Securities Regulation Daily Wrap Up, TOP STORY—U.S.: High Court takes narrow reading of liability in direct listings, (Jun. 1, 2023)

Securities Regulation Daily Wrap Up

Click to open document in a browser

By Anne Sherry, J.D.

In vacating a Ninth Circuit decision, the Supreme Court vindicated corporations' growing preference for direct listings over IPOs.

In a unanimous opinion, the Supreme Court concluded that the statutory context of Securities Act Section 11 requires a plaintiff to trace their shares to an allegedly misleading registration statement. The decision resolves a circuit split created when the Ninth Circuit held 2-to-1 that the plaintiff had standing despite not tracing the shares to the registration statement in the defendant's direct offering. The plaintiff-appellee and his supporters believe that a narrow reading undermines the purpose of Section 11 by eliminating liability in direct listings (*Slack Technologies, LLC v. Pirani*, June 1, 2023, Gorsuch, N.).

Direct listing. The instant-messaging company Slack went public in 2019 through a direct listing. By bypassing the IPO process, Slack enabled holders of preexisting unregistered shares to sell them to the public immediately. The plaintiff had bought shares on the day Slack went public and subsequently, but his Securities Act complaint did not allege that the purchases were traceable to the registration statement he claimed was misleading. A Ninth Circuit panel held that the plaintiff nevertheless had standing because he couldn't have purchased his shares if the registration statement hadn't been issued, marking the shares as "such security" under the statutory language.

Supreme Court decision. Writing for the Supreme Court, Justice Gorsuch began with that statutory language. Securities Act Section 11(a) authorizes a person to sue for a material misstatement or omission in a registration statement when the person has acquired "such security." The Court was faced with the question of whether "such security" refers to a security issued pursuant to the allegedly misleading registration statement, or whether it can also encompass securities not issued under that registration statement. Lacking any lexical referent in Section 11(a) establishing what "such security" means, the Court resorted to the context and circumstances.

Context. First, the statute imposes liability for false statements or misleading omissions in "the" registration statement, not just "a" registration statement or any registration statement. Furthermore, the statute repeatedly uses the word "such" to narrow its focus: "such part" of the registration statement, "such acquisition," "such untruth or omission." The use of "such" to train the reader's view on particular things or statements suggests that likewise, "such security" speaks to a security issued under the allegedly misleading registration statement.

In support of this reading, the Court observed that Securities Act Section 5 clearly ties "such security" to shares subject to registration. The plaintiff had anticipated this comparison, arguing that Congress could have simply borrowed the clearer language of Section 5 if it had wanted liability to be similarly limited for purposes of Section 11. "That Congress could have been clearer, no one disputes," Justice Gorsuch wrote. "But none of this proves it adopted anything like the rule [the plaintiff] proposes."

Several other provisions of the Securities Act were difficult to reconcile with the plaintiff's reading of Section 11(a). Section 6 provides that a registration is deemed effective only as to the securities therein proposed to be offered. The plaintiff's broad reading of Section 11(a) would give a registration statement effect for securities that are not specified in the registration statement as "proposed to be offered," a result that is "hard to square" with Section 6. Section 11(e) caps damages against the underwriter at the value of the registered shares; if Section 11(a) liability extended beyond registered shares, as the plaintiff argued, presumably damages would extend farther as well.

Established law. Justice Gorsuch said that not only is Slack's reading of the law the better one, it is an established one. Direct listings may be new, but the question of Section 11(a) liability was first addressed in 1967, and every court of appeals since then (even the Ninth Circuit until just now) has concluded that the "narrower" reading is the natural one. Although the plaintiff urged the Court to allow his case to proceed, he did not explain what the limits of his reading would be, how they might follow from Section 11, or how this could be squared with the statutory context clues suggesting that liability runs with registered shares.

The Court could not endorse the plaintiff's reasoning that policy and purpose favor a broader reading of the term "such security." The Supreme Court does not presume that a result consistent with one party's account of the statute's goal must be the law, nor was the plaintiff's account of the law's purpose obvious. It is equally possible that Congress intended for the strict liability of Section 11 to apply to a narrower class of claims, while allowing a broader set of claims with a higher standard of proof.

Remand. The Court remanded the case for a determination whether the plaintiff satisfied Section 11(a) as properly construed. Because the Ninth Circuit said its decision to allow the Section 12 claim followed from its Section 11 analysis, the Supreme Court also vacated and remanded the judgment as to the Section 12 claim, without "endors[ing] the Ninth Circuit's apparent belief that §11 and §12 necessarily travel together." Rather, "the two provisions contain distinct language that warrants careful consideration."

The case is No. 22-200.

Attorneys: Thomas G. Hungar (Gibson, Dunn & Crutcher LLP) for Slack Technologies, LLC f/k/a Slack Technologies, Inc. Lawrence Paul Eagel (Bragar Eagel Squire, PC) and Kevin K. Russell (Goldstein and Russell, P.C.) for Fiyyaz Pirani.

Companies: Slack Technologies, LLC f/k/a Slack Technologies, Inc.

MainStory: TopStory CorporateGovernance FraudManipulation IPOs SecuritiesOfferings SupremeCtNews