MarketWatch

The Supreme Court must uphold this democratic way for companies to go public

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The big purple banners covering the New York Stock Exchange on June 20, 2019 might have been just decoration for another colorful Silicon Valley IPO. But "WORK — the ticker symbol for Slack Technologies, Inc. — was not taking the usual route to join NYSE's listings. Slack went public with no IPO at all.

The tech unicorn, now a unit of Salesforce **CRM, 0.12%**, joined the ranks of NYSE-listed stocks through a direct listing, not a traditional initial public offering (IPO). Direct listings are different: companies generally raise no new money and only existing shares of the company are traded on the exchange.

But on April 17, the U.S. Supreme Court will hear oral argument in a case that puts this path to the public markets in jeopardy.

Direct listings offer unique benefits to companies and their shareholders by allowing existing shareholders to sell their shares on a public stock exchange without the delay and overhead associated with a traditional IPO. This can entice companies to the public markets that may have otherwise chosen to stay private. At a time when both the number of IPOs and the number of public companies remain low, having diverse paths to public listing is even more important for giving investors choice and supporting economic growth.

Direct listings offer out-of-the-garage-era employees and early investors in startup companies the liquidity of a public market and enable them to sell their shares at a market price, often with less red tape and overhead than a traditional IPO. Pre-IPO shareholders are usually prevented from selling their holdings for months after an IPO, but direct listings provide early employees and investors in startup companies the opportunity to more easily sell their shares or convert their stock-option shares to cash. Existing shareholders also benefit in a direct listing by selling their shares at a market price, rather than at a price set by underwriters in an IPO (which often leaves money on the table). Companies have likewise found direct listings to be a valuable path to go public. By eschewing the traditional underwriting process, direct listings allow companies to avoid the high transaction costs associated with a traditional IPO. Direct listings thus can provide a cost-effective avenue for a company to go public when the objective is providing employees and early investors with access to the public markets, not raising capital.

The Supreme Court case, *Pirani v. Slack*, focuses on the question of whether direct listings should be subject to a special rule for liability under Section 11 of the Securities Act of 1933. Section 11 holds anyone who helped prepare a registration statement — the disclosures required to sell a security to the public — strictly liable for any misstatement or omission in the registration statement. In other words, someone who buys the security can sue the security's issuer, underwriter, accountant, or lawyer for any misrepresentation in the registration statement, even inadvertent ones.

For more than 50 years, courts have required a plaintiff who sues under Section 11 to prove that a registered share was purchased. That can be a complicated task, especially when registered shares are trading at the same time as unregistered shares — those that are tradeable pursuant to registration exemptions. Such mingling usually occurs months later in an IPO, but for direct listings, registered and unregistered shares trade together from day one. So, the U.S. Ninth Circuit Court of Appeals created a special rule for direct listings that allows those who purchased unregistered shares to sue.

This special rule increases the costs for companies seeking a direct listing, holding them to an even higher liability standard than traditional IPOs. Not only does this rule usurp Congress's role in determining how to balance disclosure requirements with encouraging companies to go public, but it also ignores the benefits of alternative public offering methods for entrepreneurs, startup companies, investors, and the economy as a whole. Direct listings promote ingenuity and innovation by offering a company's early-stage employees and investors a more streamlined opportunity to reap a greater return on their investment than a traditional IPO. Direct listings also make a company accessible to average investors, who are largely prohibited from investing in non-public companies, and can bring more transparency to capital markets by attracting new companies to provide the disclosure that public listings require.

But expanding Section 11 liability, as the Ninth Circuit did, will add litigation costs that could make direct listings an unattractive path to the public markets, and companies inclined to use a direct listing may choose to otherwise remain private.

The Supreme Court should affirm that it is Congress that has the authority to determine the delicate balance between creating liability for inaccurate disclosure and incentivizing companies to go public. Where the traditional IPO leaves many companies without a good path to the public markets, closing off other opportunities to go public can be more damaging than just fewer celebratory opening bells.

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