Ninth Circuit decision addresses Securities Act standing for direct listings

By Peter B. Morrison, Esq., Noelle M. Reed, Esq., and Raza Rasheed, Esq., Skadden, Arps, Slate, Meagher & Flom LLP

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On Sept. 20, 2021, in the first case by a federal appellate court to have considered the issue, the 9th U.S. Circuit Court of Appeals held that a shareholder plaintiff had statutory standing to pursue claims under Sections 11 and 12(a)(2) of the Securities Act of 1933 arising out of a direct listing even though he could not prove that he purchased shares traceable to the issuer's registration statement and offering prospectus. See *Pirani v. Slack Techs., Inc.*, No. 20-16419, 2021 WL 4258835 (9th Cir. Sept. 20, 2021).

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While the decision is a win for securities plaintiffs, it remains to be seen whether the Ninth Circuit's approach will ultimately persuade other courts.

Holding that unregistered shares can confer Securities Act standing in direct listing context

When an investor purchases securities pursuant to a registration statement or offering prospectus that allegedly contains materially false or misleading statements, Sections 11 and 12(a)(2) of the Securities Act allow the person acquiring "such security" to bring a private civil claim against the issuer for damages. *See* 15 U.S.C. §§ 77k(a); 77l(a)(2). The term "such security," read in context, has long been interpreted to mean that the investor must have purchased his securities pursuant to — i.e., traceable to — the registration statement or prospectus containing the allegedly misleading statements, rather than any prior or subsequent offering documents or in a secondary market.

The *Pirani* case involved a new twist on Securities Act standing. In 2018, the Securities and Exchange Commission (SEC) approved a New York Stock Exchange (NYSE) rule change that allowed companies to publicly list their shares without undertaking an initial public offering that relies on firm commitment underwriting. In such a "direct listing," the issuer does not issue any new shares. Rather, the issuer files a registration statement solely to allow existing shareholders to sell their shares on the NYSE.

However, the registration statement covers only shares that are not otherwise exempt from registration under SEC rules. Thus, because typically some shares are exempt from registration while others are not, a direct listing usually results in both registered and unregistered shares being simultaneously offered to the market. This is different from what happens in a classic underwriter-driven IPO, in which investment banks typically insist on a months-long "lock-up" period during which existing shareholders cannot sell their unregistered shares.

Securities brokers typically do not keep track of whether individual shares are registered or unregistered when they sell them to the market. Thus, an investor who purchases shares in a direct listing will typically have no idea whether or not the shares he is buying were offered pursuant to the issuer's registration statement or offering prospectus.

This creates a potential standing issue: Does an investor have standing to bring Securities Act claims against the issuer if he cannot prove that he purchased shares that were registered under the allegedly misleading offering documents?

In *Pirani*, the Ninth Circuit held that the answer is "yes." The court reasoned that because no shares in a direct listing — whether registered or unregistered — can be traded until the issuer files its registration statement and prospectus, all shares are sufficiently traceable to the offering documents to confer standing under Section 11 and Section 12(a)(2). The 2-to-1 panel majority expressed concern that if it were to rule otherwise, shareholders may have no recourse if a company includes false and misleading statements in offering documents associated with a direct listing.

The court's decision may not be the final word on this issue

While the Ninth Circuit's decision is a win for securities plaintiffs in the narrow context of direct listings, it remains to be seen whether other circuits will adopt the same approach. As Judge Eric D. Miller noted in his forceful dissent, Sections 11 and 12(a)(2) have long been understood, in the Ninth Circuit and elsewhere, as granting standing only to shareholders who could prove that they purchased shares pursuant to the specific registration statement and offering prospectus containing alleged misstatements.

While the cases establishing this rule did not address direct listings, it is not clear why this distinction should matter. Nothing in the Securities Act's text suggests that statutory standing requirements should be changed or relaxed based on the nature of the offering.

The Ninth Circuit's decision may thus not prove persuasive to other jurists who, like Judge Miller, employ a "textualist" approach to statutory interpretation and may be reluctant to expand Securities Act standing in direct listing cases without a statutory justification for doing so. At a minimum, the dissent's approach may be adopted in at least some other circuits, teeing up a circuit split that may ultimately be resolved by the Supreme Court or Congress.

Is the Ninth Circuit's policy rationale sound?

The Ninth Circuit's decision appears to have been animated, at least in part, by a concern that if it denied standing to investors who cannot prove that they purchased registered shares, no direct listing purchasers would be able to bring Securities Act claims because brokers do not keep records of whether shares sold in the listing were registered or unregistered. While this concern may seem appealing, it may not take into account the intentionally limited scope of Securities Act claims compared with alternative causes of action.

Investors would not be deprived of *all* remedies or protections if they could not bring Securities Act claims in the direct listing context. Investors could still bring claims under Section 10(b) of the Securities Exchange Act of 1934, which allows investors to seek damages if they purchase securities in reliance on a company's false or misleading public statements but does not include the Securities Act's strict standing requirements. While Section 10(b) claims may be less attractive to plaintiffs than Securities Act claims because Section 10(b) (unlike the Securities Act) requires an investor to prove that the issuer acted with scienter, Section 10(b) still provides a complete and adequate remedy for false or misleading statements in a company's public filings.

Moreover, the SEC has the authority to take action against issuers who violate the federal securities laws and would likely be incentivized to closely scrutinize filings associated with direct listings if it knew that investors were unlikely to be able to bring private claims.

The distinctions between the standing and liability structure of the Securities Act and Exchange Act are by design. One might argue that the Ninth Circuit's decision is in tension with the congressional intent behind the federal securities laws. Specifically, while Congress chose to permit Securities Act plaintiffs to recover damages and rescissory remedies without proving that the issuer acted with wrongful intent, it limited standing to bring such claims to investors who purchased securities traceable to the offering documents at issue.

By contrast, Congress chose to allow a broader class of investors to bring Section 10(b) claims but required those investors to prove that the issuer acted with scienter to recover damages. Therefore, as the defendant argued, the Ninth Circuit's decision arguably upsets this careful balance by allowing investors to bring Securities Act claims — with no scienter requirement or need to affirmatively show loss causation — without meeting the Securities Act's demanding standing requirements.

About the authors



Peter B. Morrison (L) is the leader of the Los Angeles Litigation Group at **Skadden, Arps, Slate, Meagher & Flom LLP**, co-head of the firm's West Coast litigation practice and one of the hiring partners for the Los Angeles office. He has a litigation practice with emphasis on securities, M&A and tax litigation. He can be reached at peter.morrison@skadden.com. **Noelle M. Reed** (C) heads the Houston litigation practice at the firm. She represents clients in complex litigation in state and federal trial and appellate courts and arbitrations. She can be reached at noelle.reed@skadden.com. **Raza Rasheed** (R) is a litigation associate at the firm. He represents clients in a range of complex civil matters in state and federal courts and private arbitrations, with a particular focus on shareholder derivative suits, securities class actions and trade secret misappropriation actions. He can be reached at raza.rasheed@skadden.com.

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