

Unanimous Supreme Court Decision Limits Scope of Direct Listing Lawsuits

June 5, 2023

The US Supreme Court unanimously ruled that a shareholder suing under Section 11 of the Securities Act of 1933 must demonstrate that their shares are traceable to the allegedly misleading registration statement – a holding that will limit the scope of lawsuits brought by investors who purchase shares from companies who go public through a direct listing.

The idea that Section 11 liability is limited to where an investor can trace their shares to a false or misleading registration statement is not “particularly novel,” as the Supreme Court acknowledged. What is relatively new are direct listings. Approved by the Securities and Exchange Commission in 2018, this type of offering allows a company to simultaneously sell newly registered shares and permits existing shareholders to sell their existing, unregistered shares on the open market for the first time. This intermingling of registered and unregistered shares makes traceability an all-but-certain impossibility. In a direct listing, open market buyers have no way of knowing whether the shares they acquired are unregistered or registered.

In [this case](#), Fiyaz Pirani, an investor, purchased stock from Slack on the day of the company’s direct listing. More than half of the company’s shares available that day were unregistered shares, and the rest were registered shares.

[In a 2021 US Court of Appeals for the Ninth Circuit opinion that led to the Supreme Court appeal](#), the Ninth Circuit recognized the tracing problem posed by direct listings and held that all shares in a direct listing offering – “whether labelled as unregistered or registered” – could be traced to the registration statement. The Ninth Circuit decision was a sharp departure from decades of jurisprudence – albeit outside the direct listing context – in which lower federal courts had held that Section 11 liability only attached when a buyer could trace their shares to an allegedly misleading registration statement.

Section 11 provides that if a registration statement contains a material misstatement or omission, “any person acquiring **such security** ... may ... sue ” 15 USC §77k(a) (emphasis added). The Ninth Circuit reasoned that the unregistered shares could not have been sold “without the only operative registration in existence,” so the unregistered shares qualified as the “**such security**” referenced in the statutory text of Section 11.

The Ninth Circuit relied on public policy grounds to reach its conclusion, reasoning that “interpreting Section 11 to apply only to registered shares in a direct listing context would essentially eliminate Section 11 liability,” adding that, “his interpretation of Section 11 would create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception.”

The Supreme Court also analyzed the meaning of “such security” in Section 11 – but reached a different conclusion. The justices considered whether “such security” meant a share issued pursuant to the allegedly defective registration statement, or whether it was broader – i.e., that it could sometimes encompass shares that are not traceable to the registration statement.

Justice Neil Gorsuch, writing for the Supreme Court, acknowledged that “Congress could have been clearer” –there was “no clear referent” in Section 11 to identify the meaning of “such security.” But the justices reasoned that the context of the statute provided “several clues.” Use of the definite article “the” and repeated use of the word “such” have the effect of “train our view on particular things or statements,” suggesting that “such security” is referring to “a security registered under the particular registration statement alleged to contain a falsehood or misleading omission.”

The Supreme Court’s opinion did not directly address the Ninth Circuit’s “loophole” concerns. But the opinion indicated that any change in securities laws should come from Congress: “Naturally, Congress remains free to revise the securities laws at any time, whether to address the rise of direct listings or any other development,” Gorsuch wrote. “Our only function lies in discerning and applying the law as we find it.”

The Supreme Court remanded the case for the Ninth Circuit to determine in the first instance whether Pirani’s pleadings satisfied Section 11 “as properly construed.”

Read more about the Supreme Court’s decision – including open questions regarding Section 12 of the Securities Act – here: [SCOTUS decides Slack—in direct listings, tracing required for §11 standing](#).

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