

[Securities Regulation Daily Wrap Up, SEC NEWS—Investors group petitions Commission for new rulemaking regarding traceability of shares, \(Mar. 4, 2024\)](#)

Securities Regulation Daily Wrap Up

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By Suzanne Cosgrove

Direct listings make it possible for unregistered shares to be sold alongside shares issued pursuant to a registration statement, complicating traceability issues for Section 11 plaintiffs.

The Council of Institutional Investors (CII) has urged the SEC to initiate new rulemaking that will make it easier to trace shares sold into the marketplace through both direct listings and initial public offerings and, in the process, protect investors' rights under Section 11 of the Securities Act of 1933.

The CII said the urgency of its petition is in part a response to the Supreme Court decision *Slack Technologies, LLC v. Pirani*. The Court's ruling affirmed that shareholders must be able to "trace" their shares to the registration statement covering them.

"Until recently, traceability was not an issue, given that underwriters generally imposed a lockup period for insiders and early investors after a registration statement became effective," the CII stated in [a letter](#) sent to the Commission on February 29. "A lockup period prevented insiders and early investors from selling unregistered shares acquired before the public offering."

Slack case offers context. As reported by [Securities Regulation Daily](#) last June, the Supreme Court backed corporations' growing preference for direct listings over IPOs in a ruling involving the instant-messaging company Slack, which went public in 2019 through a direct listing. By bypassing the IPO process, holders of pre-existing unregistered Slack shares were able to sell them to the public immediately. The plaintiff in the related case bought shares on the day Slack went public and later, but his complaint did not allege the purchases were traceable to the registration statement that he claimed was misleading.

The Supreme Court concluded that the statutory context of Securities Act Section 11 required the plaintiff to trace his shares to the allegedly misleading registration statement. The Court's decision resolved a prior split ruling created by the Ninth Circuit when it held 2-to-1 that the plaintiff had standing despite not tracing the shares to the registration statement in the defendant's direct offering.

Proposed share tracing options. The CII noted a working group of academics and former SEC officials previously recommended that the Commission amend SEC Rule 144 to limit sales of unregistered securities for a certain period after the effectiveness of a registration statement.

But in its recent letter, the CII suggested three other technology-based options that would update and enhance the protections afforded under Section 11. Those technology-based solutions included:

- Requiring that registered and exempt shares are offered in a direct listing trade with differentiated tickers, at least until expiration of the relevant Section 11 statute of limitations.
- Migrating the clearance and settlement system to a distributed ledger system or to other mechanisms to allow the tracing of individual shares as individual shares, and not as fractional interests in commingled electronic book entry accounts.

Lastly, the CII referenced research by Professors John C. Coffee, Jr., and Joshua Mitts that advocated using computing power to trace the purchase of shares. As the study points out, broker-dealers, exchanges and FINRA all maintain detailed, timestamped transactional records that show when securities in one account are

transferred to another account. The records are kept and stored electronically and are all contained within the Consolidated Audit Trail, the authors noted.

The existence of the data makes it possible to trace transactions using either first-in-first-out (FIFO) or last-in-first-out (LIFO) accounting assumptions for determining the cost of inventory. Those accounting assumptions could be adapted to provide for tracing all shares without relying on other methodologies, such as probability analysis that some courts view as inadequate, the CII said.

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