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Slack's Backers Warn SCOTUS of Hit to Capital Markets from Direct Listing Case

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(Reuters) - Defenders of business software company Slack Technologies LLC told the U.S. Supreme Court this week that if the justices do not step in to overturn a ruling that allows investors in a 2019 direct listing to sue Slack for alleged misrepresentations, then every company contemplating a public offering – whether through a de-SPAC deal, an IPO or a direct listing – could face expanded liability in Securities Act class actions.

Slack petitioned the Supreme Court in August to review a 2021 ruling from the 9th U.S. Circuit Court of Appeals that said investors could proceed with Securities Act claims even though more than half of the shares in the offering were not covered by the allegedly misleading statement.

Slack's lawyers at Gibson, Dunn & Crutcher, as I'll explain, argued that the 9th Circuit majority disregarded longstanding consensus among federal appellate courts that investors must be able to trace their shares to a particular registration statement in order to sue under the Securities Act.

This week, the U.S. Chamber of Commerce and the Securities Industry and Financial Market Association, the Cato Institute, the Washington Legal Foundation and Stanford Law School professor Joseph Grundfest weighed in with amicus briefs amplifying Slack's assertion that the 9th Circuit ruling will not simply affect companies going public through direct listings. The circuit court's reasoning, Slack's amici argued, could just as well apply to other kinds of public offerings, vastly increasing companies' uncertainty and litigation risk as they consider tapping capital markets.

Plaintiffs' lawyer Lawrence Eagel of Bragar Eagel & Squire, who represents Slack investors at the Supreme Court, declined to comment on the Slack petition or amicus filings.

It's no mystery why Slack and its supporters are emphasizing their argument that the implications of the 9th Circuit's ruling extend beyond direct listings. This kind of offering, authorized by the

U.S. Securities and Exchange Commission in 2018, allows employees and early investors who have received shares in private companies to sell those shares in a public offering. Direct listings, as I've reported, are supposed to be a faster, less expensive alternative to traditional IPOs for private companies that don't necessarily need to raise capital but want to reward insiders and investors who would be barred, in a traditional IPO, from selling their shares for several months after the offering.

But very few companies have actually gone public through direct listings. According to the amicus brief filed by SIFMA and the Chamber, only 12 companies have offered direct listings since 2018, although the direct listing roster includes big names such as Spotify AB, Palantir Technologies Inc and Coinbase Global Inc. By contrast, there have been nearly 1,000 IPOs and nearly 400 SPAC deals over the same time period. So Slack has a better shot of persuading the Supreme Court to take its case if it can convince the justices that the 9th Circuit's decision will affect the entire market for public offerings, not just the handful of companies contemplating direct listings.

That argument takes some explaining. In Slack's direct listing, as I mentioned, more than half of the 285 million shares offered to the public were exempt from registration under the SEC's rules for privately issued stock. The investor who filed the Securities Act class action, Fiyyaz Pirani, conceded that he could not ascertain whether the Slack shares he purchased were issued under the allegedly misleading registration statement or were exempt from registration. But the 9th Circuit majority reasoned that it was not necessary for Pirani to trace his shares back to the registration statement because, under New York Stock Exchange rules, the entire offering could not have taken place without the registration statement.

That reasoning, according to Slack and its amici, would effectively eliminate the "tracing" requirement that federal appellate courts have widely adopted for Securities Act class actions. And without a tracing requirement, they argued, companies will face dramatically expanded litigation risk regardless of how they go public.

In a traditional IPO, for instance, the tracing requirement has meant that potential liability for a misleading registration statement ends when the lockout period expires and private shareholders begin to sell shares that were exempt from registration. But if investors don't have to trace their shares to the registration statement, Slack and its backers said, investors can sue after the lockout period ends.

"Under the decision below, any shareholder may sue under Section 11 [of the Securities Act] until the statute of limitations expires," Slack said in its petition. "That interpretation will make the 9th Circuit, already a magnet for about one-third of all securities suits, the forum of choice for plaintiffs who, like respondent here, can sue nowhere else."

The 9th Circuit majority reasoned that the Securities Act should not be read to create a giant loophole that allows companies to avoid liability for misleading registration statements simply by

simultaneously offering shares that are exempt from registration. But Slack's amici from Cato and the Washington Legal Foundation, in particular, argued that it's not the prerogative of the 9th Circuit to set policy. If Congress considers traceability in direct listings to be a problem, they said, it's up to Congress to solve it.

Grundfest and his counsel from Freshfields Bruckhaus Deringer accused the 9th Circuit of "faux textualism" as a guise for policy-making. Their brief dissected the text of the Securities Act to argue that the 9th Circuit's holding contradicts several elements of the statute, including the law's cap on damages and rules for exempting privately-issued shares from registration.

"The statute's plain text and design," the brief said, "make it abundantly clear that Section 11 liability extends only to registered shares, and that Congress never intended to attach Section 11 liability to shares that are explicitly exempt from registration and Section 11 liability, no matter how or when they legally enter the market."

Slack investors, it's worth noting, previously managed to persuade the 9th Circuit to deny en banc review, despite arguments from Slack and its supporters that presaged their Supreme Court briefs. Plaintiffs have until Nov. 3 to file their brief opposing Slack's Supreme Court bid.