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Alert

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Supreme Court Rejects Attempt to Erode Section 11 Requirements

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On June 1, the Supreme Court held in *Slack Technologies v. Pirani* that Section 11 of the Securities Act "requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement," endorsing the approach previously adopted by a majority of lower courts. The case stemmed from Slack's 2019 direct listing of registered and unregistered shares. Pirani sued Slack under Section 11 of the Securities Act alleging that Slack included materially misleading statements in the registration statement. Slack moved to dismiss the complaint because the direct listing had included unregistered shares, and Pirani had not alleged that the shares he purchased were from the 118 million shares registered under the allegedly misleading registration statement, as opposed to the 165 million pre-existing and unregistered shares that were sold in the direct listing. The district court denied Slack's motion to dismiss and the Ninth Circuit affirmed, holding that Pirani did not need to plead that his shares were traceable to Slack's registration statement.

The Supreme Court unanimously reversed the Ninth Circuit, holding that Section 11 plaintiffs must be able to trace their securities back to the allegedly misleading registration statement, as distinguished from securities already on the market or issued without a registration statement. In reaching its decision, the Court focused on the text and context of the statute, observing that when Section 11 gives standing to holders of "such securit[ies]," it is referring to those securities actually issued pursuant to a false or misleading registration statement, and not merely the same general class of securities. In doing so, the Court rejected Pirani's request to eliminate the traceability requirement that limits the universe of potential plaintiffs who can assert claims under Section 11. The Court noted that while direct listings are a recent development, the scope of Section 11 is not—and the traceability requirement has been consistently applied by the lower courts for more than 50 years. However, the Court did note that it was not resolving whether Section 12 of the Securities Act—which imposes liability for false or misleading statements in a prospectus—entails a similar requirement.

Given this decision, it would not be surprising to see more companies opting to offer securities via direct listing in an effort to mitigate Section 11 exposure and force putative plaintiffs to meet the heightened pleading and proof requirements of Section 10(b) of the Securities Exchange Act. Companies defending against Section 11 lawsuits, particularly those arising out of direct listings, should carefully scrutinize the pleadings and the evidence to determine whether plaintiffs have adequately alleged and proven that the shares at issue are traceable to the challenged registration statement. Lastly, defendants should also be aware that plaintiffs may continue to advance the minority view that claims under Section 12 do not require that they "trace" their securities back to a false or misleading prospectus.

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