

CLIENT ALERT

# Supreme Court Rules that Plaintiffs Must Plead and Prove that Shares Purchased in a Direct Listing Are Traceable to a Registration Statement Under Section 11

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On Thursday, the United States Supreme Court issued its highly-anticipated ruling in *Slack Technologies, LLC v. Pirani*, No. 22-200. In a unanimous decision authored by Justice Gorsuch, the Court vacated the Ninth Circuit’s unprecedented decision, which departed from the long-standing rule that a plaintiff must be able to “trace” their shares to an allegedly false or misleading registration statement in affirming denial of a motion to dismiss a claim arising under Section 11 of the Securities Act of 1933 (the “Securities Act”).

## Background

On June 20, 2019, Slack Technologies, Inc. went public through a “direct listing” on the New York Stock Exchange (the “NYSE”). Unlike in a traditional IPO, no shares are sold to underwriters for resale to the public market and no insiders are barred from selling under “lock-up” agreements in a direct listing.

Rather, in a direct listing, a company’s outstanding shares are listed on a stock exchange without either a primary or secondary underwritten offering, and existing shareholders become free to sell their shares on the stock exchange, some of which shares are typically registered pursuant to a concurrently filed registration statement and some of which are

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unregistered. In Slack's direct listing, approximately 118 million registered shares of common stock and approximately 165 million unregistered shares of common stock were offered for purchase.

Slack used a Form S-1 registration statement to register approximately 118 million shares of its common stock held by existing shareholders with the Securities and Exchange Commission. The selling shareholders listed in the Form S-1 were Slack's affiliates and certain other shareholders with "restricted securities" (as defined in Rule 144 under the Securities Act).

Because Slack was not selling any shares, the registration statement took the form of a resale registration statement. This permitted existing shareholders whose shares were registered on the registration statement to resell their shares as long as the registration statement remained effective and the prospectus was current. Any sales by these shareholders of shares of Slack common stock covered by the prospectus would be made through brokerage transactions on the NYSE at prevailing market prices.

All other Slack shareholders who had held their shares of common stock for at least one year were free to resell their shares without registration pursuant to Rule 144. Thus, these shares were not registered pursuant to the Form S-1 but could still be sold through brokerage transactions on the NYSE at prevailing market prices.

After Slack's share price dropped due to disruptions in its service, the plaintiff filed a class action lawsuit against Slack, alleging that Slack misled investors in its disclosures surrounding service disruptions and competition. Slack filed a motion to dismiss, arguing that the plaintiff lacked standing under Sections 11 and 12(a)(2) of the Securities Act because he could not allege that his shares were traceable to the allegedly misleading registration statement.<sup>1</sup> In other words, the plaintiff could not allege that he was entitled to sue "as a person acquiring such security" pursuant to the allegedly misleading registration statement as required by the Securities Act. Given the nature of the direct listing, the plaintiff could have purchased unregistered Slack shares. Adopting a broad reading of the statutory text, the district court held that the plaintiff had standing to sue because even if his shares were unregistered, he could still show that they were "of the same nature" as those issued under the relevant registration statement, but certified its ruling for interlocutory appeal. *Pirani v. Slack Techs., Inc.*, 445 F. Supp. 3d 367 (N.D. Cal. 2020).

On September 20, 2021, a divided Ninth Circuit panel affirmed the district court's holding, albeit on different grounds. *Pirani v. Slack Techs., Inc.*, 13 F.4th 940 (9th Cir. 2021). In ruling that the plaintiff had standing to sue under Section 11, the Ninth Circuit focused on the fact that the NYSE's rules require a company doing a direct listing to file a registration statement and that single registration statement effectively allows for the sale of both registered and unregistered shares

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<sup>1</sup> Section 11 of the Securities Act imposes strict liability on issuing companies when their registration statements contain material misstatements or misleading omissions. Section 10 of the Securities Exchange Act of 1934 (the "Exchange Act") sweeps more broadly, allowing suits in connection with the purchase and sale of any security (whether or not registered), but to prevail under Section 10 of the Exchange Act a plaintiff must prove that any material misleading statement or omission was made with scienter.

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to the public. In other words, all of the shares sold in Slack’s listing were “such securities” within the meaning of Section 11 because they were all traceable to that single registration statement, irrespective of whether they were registered. Applying this same logic, the Ninth Circuit also held that the plaintiff had standing to sue under Section 12(a)(2).

Prior to the Ninth Circuit’s ruling, every circuit court—including the Ninth Circuit—has strictly enforced Section 11’s tracing requirement. On December 13, 2022, the Supreme Court granted certiorari to resolve the circuit split created by the Ninth Circuit’s ruling.

### Section 11 Only Applies to Shares Traceable to a Registration Statement

The Supreme Court vacated the Ninth Circuit’s ruling and remanded, holding that liability under Section 11 attaches only when a buyer can trace their shares to a false or misleading registration statement. 598 U.S. \_\_\_, 9–10 (2023). The Court explained that even though Section 11 lacks any “clear referent” as to the meaning of the term “such security,” “contextual clues” make clear that the provision is limited to securities registered under the registration statement, including the fact that Section 11(e) caps damages against underwriters in a Section 11 suit to the value of registered shares alone. *Id.* at 2–3. The Court also emphasized that while direct listings are new, the question of how far Section 11 liability extends is not—“every court of appeals to consider the issue has reached the same conclusion: To bring a claim under §11, the securities held by the plaintiff must be traceable to the particular registration statement alleged to be false or misleading.” *Id.* at 7, n.2 (citing cases). The Court further noted that had Congress intended for Section 11 liability to attach to any security, whether traceable to an allegedly defective registration statement or not, it could have done so. *Id.* at 8–9. Moreover, the Court rejected the “single registration statement” theory, noting that there are no clear limits to that theory and it cannot be squared with the other contextual clues. *Id.* at 9.

While the Court reached a ruling on the plaintiff’s Section 11 claim, it expressly declined to reach the merits of the plaintiff’s claim under Section 12 of the Securities Act. *Id.* at 10, n.3. The Court explained that the Ninth Circuit’s ruling on the plaintiff’s claim “follow[ed] from” its Section 11 analysis. In rejecting the Ninth Circuit’s Section 11 analysis, the Court also vacated its judgment with respect to the plaintiff’s claim under Section 12. *Id.* In doing so, the Court made clear that it does not “endorse the Ninth Circuit’s apparent belief that [Sections 11 and 12] necessarily travel together” and “caution[ed] that the two provisions contain distinct language that warrants careful consideration.” *Id.*

### Conclusion

The Supreme Court’s decision reaffirms the well-established rule that for claims under Section 11 plaintiffs must be able to trace their shares to the registration statement they claim to be misleading. The ruling makes clear that no exception to this rule exists for direct listings, which provides companies that take the direct listing route with a strong defense to Section 11 claims. Determining companies’ potential exposure under Section 12 of the Securities Act for direct listings will

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need to await further ruling from the federal courts. In addition, companies that pursue direct listings will still face possible liability under Section 10 of the Exchange Act, as the Supreme Court observed.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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