Inside the Courts
An Update From Skadden Securities Litigators

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SCOTUS Bars Section 11 Claims Based on Direct Listing

A unanimous Supreme Court today made it more difficult for shareholders to file suits under Section 11 of the Securities Act of 1933 (the Securities Act or the Act). The Court held in *Slack Technologies, LLC v. Fiyyaz Pirani* that shareholders filing suit under the Act must plead and prove that they bought shares registered under the registration statement they claim is misleading. In so doing, the Court resolved a question of first impression arising out of the New York Stock Exchange's (NYSE's) rule that allows companies to sell shares through a direct listing. The Court held that Section 11 liability does not apply to directly listed shares.

Slack went public through a direct listing on the NYSE in 2019. Unlike a traditional IPO, in which a company sells registered shares and holders of existing, unregistered shares are subject to a lock-up period, in a direct listing the company does not offer new shares. Rather, the company's existing shareholders have the option to sell their shares and, as a result, a combination of registered shares and shares exempt from registration under SEC Rule 144 are sold. In a traditional IPO, a shareholder's purchase of shares is traceable to a company's registration statement for purposes of establishing a right to recover for claims under the Securities Act; in a direct listing, the shares are not traceable to a registration statement.

At the time of Slack's direct listing, there were 283 million preexisting Slack shares, of which only 118 million were subject to the Act's registration requirement. Slack's registration statement registered only those 118 million shares. It is, in practice, impossible for any purchaser in the offering to know whether the shares they purchased were registered or unregistered.

Notwithstanding this challenge, a purchaser filed a suit under Sections 11, 12(a)(2) and 15 of the Act. Slack moved to dismiss, saying the plaintiff could not establish that he bought shares sold pursuant to the registration statement. The U.S. District Court for the Northern District of California denied Slack's motion to dismiss and extended the Securities Act protections to directly listed shares. The court certified its decision for interlocutory appeal, and a divided panel of the Ninth Circuit affirmed.

Reversing the Ninth Circuit, the Court today unanimously found that Section 11 liability attaches only to shares that are traceable to a specific registration statement, based on false or misleading information in the registration statement. Justice Gorsuch's opinion focuses both on the language of the Securities Act and on the context in which that specific language sits. In so doing, the Justices shut the door on an effort to significantly expand liability under Section 11.

Please feel free to reach out to the authors or your regular Skadden contact if you'd like to discuss further.

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