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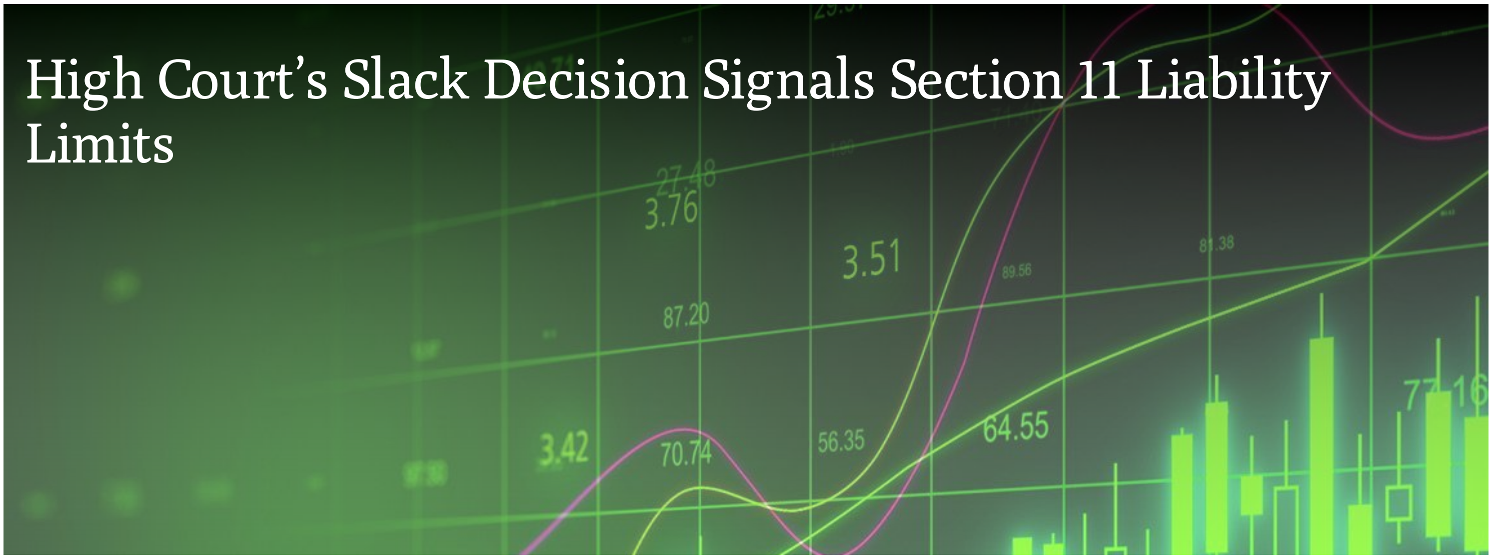
High Court's Slack Decision Signals Section 11 Liability Limits



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The US Supreme Court's unanimous decision in *Slack Technologies v. Pirani* holds that under Section 11 of the Securities Act of 1933, plaintiffs must plead and prove they purchased securities issued under the allegedly defective registration statement, versus other available securities.

While the case arose from Slack Technologies' 2019 direct listing, the court's holding may have broader implications for traditional initial public offerings, secondary offerings, and even de-SPAC transactions.

The decision was grounded in the text of Section 11(a), which authorizes a shareholder to sue for a material misstatement or omission in a registration statement when the shareholder has acquired "such security." The court held that "such security" refers only "to a security registered under the particular registration statement alleged to contain a falsehood or misleading omission."

The court's decision may affect not just direct listings, but also any situation where a company has multiple pools of shares publicly trading. That includes successive offerings under different registration statements or even traditional IPOs after unregistered shares start trading.

In these situations, courts have long noted that tracing shares to the allegedly defective registration statement is "often impossible," and aftermarket purchasers usually "will not be able to trace their shares back to a particular offering" because it requires showing "the chain of title for their shares … starting with their own purchases and ending with someone who bought directly in the [defective] offering."

Companies deciding between a direct listing and a traditional underwritten IPO may choose a direct listing to minimize Section 11 exposure. Alternatively, companies that choose a traditional underwritten IPO may forgo or shorten the "lock-up" period under which unregistered shares are unavailable for trading.

While IPOs traditionally have a lock-up period of around six months, a lock-up isn't legally required, and IPOs without lock-up periods may fall under *Slack*'s protection. Even prior to *Slack*, companies had experimented with shorter lock-up periods.

The decision may also protect companies going public through de-SPAC transactions with a special purpose acquisition company. In de-SPAC transactions, the special purpose acquisition company issues securities pursuant to a registration statement via a traditional IPO. The SPAC then identifies a merger target and takes the target public through a de-SPAC transaction.

The de-SPAC transaction typically registers additional shares under a second registration statement detailing the transaction, known as the de-SPAC registration statement. Under *Slack* and existing case law, plaintiffs may face difficulties tracing their shares to the allegedly defective de-SPAC registration statement because shares are issued under both the IPO and de-SPAC registration statements.

Also at issue in *Slack* was plaintiff's standing to bring a claim under Section 12 of the Securities Act, which provides liability for the sale of a security through a misleading prospectus or oral communication. While much of the oral argument focused on Section 12, the court's decision mostly deferred the issue.

The court vacated the Ninth Circuit's judgment because it "followed from its [flawed] analysis of [the Section] 11 claim" and instructed the lower court to "reconsider in light of our holding today about the meaning of [Section] 11." However, in doing so, the court noted that it didn't endorse the belief that Sections 11 and 12 "necessarily travel together" and cautioned that the two provisions "contain distinct language that warrants careful consideration." Courts likely will take a closer look at the text of Section 12 in evaluating the merits of a claim thereunder.

Notably, Section 12(a)(2), like Section 11, contains the words "such security." The statute provides that any person who "offers or sells a security" by means of a misleading "prospectus or oral communication" "shall be liable … to the person purchasing such security from him … ." "Such security" seemingly refers to the specific securities sold under the allegedly misleading prospectus or oral statement, not just any security traded at that time.

Furthermore, many of the same "contextual clues" the court relied on for its Section 11 analysis also apply to Section 12, which is part of the same statutory scheme—the Securities Act— "focused primarily on regulation of new offerings." Thus, if courts strictly adhere to Section 12's statutory text, as the Supreme Court did with Section 11, Section 12 statutory standing likely will be limited to shareholders who purchased the shares sold by the allegedly defective prospectus or oral statement.

Moreover, standing in Section 12 cases usually has been more difficult to establish than in Section 11. That is because Section 12 has a strict privity requirement that limits standing to shareholders who were firsthand purchasers in the offering at issue, and not to aftermarket purchasers, regardless of the ability to trace the shares.

Section 12's privity requirement doesn't allow for tracing, and *Slack* doesn't appear to disturb this generally accepted view of the law. Nevertheless, given the court's clear holding limiting Section 11 liability, shareholder plaintiffs may pay more attention to Section 12 than they previously did, and lower courts will help further develop the law.

The case is Slack Technologies v. Pirani, U.S., 22-200, 6/1/23.

Summer Associate Katelyn Taira also contributed to this article.

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