LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Why Slack Decision Struck A Nerve With Corporate America

By **John Browne and Lauren Ormsbee** (November 4, 2021, 6:02 PM EDT)

John Browne

Lauren Ormsbee

On Nov. 3, the defendants filed an aggressive petition for rehearing and rehearing en banc asking the U.S. Court of Appeals for the Ninth Circuit to reconsider its recent pro-investor decision in Pirani v. Slack Technologies Inc.

The Slack decision addressed an important issue of first impression: Do investors have standing to pursue Securities Act claims when a company makes material misrepresentations in connection with a direct listing initial public offering?

Direct listing IPOs are a new going-public alternative to traditional IPOs and have become increasingly popular in the wake of recent U.S. Securities and Exchange Commission regulatory changes. The Slack panel held in a 2-1 decision that investors have standing to pursue the same Securities Act claims in direct listing IPOs as they are able to pursue in traditional IPOs.

The defendants' petition for rehearing and rehearing en banc argues strenuously that the Slack panel's decision "breaks with five-plus decades of previously uniform precedent on the meaning of Section 11" and improperly elevates policy concerns over the plain language of the Securities Act.[1]

The defendants ask the Ninth Circuit to reconvene in full, reverse the Slack panel, and dismiss the case in its entirety.

The strongly worded petition represents just the latest shot in a hotly contested battle that, regardless of how the petition is decided, will likely end in an appeal to the U.S. Supreme Court. The ultimate outcome of this fight between investors and corporate defendants bears close watching, as it will have far-reaching consequences impacting investor rights and the scope of the Securities Act.

Slack Background

Until recently, companies seeking access to the public markets did so through a traditional IPO. In a traditional IPO, all the shares in circulation following the IPO are issued pursuant to a registration statement filed by the company. The Wall Street banks acting as underwriters then impose a lockup period on corporate insiders to prevent them from selling their personal, unregistered shares into the marketplace for several months.

This tried-and-true regime for going public existed largely undisturbed for more than 80 years. That all changed between 2018 and 2020, when the SEC enacted sweeping regulatory changes allowing corporations to bypass the traditional IPO process in favor of a direct listing IPO. In a direct listing IPO there are no underwriters — and therefore no lockup period — so company insiders can sell their personal holdings of unregistered shares into the market on the same day as the IPO.

As addressed in Slack, this new feature of direct listing IPOs raised novel questions about the application of a judicially created doctrine called tracing, which requires an investor bringing Securities Act claims to prove she purchased securities issued pursuant or traceable to a registration statement containing a material misrepresentation or omission.

If the investor is unable to trace the securities she purchased to the registration statement, then she does not have standing to pursue Securities Act claims.

In a direct listing IPO, because the registered shares issued by the company and the unregistered shares previously held by insiders are sold into the aftermarket simultaneously, they are indistinguishable from each other the from moment they begin trading. It is therefore impossible for any investor to trace her share purchases back to the defective registration statement.

The Ninth Circuit's Slack Decision

The defendants in Slack asked the U.S. District Court for the Northern District of California district court to dismiss the investor complaint, arguing that it was impossible for the plaintiff to prove tracing, and therefore no investors had standing to bring Securities Act claims. Although the district court rejected that argument and sustained the complaint, it recognized the novelty of the issue and granted the defendants the right to pursue an immediate interlocutory appeal to the Ninth Circuit.

The Ninth Circuit was the first appellate court to consider the issue. The Slack panel held in a split 2-1 decision that the broad remedial purpose of the Securities Act would be fatally undercut if companies could avoid Securities Act liability by simultaneously injecting registered and unregistered shares into the marketplace.

Accordingly, the majority held that even unregistered shares sold in a direct listing are actionable under the Securities Act "because their public sale cannot occur without the only operative registration in existence."[2]

In dissent, U.S. Circuit Judge Eric Miller disagreed, arguing that because the plaintiff "cannot show that the shares he purchased 'were issued under the allegedly false or misleading registration statement,' he lacks statutory standing to bring a section 11 claim."[3]

Judge Miller acknowledged the policy concerns that partially fueled the majority decision but cited the old trope that "they are no basis for changing the settled interpretation of the statutory text," and that the responsibility for clarifying the statutory language "lies in Congress."[4]

The En Banc Petition and Recent Ninth Circuit Practice

While petitions for rehearing and rehearing en banc are usually denied, the Ninth Circuit has seen a recent uptick in accepting such petitions. In 2021, the Ninth Circuit granted en banc hearings at the rate of more than once per month, making a previously rare procedure somewhat more frequent.

The defendants push hard in their petition to convince the Ninth Circuit that the Slack decision is worthy of the rare relief of an en banc hearing. The defendants argue loudly — and surely the plaintiffs would contend, they argue wrongly — that for pure policy-based reasons, the panel decision departed from decisions of the Supreme Court and eight courts of appeals in holding that the tracing requirement must be strictly enforced.[5]

The defendants rely heavily on the opinion of dissenting Judge Miller, calling it persuasive, and contend that the panel's decision was "inconsistent with long-settled law" and "declined to follow [Ninth Circuit] precedent."

And, in response to the plaintiff's arguments that denying Securities Act protections to direct listings would undermine the purpose of the statute, the defendants retort that "the majority's decision rewrites the Securities Act, eviscerating the statute's distinction between shares that are, and shares that are not, required to be registered."[6]

The defendants also have lined up powerful corporate interest groups who intend to file amicus briefs in support of their petition. Although the deadline for filing those briefs is not until later in November, pro-defendant friend-of-the-court briefs were previously submitted on the underlying appeal by the Securities Industry and Financial Markets Association, the U.S. Chamber of Commerce, and the National Venture Capital Association — organizations that often support the rollback of securities laws in amici briefs filed in courts across the nation.

What's Next

It is clear that the Slack decision has struck a nerve with corporate America. It has been sharply criticized by corporate interest groups and in client alerts published by large defense firms. The defendants have indicated that they are going to challenge the decision all the way to the Supreme Court if necessary.

Thus, even if the petition for rehearing is denied by the Ninth Circuit, it is clear that this case is far from over. If either the Ninth Circuit or the Supreme Court overrules the panel decision, shareholders will lose one of the most important enforcement tools available to them for decades, the strong remedial powers of the Securities Act.

John C. Browne and Lauren Ormsbee are partners at Bernstein Litowitz Berger & Grossmann LLP.

[1] Petition for Rehearing and Rehearing En Banc, No. 20-16419, Dkt. # 59 (9th Cir.) (Nov. 3, 2021), at 15.

[2] Pirani v. Slack Technologies, Inc. , 13 F.4th 940, 947 (9th Cir. 2021).

[3] Id. at 953 (citing In re Century Aluminum Co. Secs. Litig. , 729 F.3d 1104, 1106 (9th Cir. 2013).

[4] Id.

[5] Id. at 1.

[6] Id. at 1.
