Ninth Circuit Slack Decision Withstands En Banc Rehearing Petition: Is A Supreme Court Cert Petition Next?

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Ninth Circuit *Slack* Decision Withstands En Banc Rehearing Petition: Is A Supreme Court Cert Petition Next?

By John C. Browne and Lauren Ormsbee

On May 2, 2022, the U.S Court for the Ninth Circuit withstood once again a nearly three year effort to eliminate shareholders' standing to pursue Securities Act claims in connection with a direct listing initial public offering made by Slack Technologies, Inc. ("Slack"). In a single-page 2-1 order, the Circuit Court panel (the "Panel") rejected defendants' petition to rehear en banc its recent pro-investor decision in *Pirani v. Slack Technologies, Inc.*[1] This latest win for investors' rights may be short lived. The

Slack defendants are likely to seek Supreme Court review, which would place Section 11 standing on the national spotlight.

The District Court and Ninth Circuit Hold That Tracing Is No Barrier to Standing In A Direct Listing

Direct listing IPOs are a relatively recent alternative for companies seeking to go public. Created by the New York Stock Exchange in 2018 (and later approved by the SEC), a direct listing allows existing private shareholders of a not-yet public company to offer unregistered shares for sale on a public exchange simultaneously with newly outstanding registered shares issued pursuant to a company's registration statement.[2]

On June 20, 2019, Slack went public through a direct listing—only the second direct listing IPO under the new NYSE rules—releasing 118 million registered shares and 165 million unregistered shares into the public market for purchase. *Slack* involved an investor who purchased publicly-traded Slack shares shortly following the company's direct listing IPO, and who alleged that the defendants had issued a false and misleading registration statement in connection with the IPO.

Defendants challenged the investor's (and all investors') standing to bring any Securities Act claims on the grounds that it was impossible to "trace" which of the purchased shares were registered as opposed to unregistered. This challenge was not entirely unexpected. Indeed, in December 2019, attorneys from Latham & Watkins LLP, the law firm that advised Slack in its direct listing IPO, published an article noting that "an important advantage of the direct listing" was that it could prevent shareholder litigation under Section 11 of the Securities Act because it is "difficult (if not impossible)" to meet Section 11's tracing requirement in the context of a direct listing.[3]

On April 21, 2020, District Court Judge Susan Illston of the U.S. District Court of the Northern District of California reviewed the legislative history of the Securities Act and found it to be remedial in nature, concluding that accepting defendants' view of tracing would "cause the elimination of civil liability under the Securities Act," a result at odds with the "central purposes" of the statute. The district court denied defendants' motion to dismiss and held that tracing could be established by purchasers of either registered or unregistered securities because they were "a security of the same nature as that issued pursuant to the registration statement."[4]

The district court certified the issue for appeal to the Ninth Circuit. On September 20, 2021, the Ninth Circuit Panel affirmed the district court in a split 2-1 opinion. The Panel majority agreed with the district court that the broad remedial purpose of the Securities Act would be undercut if companies could circumvent Securities Act liability

by commingling registered and unregistered shares in the marketplace. Ultimately, the majority held that unregistered shares sold in a direct listing effectuated by a materially misleading registration statement are actionable under the Securities Act "because their public sale cannot occur without the only operative registration in existence."[5]

The En Banc Petition for Rehearing En Banc

Defendants filed a strongly-worded petition for rehearing and rehearing en banc on November 3, 2021, arguing that the Ninth Circuit's majority opinion departed from Supreme Court precedent and the opinions of eight courts of appeals, which defendants argued held that the tracing requirement must be strictly enforced. Defendants also contended that the policy implications of the Panel majority opinion could have an impact broader than direct listing IPOs, noting that a commentator recently posed the question of whether "Section 11 liability would extend forever unless an issuer sold new shares under a second registration statement."[6]

Corporate interest groups sharply criticized the Panel decision, and several filed amicus briefs in support of the en banc petition, including the Cato Institute, the Securities Industry and Financial Markets Association, the Chamber of Commerce, and the National Venture Capital Association.[7]

On December 20, 2021, plaintiff opposed the petition for an en banc rehearing.[8] A group of twelve institutional investor U.S. public pension funds that collectively invest billions of dollars on behalf of hundreds of thousands of American workers, including firefighters, police officers, teachers, and healthcare workers, filed an amicus curiae in support of plaintiff.[9] Plaintiff and the amici argued that the district court and Panel opinion were correctly decided.

The En Banc Order and What's Next

On May 2, 2022, the Ninth Circuit panel issued a single-page order indicating that the Panel voted by the same 2-1 margin as the opinion to deny the petition for rehearing and rehearing en banc. The order further noted that "the full court has been advised of the petition for rehearing en banc, and no judge has requested a vote on whether to rehear the matter en banc."

While plaintiff has prevailed to date, the fight may not yet be over. Defendants now have 90 days, until August 1, 2022, to file a petition for certiorari with the Supreme Court. Defendants have not yet indicated whether their next step is to seek certiorari. The strong remedial powers of the Securities Act, and shareholders' decades'-long right to enforce the Securities Act when a public offering is tainted by materially misleading representations hangs in the balance. But for today, those rights remain intact.

*John C. Browne and Lauren Ormsbee are partners in BLB&G's market-leading securities litigation practice. You can view John's full biography **here** and Lauren's is available **here**.*

[1] Order, No. 20-16419, Dkt. #75 (9th Cir.) (May 2, 2022). En banc is a legal term derived from French, meaning "in the bench." It means that an entire appellate court sits to review a case, as opposed to the common appellate practice of sitting in three-jurist panels.

[2] *See* Exchange Act Release No. 34-82627, (Feb. 2, 2018); Exchange Act Release No. 90768 (Dec. 22, 2020).

[3] *See* Complex and Novel Section 11 Liability Issues of Direct Listings, Corporate Counsel (Dec. 20, 2019) (https://www.lw.com/thoughtLeadership/section-eleven-liability-direct-listings).

[4] *Pirani v. Slack Tech., Inc.*, 445 F. Supp. 3d 367 (N.D. Cal. 2020).

[5] *Pirani v. Slack Tech., Inc.*, 13 F. 4th 940, 947 (9th Cir. 2021).

[6] Petition for Rehearing and Rehearing En Banc, No. 20-16419, Dkt. # 59 (Nov. 3, 2021).

[7] Amici Curiae Briefs in support of Petitioner, No. 20-16419, Dkt. # 62-63 (November 15, 2021). Former SEC Chairman Joseph Grundfest also submitted as amicus curiae brief in support of Slack. *See* Dkt. # 61.

[8] Plaintiff-Appellee's Respond to Defendants'-Appellants' Petition for Rehearing En Banc, No. 20-16419, Dkt. # 69 (Dec. 20, 2021).

[9] Brief of Investor Amici Curiae in Opposition to Defendants'-Appellants' Petition for Rehearing En Banc, No. 20-16419, Dkt. # 71 (Dec. 30, 2021). The authors of this article represented the 12 institutional investor amici and authored the amicus brief on their behalf.

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with a direct listing initial public offering made by Slack Technologies, Inc. In the article below, BLB&G Partners John C. Browne and Lauren Ormsbee examine the implications for investors, and discuss why this latest win for investors' rights may be short lived.