent to which tracing is possible in modern securities markets. As noted, the Court's decision also leaves open the question of how the Ninth Circuit (and other courts of appeals) will interpret the scope of Section 12 claims. And finally, the Court declined to address the question whether Slack was required to register all the securities sold in the direct listing — an argument Pirani did not make until the case reached the Supreme Court.

Ultimately, the Court's *Slack* decision recognized that the federal securities laws work together to create a "balanced liability regime." As the Court observed, Section 11 of the Securities Act is "limited in scope" and imposes strict liability for material misstatements or omissions in a registration statement. In contrast, the main liability provision of the Securities Exchange Act of 1934, Section 10(b), "allows suits involving any sale of a security but only on proof of scienter." As the Court explained, Congress may well have "sought a balanced liability regime that allows a narrow class of claims to proceed on lesser proof but requires a higher standard of proof to sustain a broader set of claims." So while the plaintiff in Slack expressed concern that limiting shareholder claims under Section 11 would be inconsistent with the law's "policy and purpose," the Court recognized the multiplicity of liability provisions available under the federal securities laws and declined to read beyond the statutory text to address the particular circumstances of a direct listing transaction.

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Endnotes

[1] No. 22-200, 598 U.S. — (2023).

[2] Latham & Watkins represented the U.S. Chamber of Commerce, the Securities Industry and Financial Markets Association, and the National Association of Manufacturers in connection with amicus briefs filed in *Slack* at the Ninth Circuit, and at the certiorari and merits stages of the Supreme Court case.

[3] Section 11 states in relevant part: "In 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 misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue" the issuer, its directors, the underwriters and other enumerated parties. 15 U.S.C. §77k(a).

[4] *Barnes v. Osofksy*, 373 F.2d 269 (2d Cir. 1967); *see also In re Ariad Pharms., Inc. Secs. Litig.*, 842 F.3d 744 (1st Cir. 2016); *Rosenzweig v. Azurix Corp.*, 332 F.3d 854 (5th Cir. 2003); *Lee v. Ernst & Young, LLP*, 294 F.3d 969 (8th Cir. 2002); *Joseph v. Wiles*, 223 F.3d 1155 (10th Cir. 2000), *abrogated on other grounds, Cal. Pub. Emps.' Ret. Sys. v. ANZ Secs., Inc.*, 582 U.S. 497 (2017); *APA Excelsior III L.P. v. Premiere Techs., Inc.*, 476 F 3d 1261, 1271 (11th Cir. 2007).