Slack will ask Supreme Court to review novel ‘direct listing’ case

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Slack Technologies Inc will ask the U.S. Supreme Court to review a first-of-its-kind appellate ruling that, according to the company and its friends in the business lobby, has thwarted access to capital markets for successful private companies.

The Securities and Exchange Commission cleared the way in 2018 for privately held companies to go public through the sale of shares held by corporate insiders and early investors. These “direct listings” were supposed to be a faster, less expensive alternative to traditional IPOs for private companies that didn’t necessarily need to raise capital but wanted to reward insiders and investors.

In a direct listing, as opposed to a traditional IPO, those insiders can sell their shares without a lock-up period, allowing them, rather than IPO underwriters, to reap most of the benefits of the public offering.

Sounds like a great option for successful private companies, right? But only a handful of companies have taken advantage of direct listings.

In part, that’s probably because blank-check special purpose acquisition companies provided a different way for private companies to go public during the SPAC market boom in 2020 and 2021.

But Slack and its lawyers from Gibson, Dunn & Crutcher contend there’s another reason why direct listings have been few and far between: As the company and its amici told the 9th U.S. Circuit Court of Appeals in briefs last fall, private businesses are worried about facing outsized

Securities Act liability for direct listings. According to Slack, that fear is the result of a 2021 ruling from a divided three-judge panel, which held that an investor in Slack's 2019 direct listing could move ahead with a securities class action even though he could not prove the Slack shares he bought were traceable to an allegedly misleading registration statement.

Slack and its amici claimed that the panel's decision was at odds with long-standing precedent that requires investors to show that their shares were sold under the auspices of an allegedly misleading registration. They also argued, more sweepingly, that the 9th Circuit's decision had created uncertainty that effectively foreclosed direct listings as a route for private companies to go public.

Those arguments – which were countered by Slack investors and their amici from 12 big institutional investment funds – failed to sway the 9th Circuit. On Monday, the appeals court declined to rehear the case. Judge Eric Miller, who dissented from last year's panel decision, voted for rehearing, but the two judges in the majority, Judge Sidney Thomas and U.S. Court of International Trade Judge Jane Restani, sitting by designation, opposed it. Slack had asked for en banc review as an alternative to a panel rehearing but no 9th Circuit judge called for a vote on the company's en banc request.

A Slack spokesperson told me by email that the company's next move will be a petition to the U.S. Supreme Court.

The company and its amici, including the Securities Industry and Financial Markets Association, the U.S. Chamber of Commerce, the Cato Institute and the influential Stanford Law School professor Joseph Grundfest, can't claim a circuit split on Securities Act claims arising from direct listings, since the 9th Circuit was the first court to address the issue. But it's a very good bet that Slack will argue the majority ruling contradicts precedent from at least five other circuits that restrict Securities Act claims to investors who can trace their shares directly to allegedly misleading offering documents.

It's also likely that Slack will blame the 9th Circuit decision for shutting down direct listings, to the detriment of both private companies and investors who want to buy insiders' shares.

The 9th Circuit majority came at the policy question from a different perspective, and it takes a little explaining. In Slack's direct listing, about 285 million privately held shares were offered to the public. Most of those shares – 165 million – were exempt from registration under SEC rules for privately issued stock. Only about 118 million shares were registered under the registration statement later alleged to have been misleading. The lead plaintiff, Fiyyaz Pirani, conceded that he could not ascertain whether the 30,000 shares he bought in the direct listing were registered or unregistered.

The 9th Circuit majority said that didn't matter. Slack's entire public offering could not have taken place, the majority said, if the company had not issued a registration statement. So all of the stock sold in the offering, the court held, were traceable to the registration statement, regardless of whether specific shares were registered or unregistered.

To hold otherwise, the majority said, would undermine the whole purpose of the Securities Act, which is to protect investors from misleading offering documents. Slack's proposed traceability requirement for direct listings in which both registered and unregistered shares are sold, the court said, "would create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception."

Pirani's lawyers from Bragar Eagel & Squire and amicus counsel from Bernstein Litowitz Berger & Grossmann emphasized that point in their briefs opposing a 9th Circuit rehearing. The traceability requirement, they said, addresses concerns about secondary offerings – not about a single offering covered by one registration statement. If a company sells shares under the auspices of a misleading registration statement, they said, it's liable under the Securities Act, plain and simple.

"It is defendants' proposed construction, not the panel's, that would make early-stage investing riskier and more expensive for startups," Bernstein Litowitz wrote in the investment funds' brief.

Shareholder lawyer Lawrence Eagel declined to comment.

The Supreme Court showed last year, when it granted review in a case presenting the question of whether state courts can order early discovery in Securities Act cases, that it's willing to take up securities class action issues even when there's no clear split among federal circuits. (The Supreme Court ended up dropping that case after the parties settled.) We'll see if Slack can sell the 9th Circuit's direct listing decision as a capital markets crisis.