Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—9th Cir.: Industry groups unite in opposition to lower court's traceability ruling, (Nov. 4, 2020)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Mark S. Nelson, J.D.

A trio of groups representing the broader securities industry, businesses, and venture capital firms urged the Ninth Circuit to uphold 50-years of precedent requiring that IPO shares be traceable to a specific registration statement under Securities Act Section 11.

A decision by a U.S. District Court in California has brought together a number of securities industry groups in opposition to a broader reading of the "such security" traceability language contained in Securities Act Section 11. The case, applying a broad view of traceability to Slack Technologies, Inc.'s direct listing, runs counter to long-held precedents in multiple federal jurisdictions, including the Ninth Circuit, said an amicus brief filed by the Securities Industry and Financial Markets Association, the Chamber of Commerce of the United States of America, and the National Venture Capital Association (*Pirani v. Slack Technologies, Inc.*, November 2, 2020).

Traceability can be difficult. Slack engaged in a direct listing and, in the district court, argued, among other things, that its legal liability should be limited because the plaintiffs' shares were untraceable to a specific registration statement. The district court, however, rejected a narrow reading of Securities Act Section 11's "such security" language but also certified the question of how Section 11 should apply to direct listings to the Ninth Circuit, which already has a precedent contrary to the district court's conclusion.

Securities plaintiffs and industry groups such as the Council of Institutional Investors (CII) have argued in multiple contexts that direct listings can make it more difficult to trace shares back to a specific registration statement in private securities litigation, as generally is required by the "such security" language of Securities Act Section 11.

The district court's opinion in *Slack* ultimately concluded that a broader view of "such security" was justified, but not before discussing at length the former Second Circuit Judge Henry Friendly's reasoning in an earlier case about traceability. There, Judge Friendly had adopted a narrow view of Section 11 but nevertheless had remarked that a broader view might be justified in some instances if there was "good reason" for a departure from the narrow view. The district judge then quoted Judge Friendly's narrow and broad readings of Section 11: (1) the narrow reading would be limited to "acquiring a security issued pursuant to the registration statement" and (2) the broader reading would apply to "acquiring a security of the same nature as that issued pursuant to the registration statement." Judge Friendly was one of the preeminent securities law jurists in his time (See footnote 4 in the district court's opinion, citing Louis Loss's tribute upon Judge Friendly's passing: "Judge Friendly, without a doubt, did more to shape the law of securities regulation than any judge in the country." The late Loss was a co-author of the Wolters Kluwer treatise *Securities Regulation*).

Policy requires narrow view of traceability. According to SIFMA, the Chamber of Commerce, and the NVCA, it has long been the policy of federal courts to adhere to the narrow view of traceability and that the district court's opinion in the *Slack* case failed to adequately limit that court's holding.

For one, SIFMA, the Chamber of Commerce, and the NVCA argue that the narrow traceability requirement described by Judge Friendly has dominated federal courts' Section 11 decisions for more than 50 years, including in recent cases decided by the Ninth Circuit. The groups posit that the issue of traceability has become more urgent due to the "tidal wave" of Section 11 cases now being filed in federal and state courts as a result of the Supreme Court's *Cyan* decision, in which the justices upheld the Securities Act's historical concurrent

federal-state court jurisdiction provision. Under *Cyan*, cases alleging only Securities Act claims can be brought in state court and cannot be removed to federal court. The groups also posit that post-*Cyan* developments in Section 11 cases have produced a spike in D&O insurance premiums.

SIFMA, the Chamber of Commerce, and the NVCA also argue that the *Slack* court's attempt to "limit" the reach of its opinion would have little impact on other courts possibly adopting similar reasoning. Said the district court: "Therefore, this Court finds that in this unique circumstance—a direct listing in which shares registered under the Securities Act become available on the first day simultaneously with shares exempted from registration—the phrase 'such security' in Section 11 warrants the broader reading: 'acquiring a security of the same nature as that issued pursuant to the registration statement.'"

Moreover, SIFMA, the Chamber of Commerce, and the NVCA said Congress, not the courts, should, if needed, alter the language of Section 11 to better reflect modern securities markets. Absent congressional action, the groups said market participants themselves might seek a technological solution, such as the blockchain solution proposed by the CII in the context of a petition for review by the Commission of a NYSE proposal for conducting direct primary listings. NYSE, however, responded to the CII's public comment by noting that the SEC's Investor Advisory Committee had observed that market participants were reluctant to adopt a blockchain or other technological solution to the traceability problem because of the costs involved and the adequacy of existing means of tracing shares.

The case is No. 20-16419.

Attorneys: Andrew B. Clubok (Lathan & Watkins LLP) for the Securities Industry and Financial Markets Association, the Chamber of Commerce of the United States of America, and the National Venture Capital Association.

Companies: Slack Technologies, Inc.

LitigationEnforcement: AlternativeInvestmentFunds CorporateGovernance FedTracker Securities FraudManipulation GCNNews HedgeFundsNews IPOs PrivateEquityNews SecuritiesOfferings AlaskaNews ArizonaNews CaliforniaNews HawaiiNews IdahoNews MontanaNews NevadaNews OregonNews WashingtonNews GuamNews