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Ninth Circuit to Determine Whether Direct Listing Purchasers Have Standing Under Sections 11 and 12 of 1933 Act

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The U.S. Court of Appeals for the Ninth Circuit ("Ninth Circuit") will soon be presented the opportunity to address the novel question of whether investors who purchase a security in the context of a direct listing, rather than an initial public offering ("IPO"), have standing to bring claims under Sections 11 and 12(a)(2) of the Securities Act of 1933, despite the fact that such investors cannot allege that they purchased shares registered under and traceable to a defective registration statement. On April 21, 2020, the United States District Court for the Northern District of California answered that question in the affirmative, adopting a broad reading of the words "such security" as used in Section 11, which permits standing to "any person acquiring such security [issued pursuant to a registration statement which either contains an untrue statement of a material fact or omitted to state a material fact]." In so ruling, the district court reasoned that applying a narrow reading of "such security" would shield from civil liability under the Securities Act companies that issue their shares by way of a direct listing. The defendants sought interlocutory review of the decision, which the Ninth Circuit granted on July 24, 2020.

The case, *Fiyyaz Pirani v. Slack Technologies, Inc., et al.,* C.A. 3:19-cv-05857-SI (N.D.Cal.), involves allegations, by a proposed class of investors, that class members suffered losses as a result of misstatements or omissions of material facts contained in Slack Technologies' ("Slack") offering materials. Slack went public in 2019. In what was considered a newsworthy decision at the time, the company elected to do so without taking the traditional route of an initial public offering ("IPO"), opting instead to list its shares on the New York Stock Exchange by way of direct listing. Unlike an IPO, a direct listing involves the sale of existing shares by existing shareholders to the public. This approach, while less common, offers startup companies the opportunity to go public without diluting shares, and without the shares being subject to a lockup period, as they otherwise would be in an IPO. In addition—and at the heart of the current dispute—the company's existing stockholders generally consist of both: (1) stockholders whose shares were registered pursuant to the company's registration statement, and (2) stockholders whose shares were exempt from registration requirements. Because those existing stockholders have discretion about whether or not to sell their shares in the direct listing—and which of their shares to sell—there is generally no way of determining whether the shares sold in connection with the direct listing are registered or unregistered.

Taking advantage of this unique characteristic, Defendants argued, *inter alia*, in support of their motion to dismiss, that Plaintiff could not plead standing under Section 11 because he could not trace his purchased shares to a defective registration statement. Specifically, Defendants argued that it was “impossible” for Plaintiff to satisfy Section 11’s tracing requirement “when the market contains shares beyond those issued under the registration statement in question.” In response, Plaintiff argued that, due to the unique regulatory framework of a direct listing, this case presented a matter of first impression that, if decided in Defendant’s favor, would “provide a blueprint for companies to evade liability under Section 11 for filing a misleading registration statement.” The District Court agreed with Plaintiff, reasoning that applying a narrow reading of the term “such security” in Section 11 would result in the elimination of civil liability under the Securities Act in any instance in which a company’s shares were offered by way of direct listing instead of IPO. This result, the court opined, would be “at variance with the policy of this remedial legislation.”

The outcome of the upcoming interlocutory appeal could have significant implications for both companies and investors. As Plaintiffs and the District Court both aptly point out, strictly applying the “traceability” requirement to securities sold in direct listings would effectively shield defendants from Section 11 liability in connection with misstatements or omissions made in registration statements. Such a result would undoubtedly incentivize the use of direct listings, rather than IPO’s, and create significant—if not insurmountable—hurdles for institutional investors seeking to enforce their rights under Section 11.

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