STETSON BUSINESS LAW REVIEW

EXTENSION OF 1933 ACT SECTION 11 TRACING REQUIREMENT TO DIRECT LISTINGS: A MORAL HAZARD

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INTRODUCTION

The Securities Act of 1933 ("1933 Act") Section 11 provides for the civil liability of certain persons who sign an issuer's registration statement.[2] This is a strict liability provision: there is no need to prove scienter, reliance, or causation. However, Section 11, as interpreted by the courts, contains a tracing requirement, which requires a plaintiff to trace the ownership of their shares back to shares covered by the registration statement.[3] This Article examines Section 11 liability, with particular attention to the case of *Pirani v. Slack Technologies, Inc.,* in which both registered and exempt shares were simultaneously listed in a direct listing on the

2. Securities Act of 1933, § 11, 15 U.S.C. § 77k (1998).

3. Tracing is defined as "the process of tracking property's ownership or characteristics from the time of its origin to the present." *Tracing*, BLACK'S LAW DICTIONARY (12th ed. 2024).

New York Stock Exchange ("NYSE").[4] This Article argues that the inclusion of direct listed securities in the Section 11 tracing requirement creates a "moral hazard" in that issuers are incentivized to conduct direct listings to evade Section 11 liability.

I. STATUTORY AND REGULATORY PROVISIONS

Three significant provisions create civil liability under the 1933 Act and the Securities Exchange Act of 1934 ("1934 Act"): Section 12(a)(2) of the 1933 Act,[5] Section 11 of the 1933 Act,[6] and Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.[7] Each of these three provisions have their own requirements as to the nexus between the seller and the purchaser of the securities. Taken together, these three sections have formed a comprehensive system of Federal securities law civil liability.

A. Section 12(a)(2) of the 1933 Act

Section 12(a)(2) of the original 1933 Act provides as follows:

> (a) Any person who—
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> (1) offers or sells a security in violation of section 5, or
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> (2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraphs (2) and (14) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law

4. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 362 (N.D. Cal. 2020).
5. Securities Act of 1933, § 12, 15 U.S.C. § 77l (2000).
6. Securities Act of 1933, § 11, 15 U.S.C. § 77k (1998).
7. Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5.

> or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of *such security*, or for damages if he no longer owns the security.[8] (emphasis added).

Section 12(a)(2) of the 1933 Act requires privity between the seller and the purchaser of the securities.[9] Case law has developed the concept of the "statutory seller" of the securities: thus, to maintain a cause of action under section 12(a)(2), one must purchase the securities from a statutory seller.[10] Case law has also developed the concept of the "prospectus," as distinguished from a security sales contract.[11]

B. Section 11 of the 1933 Act

Section 11 of the 1933 Act provides as follows (emphasis added):

> In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring *such security* (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, whether at law or in equity, in any court of competent jurisdiction, sue—[12]

Section 11 is ambiguous: there is no antecedent for "such security" in Section 11. Does it refer to any security of that class, or does it refer to a specific securities position acquired directly or indirectly by the plaintiff? Section 11 of the 1933 Act is the source of the judicially created doctrine of "tracing": the plaintiff must trace ownership of the securities back to the defendant.[13] However, there is no requirement for privity between the seller and the purchaser of the securities. The legislative history of the 1933 Act was assembled into three volumes; because the tracing doctrine was

8. Securities Act of 1933 § 12 (emphasis added).
9. *Id.*
10. Pinter v. Dahl, 486 U.S. 622, 630 (1988).
11. Gustafson v. Alloyd, 513 U.S. 561, 569 (1995).
12. Securities Act of 1933, § 11, 15 U.S.C. § 77k (1998) (emphasis added).
13. *Id.*

formulated by judges after the effectiveness of the 1933 Act, the legislative history does not mention tracing.[14]

Case law under Section 11 of the 1933 Act is the only place in the securities laws where tracing is found. Tracing is not present elsewhere in the federal securities laws or regulations, nor does tracing exist in state securities laws; tracing does not appear in any version of the Uniform Securities Act,[15] or in the case law thereunder. Additionally, tracing is not mentioned in Joseph C. Long, Michael J. Kaufman, and John M. Wunderlich's multivolume treatise Blue Sky Law[16] or in the Blue Sky Law Reporter.[17]

C. Section 10(b) of the 1934 Act and Rule 10b-5 Thereunder

Rule 10b-5 under Section 10(b) of the 1934 Act provides as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[18]

Rule 10b-5 requires neither privity nor tracing; it merely requires that the transaction be "in connection with the purchase or sale of any security."[19] Rule 10b-5 case law does,however,

14. 1-3 J.S. ELLENBERGER & ELLEN P. MAHAR, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934 (1973).

15. UNIF. SEC. ACT (UNIF. L. COMM'N 2002).

16. 12, 12A, 12B JOSEPH C. LONG, ET. AL. BLUE SKY LAW (Thompson Reuters 2014), Westlaw (last updated June 2024).

17. Comm. Clearing House, BLUE SKY L. REP. (looseleaf service).

18. Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5.

19. *Id.*

require proof of scienter, reliance, and causation.[20]F Section 17(a) of the 1933 Act contains language similar to Rule 10b-5.[21] However, private plaintiffs' use of Section 17(a) is subject to limitations.[22]

D. Section 15 of the 1933 Act

Section 15 of the 1933 Act provides for controlling person liability, as follows:

> Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.[23]

A plaintiff, after alleging various primary securities law violations, frequently adds a claim of controlling person liability under Section 15.[24]

II. DEVELOPMENT OF TRACING REQUIREMENT IN CASE LAW

William O. Douglas wrote, "Section 11 gives civil rights to all purchasers (from whomsoever they purchase) against those liable on the registration statement."[25] Thus, if a Section 11 tracing case had come before the U.S. Supreme Court during his tenure, he

20. THOMAS L. HAZEN, SECURITIES REGULATION IN A NUTSHELL, 189-195 (12th ed. 2021).

21. Securities Act of 1933, §17, 15 U.S.C. § 77q.

22. Carolyn R. Saffold-Heyward, *Section 17(a) of the '33 Act: Defining the Scope of Antifraud Protection,* 37 WASH. & LEE L. REV. 859, 866 (1980); Julianne Gennuso, *Section 17(a) of the Securities Act of 1933 and an Implied Action: An Answer Is In Sight,* 3 J. OF LEGAL COMMENT. 159, 165–68 (1988).

23. Securities Act of 1933, § 15, 15 U.S.C. § 77o (2010).

24. Section 15 controlling person liability is discussed in THOMAS L. HAZEN, SECURITIES REGULATION IN A NUTSHELL, 367-368 (12th ed. 2021).

25. William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171, 177 (1933).

probably would have decided against any tracing requirement. However, no Section 11 tracing case came before the Court during his tenure; instead, *Slack Technologies v. Pirani* was the first Section 11 tracing case to come before the Court.[26]

Following is a circuit-by-circuit account of the development of the tracing doctrine. Prior to the introduction of direct listings, there was no inter-circuit split, as all circuits upheld the tracing doctrine.

A. Second Circuit

Much of the federal litigation regarding Section 11 of the 1933 Act has occurred in the U.S. District Court for the Southern District of New York and in the U.S. Court of Appeals for the Second Circuit. In view of the concentration of the financial services industry in New York City, this is not surprising.

The case which introduced tracing was *Fischman v. Raytheon Mfg. Co.*[27] The 1933 Act registration statement pertained to an issue of preferred stock, which some of the shareholders converted into common stock.[28] The company also had pre-existing common stock, which was not covered by the registration statement.[29] The plaintiffs were owners of the preexisting common stock; they sued under Section 11 of the 1933 Act.[30] U.S. District Judge Edward A. Conger ruled against the plaintiffs:

> I cannot agree with plaintiffs in this contention. The Act of 1933 was intended to and did give relief to those who were defrauded by false statements in a registration statement and prospectus filed in connection with the issue of stock. It gave relief only to those who purchased that stock. It was a special statute with a special purpose, prescribing that amount to its own code of procedure including venue provision . . . It may not be held to include relief to purchasers of another class of stock with which the registration and prospectus had no relation.[31]

26. Slack Techs., Inc., v. Pirani, 598 U.S. 759, 762 (2022).
27. Fischman v. Raytheon Mfg. *Co.*, 9 F.R.D. 707, 711 (S.D.N.Y. 1949).
28. *Id.* at 709.
29. *Id.*
30. *Id.* at 709–10.
31. *Id.* at 710–11 (citation omitted).

Rosenberg v. Globe Aircraft Corp. was primarily concerned with class action and venue, not tracing.[32] Judge Conger's decision did not engage in a futile search for the antecedent to "such securities." Also, he did not explore the 1933 Act's legislative history. Most significantly, he established the tracing doctrine without calling it "tracing."

The District Court decision was reversed on other grounds by the U.S. Court of Appeals for the Second Circuit.[33] The Second Circuit affirmed the District Court's decision as to the permitted class of plaintiffs in Section 11 litigation.[34] In an opinion by Justice Jerome Frank, the court ruled:

> A suit under Sec[tion] 11 of the 1933 Act requires no proof of fraud or deceit, and such a suit may be maintained only by one who comes within a narrow class of persons, i.e. those who purchase securities that are the direct subject of the prospectus and registration statement (here the purchasers of the preferred stock).[35]

Just like the District Court decision, the Circuit Court decision did not search for the antecedent of "such securities," did not explore the legislative history of the 1933 Act, and did not call it "tracing."

Colonial Realty Corp. v. Brunswick Corp. was also a Southern District case; it was decided in 1966.[36] The 1933 Act registration statement covered an issue of debentures, which were convertible into common stock.[37] The plaintiffs owned common stock which had not been converted from the debentures.[38] Judge David N. Edelstein did not use the word "tracing," but he did find that "such securities" had no antecedent.[39] He also explored the legislative history of the 1933 Act.[40] He concluded that the plaintiff did not have Section 11 standing:

32. Rosenberg v. Globe Aircraft Corp., 80 F. Supp. 123, 124 (E.D. Pa. 1948).
33. Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 789 (2d Cir. 1951).
34. *Id.* at 787-88.
35. *Id.* at 786.
36. Colonial Realty Corp. v. Brunswick Corp., 257 F. Supp. 875, 876 (S.D.N.Y. 1966).
37. *Id.* at 876–77.
38. *Id.* at 877.
39. *Id.* at 878.
40. *Id.* at 879.

> Plaintiff's legal theory, that the registration of any new issue registers (for Section 11 purposes) not merely the new issue but all of the outstanding shares of the same class, has an Alice in Wonderland quality. It is simply untenable on the basis of the statute, the legislative history, and the case law.[41]

Barnes v. Osofsky was a case cited often in subsequent decisions.[42] It involved both registered and unregistered stock issued by Aileen, Inc., a women's sportswear company.[43] In September 1963, the company issued a prospectus with highly impressive sales figures.[44] In October 1963, it was revealed that these sales figures were inflated.[45] Litigation commenced under the Federal securities laws in the U.S. District Court for the Southern District of New York.[46] A settlement was reached, which would have ended the matter, except that two of the plaintiffs objected to it.[47] At that point, Judge Edelstein noted that there was no proof that the shares were registered and ruled in favor of the defendants.[48]

The matter then went to the Second Circuit, which issued its decision in February 1967.[49] Judge Friendly wrote the Second Circuit's opinion.[50] He observed that Section 11 referred to "such securit[ies]" without any antecedent,[51] examined the legislative history of the 1933 Act,[52] and looked at the overall statutory scheme of the Federal securities laws.[53] He cited the prior cases *Fischman v. Raytheon Mfg. Co.*, and *Colonial Realty Corp. v. Brunswick Corp*[54] and referred to the Louis Loss multivolume securities law treatise.[55] He also referred to an amicus curiae brief from the Securities and Exchange Commission[56] and concluded that tracing should be required, although he didn't call it

41. *Id.* at 884.
42. Barnes v. Osofsky, 254 F. Supp. 721 (S.D.N.Y. 1966).
43. Barnes v. Osofsky, 373 F.2d 269, 270 (2d Cir. 1967).
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.*at 270–71.
48. *Id.*at 271–72.
49. *Barnes,* 373 F.2d at 270.
50. *Id.*
51. *Id.* at 271.
52. *Id.* at 272–73.
53. *Id.* at 272.
54. *Id.* at 273.
55. *Barnes,* 373 F.2d at 273
56. *Id.*

"tracing."[57] Thus, the District Court decision was affirmed.[58] Judge Friendly's opinion included two thoughtful comments. First, he recognized that street name accounts were increasingly being used on Wall Street, thus making tracing impracticable.[59] Second, he commented that Congress might like to revisit the tracing requirement.[60]

Wolfson v. Solomon was a Southern District case in 1972; the matter in dispute was whether to grant class action certification.[61] The court cited *Barnes v. Osofsky* in ruling that a Section 11 case is limited to the actual securities covered by the registration statement.[62]

In 1976, the Southern District decided *Lorber v. Beebe*, which involved stock of Dunkin Donuts, Inc., and included claims under Section 11, Section 12, Rule 10b-5, and state law.[63] The plaintiff made the novel Section 11 argument that "the burden of identification should be on defendants," but the court rejected this argument, concluding that the plaintiff "has neither pleaded nor could he prove that the stock he purchased was issued pursuant to the allegedly defective registration statement."[64] However, the court upheld certain other claims made by the plaintiff.[65]

Adair v. Bristol Technology Systems, Inc. was a Southern District case in 1998; the matter in dispute was a motion to dismiss.[66] The court upheld the tracing requirement, actually calling it "tracing."[67] This was the first time that the Southern District used the term "tracing" in the context of Section 11.

DeMaria v. Andersen established in the Second Circuit that privity is not required in a Section 11 case.[68] This case involved an Internet startup company.[69] The plaintiff alleged misstatements in

57. *Id.*
58. *Id.*
59. *Id.* at 272.
60. *Id.* at 273.
61. Wolfson v. Solomon, 54 F.R.D. 584, 587 (S.D.N.Y. 1972).
62. *Id.* at 588.
63. Lorber v. Beebe, 407 F. Supp. 279, 285 (S.D.N.Y. 1976). The Judge was Whitman Knapp, who achieved high visibility for chairing the Knapp Commission, which investigated police corruption in New York City.
64. *Id.*
65. *Id.* at 287–97.
66. Adair v. Bristol Tech. Sys., Inc., 179 F.R.D. 126, 128 (S.D.N.Y. 1998).
67. *Id.* at 131–32.
68. DeMaria v. Andersen, 153 F. Supp. 2d 300, 309–10 (S.D.N.Y. 2001), aff'd, 318 F.3d 170, 182 (2d Cir. 2003).
69. *See DeMaria*, 153 F. Supp. 2d at 303.

the registration statement.[70] Discrepancies between the printed prospectus and the EDGAR prospectus thickened the plot.[71] In 2001, the Southern District held that privity is not required under Section 11, but the court dismissed the case on its merits.[72] Likewise, when the case reached the Second Circuit in 2003, the court held that privity is not required under Section 11, but dismissed the case on the merits.[73] The Second Circuit declared: "[W]e hold that aftermarket purchasers who can trace their shares to an allegedly misleading registration statement have standing to sue under [Section] 11 of the 1933 Act."[74]

In re Initial Public Offering Securities Litigation was a Southern District case in 2004 which combined six apparently unrelated initial public offering ("IPO") cases.[75] Judge Shira A. Scheindlin presided over the case and continued the existing law of tracing for Section 11 claims:

> Tracing may be established either through proof of a direct chain of title from the original offering to the ultimate owner . . . . . , or through proof that the owner bought her shares in a market containing only shares issued pursuant to the allegedly defective registration statement.[76]

Judge Scheindlin, noting the impracticality of seeking to trace title of shares in an economic environment of fungible bulk street name transfers and net balance settlement systems, ruled, "[a]ccordingly, plaintiffs' [S]ection 11 class periods are appropriately limited to the periods between each [initial public offering] and the time when unregistered shares entered the market."[77]

In re WRT Energy Securities Litigation was a case of great duration in the Southern District of New York.[78] In 1997, the court ruled that Section 11 standing included a privity requirement, that the plaintiff must have purchased the securities directly from the

70. *Id.* at 303–04.
71. *Id.* at 304.
72. *Id.* at 314.
73. *DeMaria,* 318 F.3d at 177–78, 182.
74. *Id.* at 178.
75. In re Initial Pub. Offering Sec. Litig. 227 F.R.D. 65, 71 (S.D.N.Y. 2004).
76. *Id.* at 117–18.
77. *Id.* at 120.
78. In re WRT Energy Sec. Litig., No. 96 CIV. 3610 (JFK), 96 CIV. 3611 (JFK), 2005 WL 2088406 (S.D.N.Y Aug. 30, 2005).

defendant.[79] In 2003, the Second Circuit held in *DeMaria v. Andersen* that Section 11 requires tracing but not privity.[80] Thus, in 2003, the Southern District followed the Second Circuit and ruled in *WRT Energy Securities Litigation* that the plaintiffs should be given the opportunity to prove Section 11 tracing, regardless of lack of privity.[81]

B. Fifth Circuit

Rosenzweig v. Azurix Corp., decided by the Fifth Circuit in 2003, involved shares of Azurix Corp., Enron Corp. had spun off a few years before in a single public offering.[82] The plaintiffs acquired their Azurix Corp. shares in the aftermarket.[83] The Fifth Circuit ruled that the plaintiffs had Section 11 standing: although they bought the securities in the aftermarket, they could trace their shares back to the defendant.[84] However, the Fifth Circuit dismissed the Section 11 claims, finding no evidence of material misstatements in the offering materials[85] (the plaintiffs' Section 12(a)(2) and Rule10b-5 claims were dismissed on other grounds).[86]

Krim v. pcOrder.com, Inc. was decided by the Fifth Circuit in 2005.[87] The court confirmed that Section 11 traceability is available to aftermarket purchasers, such as the plaintiffs in this case.[88] These plaintiffs sought to trace their shares using a statistical method which held that at least some of their shares were covered by the 1933 Act registration statement.[89] The Fifth Circuit declined to accept the statistical method, and ruled in favor of the defendants.[90] The court commented:

> When Congress enacted the Securities Act of 1933 it was not confronted with the widespread practice of holding stock in street name that Appellants describe as an impediment, absent

79. In re WRT Energy Sec. Litig., No. 96 CIV. 3610, 96 CIV. 3611, 1997 WL 576023 at *7 (S.D.N.Y. Sept. 15, 1997).
80. *See DeMaria,* 153 F. Supp. 2d at 309–10.
81. In re WRT Energy Sec. Litig., 75 F. App'x 839, 840 (2d Cir. 2003).
82. *See* Rosenzweig v. Azurix Corp., 332 F.3d 854, 858–59 (5th Cir. 2003).
83. *Id.* at 858.
84. *Id.* at 872–73.
85. *Id.* at 873–74.
86. *Id.* at 874.
87. Krim v. pcOrder.com, Inc., 402 F.3d 489 (5th Cir. 2005).
88. *Id.* at 492.
89. *Id.* at 494–95.
90. *Id.* at 502.

> our acceptance of statistical tracing, to invoking Section 11. That present market realities, given the fungibility of stock held in street name, may render Section 11 ineffective as a practical matter in some aftermarket scenarios is an issue properly addressed by Congress. It is not within our purview to rewrite the statute to take account of changed conditions. In the words of one court, Appellants' arguments may "have the sound ring of economic reality but unfortunately they merely point up the problems involved in the present scheme of statutory regulation."[91]

The foregoing opinion is one of the few judicial opinions to explore the matter of statistical tracing.

C. Eighth Circuit

In *Kirkwood v. Taylor* (1984), the U.S. District Court for the District of Minnesota decided a case under Section 11 of the 1933 Act.[92] In an opinion by U.S. District Judge Donald Alsop, the court considered four methods by which the plaintiffs sought to achieve Section 11 standing: the direct trace method, the fungible mass method, the contrabroker method, and the heritage method.[93] The court concluded that the direct trace method is the only legitimate way to prove tracing: the other three methods provide inadequate evidence of tracing.[94] The court found that the plaintiffs' evidence under the direct trace method was inadequate, so the court dismissed the case.[95] Notably, this was the first identifiable court decision anywhere, in which the judge used the term "tracing."

Lee v. Ernst & Young LLP involved shares of Summit Medical Systems, Inc.[96] In this case, the plaintiffs sued under Section 11 of the 1933 Act in the U.S. District Court for the District of Minnesota.[97] Although the plaintiffs could trace security ownership back to the issuer, the District Court ruled for the defendants because the plaintiffs purchased the securities in the aftermarket and did not purchase the securities directly from the

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91. *Id.* at 498 (citing Colonial Realty Corp. v. Brunswick Corp., 257 F. Supp. 875 at 881 (S.D.N.Y. 1966)).

92. Kirkwood v. Taylor, 590 F. Supp. 1375, 1377 (D. Minn. 1984).

93. *Id.* at 1378–82.

94. *Id.*

95. *Id.* at 1378–86.

96. Lee v. Ernst & Young LLP, 294 F.3d 969, 971 (8th Cir. 2002).

97. *See Id.* at 971–72 (citing In re Summit Med. Sys., Inc., Sec. Litig., 10 F. Supp. 2d 1068, 1070 (D. Minn. 1998)).

defendant.[98] In 2002, the Eighth Circuit reversed the District Court. The Eighth Circuit confirmed the tracing requirement, without any privity requirement, as follows:

> We hold in the present case that standing to pursue a claim against E[rnst] & Y[oung] pursuant to [Section] 11 of the 1933 Act exists for aftermarket purchasers of Summit stock who can make a prima facie showing that the Summit shares they purchased can be traced to the registration statement alleged to be false and misleading.[99]

The Eighth Circuit also rejected the defendant's claim that the U.S. Supreme Court's decision in *Gustafson v. Alloyd* precluded aftermarket liability under Section 11.[100] The Eighth Circuit pointed out that *Gustafson* was a case under Section 12(a)(2) and not Section 11, and that *Gustafson* pertained to a totally different fact situation.[101]

D. Ninth Circuit

In *Abbey v. Computer Memories, Inc.* (1986), the U.S. District Court for the Northern District of California imposed the tracing requirement in a Section 11 case.[102] The defendant had made two offerings of stock, only one of which was covered by the registration statement.[103] The judge rejected the plaintiff's claim that his shares were probably covered by the registration statement and rejected the plaintiff's use of the fungible mass theory.[104]

In 1999, the U.S. Court of Appeals for the Ninth Circuit decided *Hertzberg v. Dignity Partners, Inc.*[105] Dignity Partners, Inc. was in the viatical settlement business: it purchased the life insurance policies of persons with AIDS.[106] In the mid-1990s, medications to treat AIDS became available, so persons with AIDS were living longer; this caused the company's fortunes and its stock

98. *Id.* at 372.
99. *Lee*, 294 F.3d at 978 (alterations added).
100. *Id.* at 975.
101. *Id.* at 976–77
102. Abbey v. Computer Memories, Inc., 634 F. Supp. 870, 872 (N.D. Cal. 1986).
103. *Id.* at 872.
104. *Id.* at 872–76.
105. Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076 (9th Cir. 1999).
106. *Id.* at 1077–78.

price to decline.[107] Dignity Partners, Inc. had made only one public offering of stock; the offering was registered under the Securities Act of 1933.[108] Although the plaintiffs could not prove privity with the defendants in the purchase of the stock, the plaintiffs pointed out that all of the company's outstanding stock was registered.[109] Thus, under the tracing doctrine, the Ninth Circuit held that the plaintiffs had standing to sue under Section 11 of the 1933 Act.[110] The *Slack Technologies Inc.* case, discussed below, arose in the Northern District of California, in the Ninth Circuit.

E. Tenth Circuit

Joseph v. Wiles involved MiniScribe Corporation convertible debentures.[111] The plaintiffs sued under Section 11 of the 1933 Act in the U.S. District Court for the District of Colorado.[112] Like in the Eighth Circuit, the plaintiffs could trace security ownership back to the issuer, the District Court ruled for the defendants because the plaintiffs purchased the securities in the aftermarket and did not purchase the securities directly from the defendant.[113] In 2000, the Tenth Circuit reversed the District Court.[114] The Tenth Circuit confirmed the tracing requirement, without any privity requirement, as follows: "[W]e conclude that an aftermarket purchaser has standing to pursue a claim under [S]ection 11 so long as he can prove the securities he bought were those sold in an offering covered by the false registration statement."[115]

The Tenth Circuit also rejected the defendant's claim that the U.S. Supreme Court's decision in *Gustafson v. Alloyd* precluded aftermarket liability under Section 11.[116] Gustafson invoked Section 12(a)(2) and not Section 11 and pertained to a totally different fact situation.[117]

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107. *Id.*
108. *Id.* at 1078
109. *Id.* at 1078, 1082.
110. *Id.* at 1082.
111. Joseph v. Wiles, 223 F.3d 1155, 1157 (10th Cir. 2000). The Federal District Court decision is unreported.
112. *Id.*
113. *Id.* at 1157–58.
114. *Id.* at 1157.
115. *Id.* at 1159 (alteration added).
116. *Id.* at 1160–61.
117. *Id.*

F. Eleventh Circuit

APA Excelsior III L.P. v. Premiere Technologies, Inc. was an Eleventh Circuit decision in 2007.[118] The court confirmed the need for tracing in a 1933 Section 11 case.[119] Additionally, the court held that a Section 11 case, in most circumstances, involves a conclusive presumption of reliance when the registration statement is materially false or misleading.[120] In this case, the court observed a narrow exception to the presumption of reliance because the case involved sophisticated investors making an arm's length investment commitment several months before the filing of the defective registration statement.[121]

G. Level of Specificity Required at Pleading Stage

The judicial circuits are not in agreement as to the degree of specificity needed to claim tracing at the pleading stage in a 1933 Act Section 11 case. For example, in the Second Circuit, general allegations are sufficient to claim tracing: "Accordingly, to establish standing under [Section] 11 at the motion to dismiss stage, [p]laintiffs need only assert that they purchased shares 'issued pursuant to, or traceable to the public offerings.'"[122]

In other circuits, a plaintiff must plead concrete facts in support of allegations of tracing. For example, the Ninth Circuit held: "When a company has issued shares in multiple offerings under more than one registration statement, however, a greater level of factual specificity will be needed before a court can reasonably infer that shares purchased in the aftermarket are traceable to a particular offering."[123]

In state court litigation, the defendant's objections are normally expressed in a demurrer. In the *Slack Technologies* state

118. APA Excelsior III L.P. v. Premiere Techs., Inc., 476 F.3d 1261 (11th Cir. 2007).
119. *Id.* at 1271–72
120. *Id.* at 1271.
121. *Id.* at 1277.
122. In re Bioscrip Sec. Litig., 95 F. Supp. 3d 711, 746 (S.D.N.Y. 2015) (alteration added) (quoting In re WRT Energy Sec. Litig., 75 F.App'x 839, 840 (2d Cir. 2003)).
123. In re Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1107 (9th Cir. 2013), *discussed in* Adam M. Apton, *Pleading Section 11 Liability for Secondary Offerings)* Adam M. Apton, *Pleading Section 11 Liability for Secondary Offerings*, ABA PRAC. POINTS, (Jan. 4, 2017), https://www.americanbar.org/groups/litigation/resources/newsletters/securities/pleading-section-11-liability-secondary-offerings/?login.

court litigation in California, the superior court judge overruled the defendants' demurrer, ruling that "[t]his is a factual dispute that need not be resolved at the pleading stage."[124]

H. Conclusions

The law of tracing under Section 11 of the 1933 Act has become well established. To have standing to sue under Section 11, one must trace ownership of the securities back to the defendant.[125] However, privity with the defendant is not required. Tracing is a judicial innovation; it is not found in federal statutes, federal legislative histories, SEC regulations, SEC releases, etc. Courts reject any argument that a portion of a fungible bulk of securities "probably" includes shares covered by the 1933 Act registration statement. In most other civil cases, the plaintiff succeeds with a preponderance of the evidence; here, the plaintiff fails to succeed with a preponderance of the evidence. None of the prior caselaw involved direct listing of securities, because direct listing did not exist until 2018. Pleading standards in Section 11 tracing cases have not been consistent among the federal circuits or the state courts. The courts' general acceptance of the tracing doctrine is attested in the securities law treatises of Louis Loss, Joel Seligman, and Troy Paredes;[126] Thomas Lee Hazen;[127] and Harold S. Bloomenthal and Samuel Wolff.[128]

III. TYPES OF OFFERINGS; TECHNOLOGY IN THE SECURITIES SETTLEMENT PROCESS CONVENTIONAL IPOS; DIRECT LISTINGS; SPACS

The three ways of taking a company public are the initial public offering ("IPO"), the direct listing, and the special purpose acquisition company ("SPAC"). Each has its own advantages and disadvantages in corporate finance.

In a conventional IPO, the corporate insiders have previously acquired their stock in the corporation by an exemption such as

124. Case Mgmt. Order #5 at 6, Slack Techs. S'holder Litig., (Cal. Super. Ct. Aug. 12, 2020) (No. 19CIV005370), 2020 WL 4919555 at *1, *2, *6.

125. *Id.* at *4.

126. 9 LOUIS LOSS ET.AL., SECURITIES REGULATION 366 (5th ed. 2018).

127. THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 278–279 (6th ed. 2009).

128. 2 HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES LAW HANDBOOK 70–74 (2021 ed).

Rule 144.[129] When the IPO takes place, a quantity of registered stock appears on the market.[130] Immediately after the IPO, the public shareholders can easily trace their stockholdings back to the registered offering because stock owned corporate insiders is subject to a lockup agreement, and thus is unavailable on the stock market.[131] Under a lockup agreement, the stock of the corporate insiders cannot be sold for a specified period, typically 180 days.[132] The lockup agreement is necessary to prevent the corporate insiders from dumping their stock onto the market; such dumping of stock onto the market would depress the market price jeopardize the underwriter's profitability.[133]

In a conventional IPO, the underwriting firm makes a firm commitment to sell the issuer's stock, in exchange for an underwriting commission and related fees. In a direct listing, there is no underwriting firm.[134] This eliminates the underwriting commission and related fees, but also eliminates the firm commitment to sell the issuer's stock; instead, the stock is released onto the stock market for whatever price the market determines.[135]

In a direct listing, as in a conventional IPO, corporate insiders have typically obtained their company stock through an exemption such as Rule 144.[136] However, unlike a conventional IPO, the registered stock and the exempted stock are listed simultaneously on the stock market.[137] There is no lockup period for the exempted stock because there is no underwriter.[138] Thus, public shareholders have no way of tracing their stockholdings back to registered stock or exempted stock.[139]

A SPAC is defined in Investopedia as "a company without commercial operations and is formed strictly to raise capital through an initial public offering (IPO) for the purpose of acquiring

129. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 379 (N.D. Cal. 2020).
130. *Id.* at 379.
131. *Id.*
132. *Id.*
133. *Id.*
134. Order Setting Aside Action by Del. Auth. and Approving a Proposed Rule Change, Exchange Act Release No. 34-90768, 85 Fed. Reg. 85807, 85815 (Dec. 22, 2020).
135. *Id.* at 8508.
136. *Pirani,* 445 F. Supp. 3d at 379.
137. *Id.*
138. *Id.* at 370–80.
139. *Id.* at 379.

or merging with an existing company."[140] Thus, a SPAC is a specialized type of IPO.

A. History of the Securities Settlement Process

At the time of the enactment of the 1933 and 1934 Acts, stock issuance and transfer were very much based on paper stock certificates.[141] William Harman Black describes this paper-based system in detail in his 1940 book *The Law of Stock Exchanges, Stockbrokers, and Customers* (1940).[142] Chapter 29 of that book, entitled Registration, Transfer, and Assignment of Securities, describes this paper-based system in detail.[143] The only reference to street name securities is a definition contained in the glossary at the end of the book: "When a certificate stands in the name of a Stock Exchange firm."[144] Thus, at that time, it was easy to trace the ownership of a stock certificate from one person to the next.

The 1960s saw a paperwork crisis on Wall Street, making it obvious that the system based on paper stock certificates needed to be replaced.[145] Street name accounts became the norm, with brokerage firms holding their clients' securities in fungible bulk.[146] The Depository Trust Company ("DTC") and the National Securities Clearing Corporation ("NSCC") provided electronic clearing and settlement services.[147] Thus, at the time of the various Section 11 tracing cases, tracing ownership of a stock position from one investor to another was totally unrealistic.

B. Possible Future Developments in the Securities Settlement Process

Although the Section 11 tracing cases were decided at a time when technology did not permit tracing of stock ownership,

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140. Julie Young, *Special Purpose Acquisition Company (SPAC) Explained: Examples and Risks*, INVESTOPEDIA (Dec. 16, 2023) https://www.investopedia.com/terms/s/spac.asp.

141. 1 William Harman Black, *The Law of Stock Exchanges, Stockbrokers, and Customers*, 51–53 (1940).

142. *See Id., generally*

143. *Id.* at 432–46.

144. *Id.* at 769.

145. *Regulation of Clearing Agencies and Transfer Agents: Hearings Before the Subcomm. on Banking, Housing, and Urban Affairs*, 93rd Cong. 1 (1973) [hereinafter *Hearings*]; U.S. GOV'T ACCOUNTABILITY OFF., GDD-97-73, PAYMENTS, CLEARANCE, AND SETTLEMENTS: A GUIDE TO THE SYSTEMS, RISKS, AND ISSUES, 107, (1997) [hereinafter, PAYMENTS].

146. *Hearings*, s*upra* note 145 at 44, 49.

147. PAYMENTS, *supra* note 145 at 48.

technology continues to advance, especially in the area of distributed ledger and blockchain technology. An SEC web page provides the following definitions:

> ["D]istributed ledger[“] refers to databases that maintain information across a network of computers in a decentralized or distributed manner. These networks commonly use cryptographic protocols to ensure data integrity and consensus mechanisms to ensure data congruity. Blockchains are one type of distributed ledger, and they are often used to issue and transfer ownership of . . . digital assets that may be securities, depending on the facts and circumstances.[148]

In 2017 and 2018, two law review articles were published, describing blockchain technology, advocating its use in securities settlements in general, and advocating its use in tracing securities ownership in particular. The first of these two articles was written by Sean Belcher, and appeared in the Colorado Technology Law Journal,[149] and the second was written by Kelsey Bolin, and appeared in the Washington University Law Review.[150]

Sean Belcher commented, “If all publicly traded companies registered their shares on a blockchain-based platform, the process of determining what offering one’s shares came from would take minutes, if not seconds.”[151] He noted that a blockchain tracing system could be established by SEC mandate, or could be established by cooperative action of securities market participants; he recommended the latter course of action.[152] Kelsey Bolin’s article concluded, “[A]pplying decentralized public ledger technology to securities transactions will enable more plaintiffs to achieve standing under Sections 11 and 12(a)(2) of the Securities Act.”[153]

The SEC has established the Strategic Hub for Innovation and Financial Technology (“FinHub”), a working group designed to

148. *Office of Strategic Hub for Innovation and Financial Technology (FinHub),* U.S. SEC. EXCH. COMM’N, (alterations added) https://www.sec.gov/about/divisions-offices/office-strategic-hub-innovation-financial-technology-finhub (last visited Oct. 23, 2024).

149. Sean Belcher, *Tracing the Invisible: Section 11’s Tracing Requirement and Blockchain*, 16 COLO. TECH. L.J. 145 (2017).

150. Kelsey Bolin, *Decentralized Public Ledger Systems and Securities Law: New Applications of Blockchain Technology and the Revitalization of Sections 11 and 12(a)(2) of the Securities Act of 1933*, 95 WASH. U. L. REV. 955 (2018).

151. Belcher, *supra* note 149, at 167.

152. *Id.* at 167, 169.

153. Bolin, *supra* note 150, at 980.

coordinate the SEC's regulatory efforts regarding emerging technologies, including blockchain.[154] In 2012, the SEC adopted Rule 613 under the 1934 Act.[155] Rule 613 requires self-regulatory organizations such as the NYSE and NASDAQ to formulate the Comprehensive Audit Trail, which would employ the latest technology in tracing securities transactions.[156] Development of the Comprehensive Audit Trail is an ongoing multi-year process. Thus, although the technology is not yet in place to allow for electronic tracing of securities ownership, a few years from now such technology will probably be in place.

IV. SRO DIRECT LISTING RULES AND EXPERIENCE

A. SRO Direct Listing Rules

"Direct listing" and "direct public offering" are equivalent terms and are used interchangeably. The federal securities statutes do not refer to "direct listing" or "direct public offering." Furthermore, SEC regulations do not use those terms, nor does the SEC issue any interpretive guidance. Instead, the SEC regulates direct listings by means of approving self-regulatory organization ("SRO") rules and standards which govern direct listings.[157] In accordance with 1934 Act Rule 19b-4, all SRO rules and standards require SEC approval.[158]

There are two types of direct listings: selling shareholder direct listings and primary direct listings. Selling shareholder direct listings involve previously issued shares, while primary direct listings involve newly issued shares.[159] Direct listings are limited to common stock; they do not involve preferred stock, bonds, etc.[160] Direct listings should not be confused with exchange

154. U.S. SEC. & EXCH. COMM'N, *supra*, note 148.

155. 17 C.F.R. § 242.613 (2024); Consolidated Audit Trail, Exchange Act Release No. 67457, 77 Fed. Reg. 45722 (Aug. 1, 2012) (codified at 17 C.F.R. § 242.613).

156. 17 C.F.R. § 242.613(a)(1)(v).

157. For example, the NYSE rule, by which Slack Technologies conducted its direct listing, was requested by the NYSE on June 13, 2017. The SEC published the proposed rule (83 Fed. Reg. 5650) and approved it on February 8, 2018.

158. 17 C.F.R. § 270.19b-4 (2024).

159. 24A WILLIAM M. PRIFTI, SECURITIES: PUBLIC AND PRIVATE OFFERINGS § 7:1.50 (2d ed.) Westlaw (database updated August 2024); *see A Current Guide to Direct Listings*, GIBSON DUNN (Jan. 1, 2018), https://www.gibsondunn.com/a-current-guide-to-direct-listings/.

160. N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL § 102.01B, Footnote (E) limits direct listings to "common equity securities."

distributions. Exchange distributions have been permitted on exchange floors for many years and involve a transaction between a single seller of a large quantity of stock and multiple buyers.[161] Exchange distributions are governed by detailed exchange rules.[162]

The NYSE rules and standards for selling shareholder direct listings were approved by the SEC, as published in the Federal Register on February 8, 2018.[163] NYSE rules and standards for primary direct listings were approved by the SEC, as published in December 2020.[164] Both types of direct listing are covered by NYSE Listed Company Manual Section 102.01B and footnote E thereunder.[165] The NYSE Listed Company Manual calls the two types of direct listings the "Selling Shareholder Direct Floor Listing" and the "Primary Direct Floor Listing," thus reminding people that the NYSE has a trading floor.[166]

The NASDAQ has made a series of regulatory filings with the SEC regarding direct listings.[167] (On NASDAQ, direct listings are a feature of its Global Select Market). The most significant of these regulatory filings occurred in May 2021, putting the NASDAQ direct listing system in approximately its present form.[168] Under NASDAQ rules, a selling shareholder direct listing is referred to as a "Direct Listing", while a primary direct listing is called a "Direct Listing with a Capital Raise."[169] NASDAQ direct listings are governed by Listing Rules IM-5315-1 and IM-5315-2.[170]

The SRO rules and standards for direct listings contain elaborate numerical criteria regarding the minimum size of the

161. JOHN DOWNES & JORDAN ELLIOT GOODMAN, BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 243 (10th ed. 2018).

162. *Id.*

163. Order Granting Accelerated Approval of Proposed Rule Change, Exchange Act Release No. 82627, 83 Fed. Reg. 5650, 5650 (Feb. 2, 2018).

164. Order Setting Aside Action by Delegated Auth. and Approving a Proposed Rule Change, Exchange Act Release No. 90768, 85 Fed. Reg. 85807, 85807 (Dec. 22, 2020).

165. N.Y. STOCK. EXCH., *supra* note 160.

166. *Id.*

167. Twelve of these appeared in the Federal Register; several amendments and numerous comment letters delayed the approval process.

168. Order Approving a Proposed Rule Change as Modified by Amendment No. 2, to Allow Companies to List in Connection with a Direct Listing, Exchange Act Release No. 91947, 86 Fed. Reg. 28169, 28169 (May 19, 2021).

169. NASDAQ, RULEBOOK - NASDAQ STOCK MKT. § IM-5315-1, IM-5315-2 (2021).

170. *Id.* at § IM-5315-1 is Selling Shareholder Direct Listing; *Id.* at § IM-5315-2 is Direct Listing with a Capital Raise.

offering.[171] However, even if the company meets all of the numerical criteria, approval of the direct listing is not automatic, but is at the discretion of the SRO.[172] The SRO establishes an "Indication Reference Price" for the opening of trading in the stock and appoints a "Designated Market Maker."[173]

In a primary direct listing on the NYSE, trading commences with a specialized type of order called an "Issuer Direct Offering Order," which is a variety of limit order.[174] In a primary direct listing on NASDAQ, trading commences with a specialized type of order known as a "Company Direct Listing Order," which is a variety of market order.[175]

A significant feature, or lack thereof, of direct listings is the absence of an underwriting firm. However, SRO rules and standards require an "independent third-party valuation" to verify that the offering meets the minimum size requirements.[176]

Before a direct listing can take place, the SEC must declare the 1933 Act registration statement effective.[177] The registration statement involves the due diligence of a law firm, an accounting firm, and other professionals, thus providing at least some evidence that the regulatory homework has been completed.[178]

In a 2023 article in *Florida State University Law Review*, Brent J. Horton took a skeptical view of this regulatory state of affairs:

> Yet, by approving direct listings in 2018 and approving the broader use of direct listings in 2020, the SEC did countenance the weakening of core investor protections. First, direct listings are "underwriter-less." There is no traditional underwriter to serve as a gatekeeper to prevent insiders from foisting troubled

171. N.Y. STOCK. EXCH., *supra* note 160. Section 102.01B Footnote (E) contains the numerical standards for direct listings. *Id.* The discretionary nature of direct listings also appears in Footnote (E): "[T]he Exchange will, on a case-by-case basis, exercise discretion to list companies that are listing in connection with a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing." *Id.*

172. *Id.*

173. Order Setting Aside Action by Delegated Auth. and Approving a Proposed Rule Change, *supra* note 164 at 85809–10.

174. *Id.* at 85809.

175. Order Approving a Proposed Rule Change as Modified by Amendment No. 2, to Allow Companies to List in Connection with a Direct Listing, Exchange Act Release No. 91947, 86 Fed. Reg. 28169, 28171 (May 7, 2021).

176. N.Y. STOCK. EXCH., *supra* note 160.

177. Order Setting Aside Action by Delegated Authority and Approving a Proposed Rule Change, 85 Fed. Reg. at 85808 n.15.

178. *Id.* at 85814.

> companies on the public at inflated valuations. Second, if investors are harmed, there are fewer remedies available. One of the primary remedies for harmed investors— Section 11 of the Securities Act—is largely unworkable in the context of a direct listing.[179]

In December 2022, the SEC approved rule changes of both the NYSE and NASDAQ which expanded the price range at which primary direct listing trading could commence.[180] For primary direct listings, these rule changes also required the appointment of an underwriter which would perform at least some of the functions of a traditional underwriter.[181]

B. SRO Direct Listings Experience

From SEC approval of the NYSE listing standard for selling shareholder direct listings in 2018 until August 2023, there have been fifteen identifiable direct listings (total of ten on the NYSE and five on NASDAQ).[182] Spotify was the first direct listing, on April 3, 2018.[183] Slack was the third direct listing, on June 20, 2019.[184] (Slack Technologies was the only direct listing which produced any identifiable litigation.) During that period, several hundred companies went public by means of a conventional IPO. Thus, direct listings have not been very popular. The Appendix to this Article is a roster of all identifiable direct listings. All fifteen have been selling shareholder direct listings, and none have been primary direct listings. (Asana, in addition to its direct listing on

179. Brent J. Horton, *Direct Listings and the Weakening of Investor Protection*, 50 FLA. ST. U. L. REV. 279, 283 (2023).

180. Order Approving a Proposed Rule Change, Exchange Act Release No. 96514, 87 Fed. Reg. 78141, 78141–42 (Dec. 15, 2022); Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of a Proposed Rule Change, Exchange Act Release No. 96443, 87 Fed. Reg. 75305, 75305–06 (Dec. 2, 2022).

181. Order Approving a Proposed Rule Change, 87 Fed. Reg. at 78142; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of a Proposed Rule Change, 87 Fed. Reg. at 75308.

182. See *infra,* Appendix, which is based on a Google search for public announcements of direct listings.

183. Chuck Mikolajczak & Stephen Nellis, *Spotify Shares Jump in Record-Setting Direct Listing*, REUTERS (Apr. 3, 2018, 6:27 PM), https://www.reuters.com/article/technology/spotify-shares-jump-in-record-setting-direct-listing-idUSKCN1HA121/.

184. U.S. SEC. & EXCHANGE COMM'N, Slack Techs., Inc.*,* (Form 10-K) 68, 81 (Jan. 31, 2021).

the NYSE, is listed on the San Francisco-based Long-Term Stock Exchange.[185])

V. SLACK TECHNOLOGIES LITIGATION

None of the cases involving Section 11 tracing of conventionally issued securities ever made it to the U.S. Supreme Court. The only Section 11 tracing case to go before the U.S. Supreme Court was *Slack Technologies Inc., v. Pirani*, which involved a direct listing of securities.

Slack Technologies was incorporated as a Delaware business corporation in 2009.[186] It was originally named Tiny Speck, Inc., but changed its name to Slack Technologies Inc. in 2014.[187] Slack was qualified to do business in California as an out-of-state business corporation[188] as its headquarters were in San Francisco.[189] Slack Technologies was a provider of a cloud-based collaboration and productivity platform.[190]

The offering in question involved Class A common stock, with 118 million shares (42% of the offering) registered under the 1933 Act and with 165 million shares (58% of the offering) exempt under Rule 144 of the 1933 Act, for a total of 283 million shares.[191] Slack Technologies filed a 1933 Act registration statement with the SEC on Form S-1.[192] The Prospectus was on SEC Form 424B4.[193] The SEC declared the registration effective on June 7, 2019.[194] The offering, both registered shares and exempt shares, went public on

185. The Long-Term Stock Exchange is located in San Francisco. It received SEC approval to operate as a national securities exchange in 2019.

186. *General Information Name Search*, DEP'T OF STATE: DIV. OF CORPS., https://icis.corp.delaware.gov/eCorp/EntitySearch/NameSearch.aspx (search "4659487" in File Number, select "Slack Technologies, Inc.") (last visited Oct. 23, 2024).

187. U.S. SEC. & EXCHANGE COMM'N, Slack Techs., Inc., Annual Report (Form 10-K) 13 (Jan. 31, 2021).

188. *Business Search*, CAL. SEC'Y OF STATE, https://bizfileonline.sos.ca.gov/search/business (search "3191734") (last visited Oct. 23, 2024).

189. U.S. SEC. AND EXCHANGE COMM'N, Slack Techs., Inc., Annual Report (Form 10-K) 54 (Jan. 31, 2021).

190. *Id.* at 3, 24.

191. Slack Techs., Inc., v. Pirani, 598 U.S. 759, 763–64.

192. U.S. SEC. & EXCHANGE COMM'N, Slack Techs., Inc., Registration Statement (Form S-1) (Apr. 26, 2019).

193. Slack Techs., Inc., 118,429,640 Shares of Class A Common Stock (Form 424B4) (June 7, 2019).

194. U.S. SEC. & EXCHANGE COMM'N, Slack Techs., Inc., Notice of Effectiveness (Form S-1) (June 7, 2019).

the NYSE on June 20, 2019, with the ticker symbol WORK.[195] The reference price was $26.00; this was an estimate provided by NYSE officials.[196] The stock actually opened at $38.50.[197]

As noted above, the NYSE adopted a rule for selling shareholder direct listings in 2018 and adopted a rule for primary direct listings in 2020. The NYSE's rule for selling shareholder direct listing governed Slack's direct listing in 2019.[198] Thus, the shares in question were already outstanding, and Slack Technologies did not receive any offering proceeds on that date.[199]

On December 1, 2020, Salesforce, Inc. (NYSE ticker symbol CRM) announced its acquisition of Slack Technologies for $27.7 billion.[200] Since the sale closed in July 2021, Slack has operated as a subsidiary of Salesforce.[201]

A. Slack Technologies State Court Litigation

The only state court litigation regarding the Slack Technologies direct listing took place in California. The first California state court lawsuit against Slack Technologies was filed in Superior Court, San Mateo County, on September 12, 2019.[202] (San Mateo County encompasses Silicon Valley.) It was entitled *Farina v. Slack Technologies Inc.*[203] It made claims under Sections 11, 12(a)(2), and 15 of the 1933 Act, but made no state law claims.[204] The Complaint pointed out that, under Section 22 of the 1933 Act, the action was not removable to the federal courts.[205]

195. U.S. SEC. & EXCHANGE COMM'N, Slack Techs., Inc., Annual Report (Form 10-K) 68 (Jan. 31, 2021).

196. Lauren Feiner, *Slack Shares Surge 48% Over Reference Price in Market Debut*, CNBC, https://www.cnbc.com/2019/06/20/slack-direct-listing-stock-begins-trading-on-new-york-stock-exchange.html (June 20, 2019, 4:04 PM).

197. *Id.*

198. N.Y. STOCK EXCH., *supra* note 160.

199. The traditional limitation of direct listings to shares previously outstanding is discussed in PRIFTI, *supra* note 159.

200. Erin Griffith & Lauren Hirsch, *Salesforce to Acquire Slack for $27.7 Billion*, N.Y. TIMES, https://www.nytimes.com/2020/12/01/technology/salesforce-slack-deal.html (Jan. 4, 2021).

201. *Salesforce Completes Acquisition of Slack*, SALESFORCE (July 21, 2021), https://www.salesforce.com/news/press-releases/2021/07/21/salesforce-slack-deal-close/.

202. Class Action Complaint for Violations of the Securities Act of 1933, Farina v. Slack Techs., Inc., No. 19-CIV-05370 (Cal. Super. Ct. Sept. 12, 2019).

203. *Id.*

204. *Id.* at 1.

205. *Id.* at 3.

Five additional lawsuits were filed against Slack Technologies.[206] All six of these lawsuits were consolidated under the caption *Slack Technologies Inc., Shareholder Litigation*.[207] Judge Marie S. Wiener presided over the case.[208] Various local counsel represented the plaintiffs.[209] Gibson Dunn & Crutcher LLP represented the defendants.[210]

The defendants filed a demurrer in February 2020.[211] On August 12, 2020, the court issued a Case Management Order which overruled the demurrer.[212] The court noted that the case was in the pleading stage, not the trial stage.[213] The court held that, regardless of the evidence of tracing required for the trial stage, the allegations of tracing in the Complaint were sufficient for the pleading stage.[214]

The court granted the plaintiffs leave to file an Amended Complaint, which they did in October 2020.[215] The defendants filed an Answer in November 2020.[216] The plaintiffs filed a motion for class certification on October 22, 2021; that motion remains pending.[217] On October 26, 2022, the state court action was stayed pending the certiorari petition to the U.S. Supreme Court.[218]

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206. Docket Sheet, Farina v. Slack Techs., Inc., No. 19-CIV-05370 (Cal. Super. Ct. Sept. 12, 2019).

207. *Id.*; Consolidated Class Action Complaint for Violations of the Securities Act of 1933, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Dec. 24, 2019).

208. Case Management Order Number Five, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Aug. 12, 2020).

209. *Id.* at 1.

210. *Id.* at 1–2.

211. Defendants' Notice of Demurrer and Demurrer to Plaintiffs' Consolidated Class Action Complaint for Violations of the Securities Act of 1933, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Feb. 20, 2020).

212. Case Management Order Number Five at 2, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Aug. 12, 2020).

213. *Id.* at 6.

214. *Id.* at 3.

215. First Amended Consolidated Class Action Complaint for Violations of the Securities Act of 1933, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Oct. 5, 2020).

216. Defendants' Answer to Plaintiffs' Unverified First Amended Consolidated Class Action Complaint for Violations of the Securities Act of 1933, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Nov. 3, 2020).

217. Plaintiffs' Notice of Motion and Motion for Class Certification and Appointment of Class Representatives and Class Counsel, *In re* Slack Techs., Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Oct. 22, 2021).

218. Order Continuing Motion for Class Certification and Motion to Strike Expert and Staying Case Pending Resolution of Writ of Certiorari, *In re* Slack Technologies, Inc. S'holder Litig., No. 19-CIV-05370 (Cal. Super. Ct. Oct. 26, 2022).

B. Slack Technologies Federal District Court Litigation

The federal class action regarding Slack Technologies was filed in the U.S. District Court for the Northern District of California on September 19, 2019,[219] and an Amended Complaint was filed on January 6, 2020.[220] The named plaintiff was originally Tyler Dennee.[221] Later, Fiyyaz Pirani was substituted as the named plaintiff, and the case became known as *Pirani v. Slack Technologies Inc.*[222] Los Angeles-based Glancy Prongay & Murray LLP represented the plaintiffs, while Gibson Dunn & Crutcher LLP represented the defendants.[223]

The defendants were Slack Technologies, Chief Executive Officer Stewart Butterfield, Chief Financial Officer Allen Shim, its Chief Accounting Officer Brandon Zell, and six of the company's Directors.[224]

> The Complaint alleged that the defendants failed to disclose to investors:
>
> (1) that the company's Slack Platform was susceptible to recurring service-level disruptions; (2) that such disruptions were increasingly likely to occur as the company scaled its services to a larger user base; (3) that the company would provide credits even if a customer was not specifically affected by service-level disruptions; (4) that, as a result, any service-level disruptions would have a material adverse impact on the company's financial results; and (5) that, as a result of the foregoing, the defendants' positive statements about the company's business, operations, and prospects were materially misleading and/or lacked a reasonable basis.[225]

Additionally, the Complaint alleged that, when news of the company's financial difficulties became public, its share price

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219. Class Action Complaint for Violations of Federal Securities Laws, Dennee v. Slack Techs., Inc., No. 19-CV-05857 (N.D. Cal. Sept. 19, 2019) [hereinafter Dennee Class Action Complaint].

220. Amended Class Action Complaint for Violations of Federal Securities Laws, Dennee v. Slack Techs., Inc., No. 19-CV-05857 (N.D. Cal. Jan. 6, 2020) [hereinafter Dennee Amended Class Action Complaint].

221. *Id.*

222. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 367 (N.D. Cal. 2020).

223. *Id.* at 371–72.

224. *Id.* at 372.

225. Dennee Class Action Complaint, *supra* note 219, at 2.

declined from $31.07 to $27.38.[226] The complaint further alleged violations of Sections 11 and 15 of the Securities Act of 1933.[227] The Amended Complaint alleged violations of Sections 11, 12, and 15 of the Securities Act of 1933.[228] No claims were made under state law.

The defendants filed a motion to dismiss on January 21, 2020.[229] The defendants alleged that the plaintiffs could not trace their shares to shares registered under the Securities Act of 1933 and thus lacked standing under Section 11.[230] The defendants also alleged that the plaintiffs lacked standing under Section 12 because the plaintiffs could not prove that the shares were sold to them "by means of a prospectus" and could not prove privity with the sellers.[231] The defendants further alleged that the Section 15 claim should be dismissed because the plaintiffs could not prove the underlying violations of Sections 11 and 12.[232]

At no point did the District Court conduct a full trial-type hearing. The District Court did issue an Order on April 21, 2020, which addressed the substantive issues in the case.[233] The court recognized that a direct listing was a novel development, so the question of whether to extend the tracing requirement to a direct listing was a matter of first impression.[234] The court noted that the simultaneous offering of registered and exempt shares would make tracing impossible and would "eviscerate the rights afforded by Section 11."[235] Thus, the court declined to extend the tracing requirement to direct listings.[236] The court also upheld the plaintiffs' claims under Sections 12(a)(2) and 15.[237] From the

226. *Id.*
227. *Id.*
228. Dennee Amended Class Action Complaint, *supra* note 220, at 4.
229. Defendants' Notice of Motion and Motion to Dismiss Amended Class Action Complaint for Violations of Federal Securities Laws; Memorandum of Points and Authorities in Support Thereof, Dennee v. Slack Techs., Inc., No. 19-CV-05857 (N.D. Cal. Jan. 21, 2020).
230. *Id.* at 7–9.
231. *Id.* at 10–14.
232. *Id.* at 23–24.
233. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 372 (N.D. Cal. 2020).
234. *Id.* at 378.
235. *Id.* at 379.
236. *Id.* at 381.
237. *Id.* at 384–85, 392–93.

District Court, the case went up to the U.S. Court of Appeals for the Ninth Circuit on an interlocutory appeal.[238]

C. Slack Technologies Case in the Ninth Circuit

The District Court Order of April 21, 2020, was certified for interlocutory appeal on June 5, 2020, at the request of the defendants.[239] On July 23, 2020, the Ninth Circuit granted the petition for interlocutory appeal.[240] The plaintiffs were represented by Bragar Eagel & Squire, P.C., and the defendants were represented by Gibson Dunn & Crutcher LLP.[241]

Three amici curiae briefs were filed, all of them in support of Slack Technologies: a brief from the Cato Institute;[242] a brief from the Securities Industry and Financial Markets Association ("SIFMA"), the National Venture Capital Association, and the U.S. Chamber of Commerce;[243] and a brief from former SEC Commissioner Joseph A. Grundfest.[244] These three amici curiae briefs argued in favor of stare decisis and advocated policy arguments in favor of capital formation.[245]

On September 20, 2021, a three-judge panel of the Ninth Circuit decided the case 2-1 in favor of the plaintiffs.[246] The opinion was written by Judge Jane A. Restani, who was joined by Chief Judge Sidney R. Thomas; Judge Eric D. Miller dissented.[247] The panel recognized that this was a case of first impression because direct listings had not been introduced until 2018; thus, the panel

238. Pirani v. Slack Techs., Inc., No. 19-cv-05857, 2020 WL 7061035, at *1 (N.D. Cal. June 5, 2020).

239. *Id.* at *1–2.

240. Pirani v. Slack Techs., Inc., 13 F.4th 940, 945 (9th Cir. 2021).

241. *Id.* at 942–43.

242. Brief of the Cato Institute as Amicus Curiae in Support of Petition for Rehearing and Rehearing En Banc, Pirani v. Slack Techs., Inc., 13 F.4th 940 (9th Cir. 2021) (No. 20-16419) [hereinafter The Cato Institute Amici Curiae Brief].

243. Brief of Amici Curiae Securities Industry and Financial Markets Association, Chamber of Commerce of the United States of America, and National Venture Capital Association in Support of Defendants-Appellants, *Pirani*, 13 F.4th 940 (No. 20-16419) [hereinafter The SIFMA Amici Curiae Brief].

244. Brief of Amicus Curiae Former SEC Commissioner Joseph A. Grundfest in Support of Defendants'-Appellants' Petition for Rehearing and Rehearing En Banc, *Pirani*, 13 F.4th 940 (No. 20-16419) [hereinafter The Former SEC Commissioner Amici Curiae Brief].

245. The Cato Institute Amici Curiae Brief, *supra* note 242, at 1; The SIFMA Amici Curiae Brief, *supra* note 243 at 1, 3; The Former SEC Commissioner Amici Curiae Brief, *supra* note 244, at 2.

246. *Pirani,* 13 F.4th at 943.

247. *Id.*

did not rely on the extensive case law that had interpreted Section 11 in more traditional settings over the years.[248] They also noted that this case was based on the novel regulatory structure of a direct listing, in which registered and exempted securities entered the market simultaneously.[249] The panel further noted that the NYSE direct listing rule required a registered offering (complete with a 1933 Act registration statement) to accompany the exempted offering.[250]

The Ninth Circuit panel examined the legislative history of the 1933 Act and focused on the following passage (emphasis added):" Fundamentally, these sections [11 and 12] entitle the buyer of securities *sold upon a registration statement* including an untrue statement or omission of a material fact to sue for recovery of his purchase price, or for damages."[251]

In view of the NYSE requirement for the registered offering to accompany the exempt offering, the Ninth Circuit found that both the registered shares and the exempted shares were "sold upon a registration statement" and thus would qualify under Section 11.[252] The panel went on to conclude that the exempted securities in the direct listing were "such securities" for purposes of Section 11.[253]

The panel observed that Section 12 liability (resulting from a false prospectus) is consistent with Section 11 liability (resulting from a false registration statement).[254] However, the panel concluded, "[t]he dispute is heavily fact dependent, and we decline to address it at this juncture," so the panel declined to rule on the Section 12 claim.[255] The panel upheld Pirani's Section 15 claim: "Because standing exists for Pirani's Section 11 claim against Slack, standing exists for the dependent Section 15 claim against controlling persons."[256]

In Judge Miller's dissent, he did not see this as a novel issue but instead saw it as another routine Section 11 tracing case.[257] He

248. *Id.* at 944, 946–47.
249. *Id.* at 946.
250. *Id.* at 947.
251. H.R. REP. No. 73–85, at 9 (1933).
252. *Pirani*, 13 F.4th at 948–49.
253. *Id.* at 947, 949.
254. *Id.*
255. *Id.* at 950.
256. *Id.*
257. *Id.* (Miller, J., dissenting).

cited cases from various circuits that upheld the Section 11 tracing requirements.[258] (His list of cited cases included *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.,* (1st Cir. 2011), which involved Sections 11, 12, and 15 of the 1933 Act, but which did not involve Section 11 tracing[259]). Upholding stare decisis over policy, he declared, "whatever the merit of the policy considerations, they are no basis for changing the settled interpretation of the statutory text."[260]

On May 2, 2022, the three-judge panel denied appellants' petition for rehearing and rehearing en banc.[261] The panel advised the full Ninth Circuit of the petition for rehearing en banc, and no judge requested a vote on whether to rehear the matter en banc.[262]

VI. INTERLOCUTORY APPEAL TO U.S. SUPREME COURT

A. Arguments of Slack Technologies

On August 31, 2022, Slack Technologies filed a petition for a writ of certiorari to the U.S. Supreme Court.[263] On November 2, 2022, Pirani filed his brief in opposition to the petition for a writ of certiorari.[264] On November 21, 2022, Slack Technologies filed its reply in support of the petition for a writ of certiorari.[265] On December 13, 2022, the U.S. Supreme Court granted the petition for a writ of certiorari.[266]

Slack's petition for certiorari and subsequent legal brief were based on Sections 11, 12, and 15 of the 1933 Act.[267] Slack alleged that the Ninth Circuit's decision conflicted with the decisions of seven other circuits regarding the scope of Section 11 over the past 60 years.[268] Slack also alleged that the Ninth Circuit decision

258. *Pirani*, 13 F.4th at 952 (Miller, J., dissenting).
259. *Id.* (citing Plumbers' Union Loc. No. 12 Pension Fund v. Nomura Asset Acceptance Corp., 632 F.3d 762, 768 & n.5 (1st Cir. 2011)).
260. *Pirani,* 13 F.4th at 953 (Miller, J., dissenting).
261. Order, Pirani v. Slack Techs., Inc., 13 F.4th 940 (9th Cir. 2021) (No. 20-16419).
262. *Id.*
263. Petition for a Writ of Certiorari, Slack Techs., LLC v. Pirani, 598 U.S. 759 (2023) (No. 22-200).
264. Brief for Respondent in Opposition to Petition for a Writ of Certiorari, *Pirani*, 598 U.S. 759 (No. 22-200).
265. Reply in Support of Petition for a Writ of Certiorari, *Pirani*, 598 U.S. 759 (No. 22-200).
266. Certiorari Granted, *Pirani*, 598 U.S. 759 (No. 22-200).
267. Petition for a Writ of Certiorari, *supra* note 263, at 2–3.
268. *Id.* at 3–5.

conflicted with the U.S. Supreme Court's decision in *Herman & MacLean v. Huddleston.*[269] That case was based on Section 10(b) of the 1934 Act; it was dictum as to Section 11 of the 1933 Act.[270] Furthermore, Slack alleged that, under *Gustafson v. Alloyd Co.,* Section 12 claims are limited to cases in which the plaintiffs can plead and prove that they purchased shares which were sold under the prospectus.[271]

Slack claimed that the Ninth Circuit's policy rationale was insufficient to overturn 60 years' worth of stare decisis.[272] Slack did not, however, advance any of its own policy arguments; thus, it did not explore the economics or legal risks of offering securities under a 1933 Act registration statement.[273]

B. Arguments of Pirani

Pirani's brief before the U.S. Supreme Court emphasized that this case of a direct listing is easily distinguishable from prior Section 11 tracing cases, which did not involve direct listings.[274] Pirani stressed that the NYSE direct listing rule requires exempted shares to be accompanied by shares registered under the 1933 Act.[275]

Latham & Watkins LLP advised Slack Technologies in its direct listing application. Pirani's brief noted that Latham & Watkins LLP attorneys had written an article which advocated direct listings as a means of evading Section 11 liability:

> In this article, we discuss another important advantage of the direct listing: the potential to deter private plaintiffs from bringing claims under Section 11 of the Securities Act of 1933, which imposes strict liability for material misstatements or omissions in registration statements. The primary reason a direct listing could deter litigation is by restricting the class of persons who have standing to sue under Section 11.[276]

269. *Id.* at 24–25 (citing Herman & MacLean v. Huddleston, 459 U.S. 375, 378 (1983)).
270. Petition for a Writ of Certiorari, *supra* note 263 at 24–25.
271. *Id.* at 7 (citing Gustafson v. Alloyd Co., 513 U.S. 561, 570-71 (1995)).
272. *Id.* at 3–5.
273. Petition for a Writ of Certiorari, *supra* note 263, at 3–5.
274. Brief for Respondent in Opposition to Petition for a Writ of Certiorari, *supra* note 264, at 2.
275. *Id.* at 1.
276. *Id.* at 11.

Pirani quoted the SEC approval order for NYSE primary direct listings in 2020:

> Although judicial precedent on this topic may continue to evolve, the Commission is aware of only one court [the Northern District of California] that has considered this issue in the direct listing context to date, and that court ruled in favor of allowing the plaintiffs to pursue Section 11 claims.[277]

Thus, although the SEC approval order did not recommend or require the elimination of the Section 11 tracing requirement in direct listing cases, Pirani claimed that the SEC approval order seemed to opine that the law has been evolving in that direction.

C. Briefs of Amici Curiae

Ten amici curiae briefs were filed with the U.S. Supreme Court, six in favor of Pirani and four in favor of Slack Technologies. Although the NYSE and NASDAQ had a financial interest in this case, from potential listing fees and transaction fees, they did not file amici curiae briefs, much less did they seek to join as parties to the litigation.

Likewise, the SEC did not participate in any capacity in the *Slack Technologies* case. In four prior civil cases regarding the Section 11 tracing requirement, the SEC filed amicus briefs expressing its position that a Section 11 claim requires tracing but not privity.[278]

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277. *Id.* at 12.

278. Brief for the Securities and Exchange Commission, Amicus Curiae, *Barnes v. Osofsky,* 373 F.2d 269 (2d Cir. 1967) (No. 30867-69); Brief of the Securities and Exchange Commission, Amicus Curiae, Supporting Appellants and Reversal Solely on the Issue Addressed, Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076 (9th Cir. 1999) (No. 98-16394); Brief of the Securities and Exchange Commission, Amicus Curiae, in Support of Appellants, In re WRT Energy Sec. Litig., 75 F. App'x 839 (2d Cir. 2003) (No. 02-7829); Brief of the Securities and Exchange Commission as Amicus Curiae in Support of Appellants on the Issues Specified, Lee v. Ernst & Young, LLP, 294 F.3d 969 (8th Cir. 2002) (No. 01-1369). Additionally, during oral argument before the Supreme Court, Chief Justice Roberts and Petitioners' attorney, Thomas Hungar, engaged in the following exchange:

> The Chief Justice: You indicated that the reason the SEC wasn't here, because they obviously adhered to the prior position that they had expressed. Do you have any evidence for that?
>
> Mr. Hungar: No, Your Honor, but we think that's a reasonable inference since, if they had wanted this Court to be aware that they had a different position, I would think they would have told the Court.

Oral Argument of Thomas G. Hungar on Behalf of the Petitioners at 31–32, Slack Techs., LLC v. Pirani, 598 U.S. 759 (2023) (No. 22-200).

D. Amici Curiae Briefs in Support of Pirani

On November 2, 2022, Bernstein Litowitz Berger & Grossman LLP filed an amicus curiae brief on behalf of eleven "Investor Amici Curiae."[279] These investors were large public pension funds.[280] The brief argued in favor of the policy of full and fair disclosure and argued that the Ninth Circuit opinion was supported by traditional statutory construction.[281] The brief argued that this was an issue of first impression:

> Deciding an issue of first impression, the Ninth Circuit held that in the specific situation of a direct listing offering of both registered and unregistered securities—a new mechanism that first became available in 2018—[Section] 11's reference to "such security" encompasses all securities issued in the direct listing because sale of all the securities was authorized by the registration statement.[282]

On March 6, 2023, an amicus curiae brief was filed on behalf of eight "Former SEC Officials."[283] Four of these officials had previously served as SEC Commissioners: Luis A. Aguilar, Roberta Karmel, Allison Herren Lee, and Bevis Longstreth.[284] This brief stressed the importance of private enforcement of Sections 11 and 12 of the 1933 Act and noted that the SEC expected that these sections would apply to direct listings.[285]

That same day, an amicus curiae brief was filed on behalf of four "Evidence and Civil Procedure Scholars."[286] This brief argued that, in a Section 11 tracing case, the plaintiff should be presumed to have standing.[287] This brief also recommended that the case be remanded rather than dismissed.[288]

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279. Brief of Investor Amici Curiae in Opposition to Petition for a Writ of Certiorari, Slack Techs., LLC v. Pirani, 598 U.S. 759 (2023) (No. 22-200).

280. *Id.* at 1–2, apps. 1–4.

281. *Id.* at 4–9.

282. *Id.* at 2.

283. Brief of Former SEC Officials as Amici Curiae in Support of Respondent, *Pirani*, 598 U.S. 759 (No. 22-200).

284. *Id.* at 1–4.

285. *Id.* at 4–6.

286. Brief of Evidence and Civil Procedure Scholars as Amici Curiae in Support of the Respondent, *Pirani*, 598 U.S. 759 (No. 22-200).

287. *Id.* at 4–15.

288. *Id.* at 15–16.

Additionally, on that same day, another amicus curiae brief was filed on behalf of sixteen "Law and Business Professors."[289] The most prominent among them were Thomas Lee Hazen and Joel Seligman.[290] This brief expressed concern that issuers could commingle registered and exempt shares to deliberately evade Section 11 tracing claims.[291] This brief recommended blockchain tracing to substantiate Section 11 claims and that the case be remanded to allow the plaintiffs to obtain evidence of tracing through reasonable discovery.[292]

An amicus curiae brief was also filed on behalf of thirteen "Institutional Investors," most of which were public pension funds.[293] The brief noted the Section 11 tracing problem created by the commingling of registered and exempt shares and urged the U.S. Supreme Court to affirm the Ninth Circuit decision.[294]

On March 6, 2023, an amicus curiae brief was filed on behalf of Nokota Capital Management L.P., a New York-based investment advisory firm registered under the Investment Company Act of 1940.[295] The brief noted that "critical investor protections" were at stake.[296] The brief argued that a direct listing should be regarded as a registered public offering because a direct listing takes place pursuant to NYSE rules approved by the SEC and because an effective 1933 Act registration statement is a prerequisite to a direct listing.[297]

E. Amici Curiae Briefs in Support of Slack Technologies

On February 3, 2023, Latham & Watkins LLP filed an amicus curiae brief on behalf of the U.S. Chamber of Commerce, SIFMA,

289. Brief for Amici Curiae Law and Business Professors in Support of Respondent, *Pirani*, 598 U.S. 759 (No. 22-200).
290. *Id.* at 1–3.
291. *Id.* at 3–6.
292. *Id.*
293. Brief of Institutional Investors as Amici Curiae in Support of Respondent, *Pirani*, 598 U.S. 759 (No. 22-200).
294. *Id.* at 2–4.
295. Brief for Nokota Capital Management, LP as Amicus Curiae Supporting Respondent, *Pirani*, 598 U.S. 759 (No. 22-200).
296. *Id.* at 1.
297. *Id.* at 1–2.

and the National Association of Manufacturers.[298] This brief argued that the Ninth Circuit decision was based on misplaced policy considerations, and would undermine the certainty needed for the operation of the capital markets.[299] The brief claimed that the Ninth Circuit decision would create Section 11 liability for Rule 144 offerings, which had never been done before.[300]

On February 3, 2023, Orrick Herrington & Sutcliffe LLP filed an amicus curiae brief on behalf of the Washington Legal Foundation.[301] The brief argued that the Section 11 tracing requirement has been well-established over the past 50 years.[302] First, the courts have uniformly upheld the tracing requirement.[303] Second, Congress has revisited Section 11 multiple times but has not provided an antecedent for "such securities."[304] (Congress has also revisited Section 12 but has made no changes to that section's privity requirement.[305]) The brief further argued that eliminating the tracing requirement would harm the capital markets.[306]

That same day, Wilmer Cutler Pickering Hale and Dorr LLP filed an amicus curiae brief on behalf of the Cato Institute.[307] The brief argued in favor of stare decisis, i.e. that the U.S. Supreme Court should follow the lower courts in upholding the Section 11 tracing requirement.[308] The brief further argued that direct listings create opportunities in the capital markets and that direct listings should not be burdened by eliminating the tracing requirement.[309] The brief recognized that securities transfer technology has changed since the enactment of the 1933 Act, but (citing *Krim v. pcOrder.com*) argued that it was up to Congress to keep abreast of changing technology.[310]

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298. Brief for the Chamber of Commerce of the United States of America, the Securities Industry and Financial Markets Association, and the National Association of Manufacturers as Amici Curiae in Support of Petitioners, *Pirani*, 598 U.S. 759 (No. 22-200).

299. *Id.* at 2–4.

300. *Id.* at 15–16.

301. Brief of Washington Legal Foundation as Amicus Curiae in Support of Petitioners, *Pirani*, 598 U.S. 759 (No. 22-200).

302. *Id.* at 2.

303. *Id.*

304. *Id.* at 3.

305. *Id.*

306. *Id.* at 3–4.

307. Brief for the Cato Institute as Amicus Curiae Supporting Petitioners, *Pirani*, 598 U.S. 759 (No. 22-200).

308. *Id.* at 2.

309. *Id.* at 3.

310. *Id.* at 11.

Additionally, that same day, Freshfields Bruckhaus Deringer US LLP filed an amicus curiae brief on behalf of former SEC Chair Jay Clayton and former SEC Commissioner Joseph A. Grundfest.[311] The brief argued that the Ninth Circuit decision conflicted with the 1933 Act's legislative history, statutory text, and case law.[312] It proposed three administrative solutions to the tracing problem:[313] first, assigning different ticker symbols to the registered and exempt shares;[314] second, implementing a one-day lockup period for the exempt shares;[315] and third using blockchain tracing.[316]

F. U.S. Supreme Court Oral Arguments and Decision

The U.S. Supreme Court's Notice of Questions Presented stated that the question before the Court "for more than 50 years" was a matter of "well-established law."[317] However, the issue of direct listings is novel, as direct listings did not exist until 2018.[318] (The Court's Notice of Questions Presented did little to enhance the Court's image of impartiality.)

Oral arguments before the U.S. Supreme Court took place on April 17, 2023.[319] Slack Technologies was represented by Thomas G. Hungar, a Partner at the DC office of Gibson Dunn & Crutcher LLP.[320] Pirani was represented by Kevin K. Russell, a Partner of Goldstein, Russell & Woofter LLC, a boutique law firm in Washington, DC.[321]

On April 17, 2023, all nine Justices attended oral arguments. Thomas G. Hungar (representing Slack Technologies) based his argument on stare decisis without making any policy arguments.[322] Kevin K. Russell (representing Pirani) presented a

311. Brief for Amici Curiae The Honorable Jay Clayton and The Honorable Joseph A. Grundfest in Support of Petitioners, *Pirani*, 598 U.S. 759 (No. 22-200).
312. *Id.* at 2–3.
313. *Id.* at 31–33.
314. *Id.* at 31–32.
315. *Id.* at 32–33.
316. *Id.* at 33.
317. Question Presented, *Pirani*, 598 U.S. 759 (No. 22-200).
318. Order Granting Accelerated Approval of Proposed Rule Change, *supra* note 164.
319. U.S. Supreme Court Argument Calendar (October 2022 Term), https://www.supremecourt.gov/oral_arguments/argument_calendars/MonthlyArgumentCalApril2023.pdf (Apr. 14, 2023).
320. Oral Argument of Thomas G. Hungar on Behalf of the Petitioners, *supra* note 278.
321. *Id.*
322. *Id.* at 3–4.

policy argument against stare decisis.[323] Justice Clarence Thomas, despite his conservative reputation, asked questions distinguishing between the law governing conventional offerings and the law governing direct listings.[324] Justice Brett Kavanaugh inquired whether extending the tracing requirement to direct listings would motivate issuers to issue exempt shares simultaneously with registered shares, creating an "opt-out" from Section 11 liability under the 1933 Act.[325] Hungar indicated that the Consolidated Audit Trail, being developed by self-regulatory organizations under the supervision of the SEC, could eventually enable the tracing of shares in direct listings.[326]

G. Summary of Opinion

The U.S. Supreme Court issued its decision on June 1, 2023.[327] It was a unanimous 9-0 decision in favor of Slack Technologies.[328] The *Pirani* opinion was written by Justice Neil Gorsuch.[329] This was one of the seven opinions he wrote in the first six months of 2023.[330] The Court's decision pertained exclusively to Section 11 liability and stated that the Court expressed "no views about the proper interpretation of [Section] 12 or its application to this case."[331] The decision was based on textual analysis and stare decisis; Little discussion of public policy and no discussion of legislative history was included.[332] The Court noted the problem that Section 11 referred to "such security" without providing an antecedent.[333]

The Court then raised seven points of textual analysis. First, Section 11 says "the" registration statement instead of "a"

323. *Id.* at 45–47.
324. *Id.* at 4–5.
325. *Id.* at 28.
326. Oral Argument of Thomas G. Hungar on Behalf of the Petitioners, *supra* note 278, at 31.
327. Slack Techs., LLC v. Pirani, 598 U.S. 759, 762 (2023). The Court issued its judgment on July 3, 2023, with Slack Technologies to recover costs of $1,955 from Pirani. Judgement, *Pirani*, 598 U.S. 759 (No. 22-200).
328. *Pirani*, 598 U.S. at 761.
329. *Id.*
330. The seven opinions by Justice Gorsuch in the first half of 2023 were Nos. 21-1168, 22-200, 21-757, 21-468, 21-887, 21-476, and 21-1195. *See* Opinions of the Court (October 2022 Term), https://www.supremecourt.gov/opinions/slipopinion/22 (last visited Sept. 17, 2024).
331. *Pirani*, 598 U.S. at 770 n.3.
332. *Id.* at 766.
333. *Id.*

registration statement or "any" registration statement, indicating a narrow reading of Section 11.[334] Second, Section 11 says "'such part' of the registration statement that contains misstatement or misleading omission.", further indicating a narrow reading of Section 11.[335] Third, Section 11 says "'such acquisition' when a person has acquired securities pursuant to the registration statement.", also indicating a narrow reading of Section 11.[336] Fourth, the Court noted that Section 11 says "'such untruth or omission' found in the registration statement."[337] The Court again found this indicative of a narrow reading of Section 11.[338] Fifth, the Court shifted to Section 5, which says that "[u]nless a registration statement is in effect for a security, it is unlawful to sell 'such security.'"[339] Sixth, the Court shifted to Section 6, which says that "a registration statement shall be deemed effective only as to the securities specified therein as proposed to be offered."[340] Seventh, the Court shifted to Section 11(e), which limits the recovery in a Section 11 case to the "total price at which the securities underwritten by him and distributed to the public were offered to the public."[341] As the Court pointed out, "[t]his provision thus ties the maximum available recovery to the value of the registered shares alone."[342]

The Court next turned to the matter of stare decisis. The Court referred to *Barnes v. Osofsky*, in which Judge Friendly concluded that "the narrower reading" of Section 11 was "the more natural one."[343] The Court observed that the narrower reading requiring proof of tracing had been consistently observed by the courts until the District Court and Court of Appeals decisions in *Pirani*.[344] The Court then turned to Pirani's policy argument that eliminating the Section 11 tracing requirement would serve the overarching purposes of the 1933 Act. The Court maintained that anything that

334. *Id.* at 767.
335. *Id.*
336. *Pirani*, 598 U.S. at 767.
337. *Id.*
338. *Id.*
339. *Id.* (alteration added)
340. *Id.*
341. *Pirani*, 598 U.S. at 767.
342. *Id.* at 766–68.
343. *Id.* at 768.
344. *Id.*

would serve the overarching purposes of a statute does not automatically become law.[345]

The Court noted that Congress is free to amend the securities laws at any time, "whether to address the rise of direct listings or any other development."[346] The Court vacated the Ninth Circuit's judgment and remanded the case to the Ninth Circuit.[347]

H. Subsequent Court Proceedings

The docket sheet of the California state court litigation indicates a scheduled settlement conference on February 23, 2024.[348] The docket sheet for the Ninth Circuit case indicates that on July 5, 2023, the Ninth Circuit requested the parties to file briefs on all issues remaining open after the U.S. Supreme Court decision.[349] The docket sheet for the Northern District of California case indicates no substantive developments following the U.S. Supreme Court decision.[350]

I. Subsequent Legislative and Regulatory Developments

The U.S. Supreme Court indicated that changes to the tracing requirement could be made by an Act of Congress.[351] Since the Court's decision, no bills have been introduced, on either the House or Senate side, which would modify the tracing requirement. Likewise, since the Court's decision, no regulatory developments regarding direct listings have occurred at the SEC, the NYSE, or NASDAQ.

VII. PATTERN OF JUDICIAL RULINGS

Thirteen members of the Federal bench have ruled in the *Slack Technologies* litigation: one District Court judge, three Court of Appeals judges, and nine Supreme Court justices. At the District Court level, Judge Illston (a Democratic nominee) ruled in favor of

345. *Id.* at 769.
346. *Id.* at 770.
347. *Pirani*, 598 U.S. at 770.
348. Docket Sheet, *Slack Techs. Inc.*, No. 19-cv-005370, (Cal. Super. Ct. 2023).
349. Docket Sheet, *Pirani v. Slack Techs., Inc.*, No. 20-16419 (9th Cir. 2023).
350. Docket Sheet, *Pirani v. Slack Techs., Inc.*, No. 3:19-cv-05857-SI (N.D. Cal. 2023).
351. *Pirani*, 598 U.S. at 770.

the plaintiffs.[352] At the Court of Appeals level, Judge Restani (a Republican nominee) and Chief Judge Thomas (a Democratic nominee) ruled in favor of the plaintiffs, while Judge Miller (a Republican nominee) ruled in favor of the defendants.[353] At the Supreme Court level, all nine justices (six Republican nominees and three Democratic nominees) ruled in favor of the defendants.[354] Thus, only one Republican nominee (Judge Restani) ruled in favor of the plaintiffs.

The thirteen members of the Federal bench who ruled in the *Slack Technologies* litigation had no identifiable experience in securities transactions. (Justice Neil Gorsuch had securities law experience, but only as a litigator.[355]F) Lawyers who arrange securities transactions acquire a sense of what is realistic and what is a potential deal-killer. **In particular, counsel to an institutional buyer would probably advise against investment in a direct listing without the availability of a Section 11 cause of action; such availability would be predicated on elimination of the Section 11 tracing requirement.**

In the first half of 2023, the U.S. Supreme Court issued 58 decisions: 23 unanimous decisions and 35 split decisions.[356] Thus,

352. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 372 (N.D. Cal. 2020); *Susan Illston*, U.S. DIST. CT., N. DIST. OF CAL., https://www.cand.uscourts.gov/judges/illston-susan-si/ (last visited Oct. 21, 2024).).

353. Pirani v. Slack Techs., Inc., 13 F.4th 940, 943 (9th Cir. 2021); *Jane A. Restani*, FED. JUD. CTR, https://www.fjc.gov/history/judges/restani-jane(last visited Oct. 21, 2024) (judicial biographical information regarding Judge Restani): *Sidney R. Thomas*, FED. JUD. CTR, https://www.fjc.gov/history/judges/thomas-sidney-runyan (last visited Oct. 9, 2024) (judicial biographical information regarding Judge Thomas); *Eric D. Miller*, FED. JUD. CTR, https://www.fjc.gov/history/judges/miller-eric-david (last visited Oct. 21, 2024) (judicial biographical information regarding Judge Miller).

354. Slack Techs., LLC v. Pirani, 598 U.S. 759, 761 (2023).

355. According to the White House Archives site, Justice Neil Gorsuch conducted securities fraud litigation while at the Kellogg Huber law firm. *See Neil Gorsuch*, THE WHITE HOUSE ARCHIVES, https://georgewbush-whitehouse.archives.gov/infocus/judicialnominees/gorsuch.html (judicial biographical information regarding Judge Gorsuch).

356. The unanimous decisions were Nos. 22-535, 22-174, 22-49, 22-227, 21-1576, 22-148, 22-200, 21-1326, 22-210, 22-166, 22-714, 21-1333, 21-757, 21-1496, 21-1599, 21-1170, 21-270, 156 Orig., 21-887, 145 Orig., 21-908, 21-1397, and 21-432. *See* Opinions of the Court (October 2022 Term), https://www.supremecourt.gov/opinions/slipopinion/22 (last visited Sept. 17, 2024). The split decisions were Nos. 21-476, 22-506, 21-1043, 20-1199, 21-1168, 22-138, 21-1271, 22-179, 22-105, 22-58, 22-196, 22-23, 21-1484, 22-381, 21-857, 21-1052, 21-376, 21-806, 22-10, 21-1086, 21-1449, 21-454, 21-869, 21-1454, 21-1436, 21-468, 22-96, 21-1158, 21-1450, 21-442, 21-86, 21-1164, 21-1195, 21-984, and 21-846. *Id.*; Michael D. Berry, *The Numbers Reveal a United Supreme Court, and a Few Surprises*, FEDERALIST SOC'Y

about 40% of its decisions were unanimous and therefore, despite the Court's reputation as a place of fractious disagreements, the Court's unanimous decision in the *Slack Technologies* case was not unusual.

VIII. ALTERNATIVE FORUM CONSIDERATIONS

Now that the U.S. Supreme Court has extended the Section 11 tracing requirement to direct listings, a plaintiff may consider various alternatives. Section 12(a)(2) provides liability for the use of a false or misleading prospectus.[357] However, this section's privity requirement can become an obstacle.[358] One alternative is an action in Federal court under Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.[359] The drawbacks are that the plaintiff must prove reliance, scienter, and causation.[360] However, privity and tracing are not required; the only requirement is that it must be "in connection with the purchase or sale of any security."[361] The Uniform Securities Act (1956, 1985, and 2002 versions) contains a section which approximates Rule 10b-5, so litigation in state courts would be a possibility.[362] Again, the plaintiff must prove reliance, scienter, and causation, but need not prove privity or tracing.[363]

State securities laws contain securities registration provisions; violations can lead to civil liability.[364] However, the National Securities Markets Improvement Act of 1996 ("NSMIA") has greatly reduced the number of securities registrations filed at the state level; furthermore, privity may be required.[365] One possible impediment to civil litigation in the state courts is the

(Aug. 2, 2023), https://fedsoc.org/commentary/fedsoc-blog/the-numbers-reveal-a-united-supreme-court-and-a-few-surprises.

357. Securities Act of 1933 § 12, 15 U.S.C. § 77l (2000).

358. *Id.* The defendant is liable only to "the person purchasing such security." *Id.*

359. Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5.

360. THOMAS LEE. HAZEN, SECURITIES REGULATION IN A NUTSHELL 189-195 (12th ed. 2021).

361. Securities Exchange Act of 1934.

362. UNIF. SEC. ACT § 101 (amended 1958), 7C U.L.A. 478 (2018); UNIF. SEC. ACT § 501 (amended 1988), 7C U.L.A. 436 (2018); UNIF. SEC. ACT § 101 (amended 2002), 7C U.L.A. 46 (2018). The antifraud provisions are in Section 101 of the 1956 Act, Section 501 of the 1985 Act, and Section 101 of the 2002 Act. *Id.*

363. 12A JOSEPH C. LONG ET AL., BLUE SKY LAW §§ 9:31, 9:32 (2008).

364. UNIF. SEC. ACT § 410 (amended 1958), 7C U.L.A. 621 (2018); UNIF. SEC. ACT § 605 (amended 1988), 7C U.L.A. 450 (2018); UNIF. SEC. ACT § 509 (amended 2002), 7C U.L.A. 286 (2018).

365. National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416.

Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which prohibits certain forms of state court class action securities litigation.[366] In 2018, the U.S. Supreme Court defined the boundaries of SLUSA in *Cyan, Inc. v. Beaver County Employees' Retirement Fund*.[367]

IX. POLICY CONSIDERATIONS AND MORAL HAZARD ANALYSIS

A. Policy Considerations

It is a basic ethical principle that one should take responsibility for one's conduct. In the context of Section 11 of the 1933 Act, the persons who sign the registration statement should be held responsible for anything false or misleading in the registration statement. They should not be able to evade liability by means of a tracing requirement. This principle is embodied in the legislative history of the 1933 Act: Section 5 of the House legislative history is entitled "Personal Responsibility."[368]

Liability should be imposed on the signatories of a registration statement because those persons are in a position to control the contents of the registration statement. Thus, the signatories decide whether to keep the disclosure honest or to involve false and misleading information or omissions. As pointed out in the House legislative history of the 1933 Act, "If one of two presumably innocent persons must bear a loss, it is a familiar legal principle that he should bear it who has the opportunity to learn the truth and has allowed untruths to be published and relied upon."[369]

As a matter of economics, broader liability promotes better disclosure. As William O. Douglas pointed out, "the spectre of liability will have a tendency to make for conservatism in statements and representations."[370] As a matter of corporate law, all shareholders of a given class have equal rights.[371] This should

366. Securities Litigation Uniform Standards Act of 1998, Pub. L. 105-353, 112 Stat. 3227.

367. Cyan, Inc. v. Beaver Cnty. Emps. Ret. Fund, 583 U.S. 416, 442–43 (2018).

368. 73 CONG. REC. 2464 (1933).

369. *Id.* at 2913.

370. William O. Douglas, *Protecting the Investor*, 23 YALE REV. 521, 524 (1934).

371. MODEL BUS. CORP. ACT § 6.01 (AM. BAR. ASS'N 2024) ("Except to the extent varied as permitted by this section, all shares of a class or series must have terms, including

include equal rights to sue for impairment of share value. If the right to sue under the 1933 Act is given to holders of traceable shares but not given to holders of non-traceable shares, it violates the corporate law principle of equal rights for all shareholders of a given class. This argument has not yet been made in litigation under Section 11 of the 1933 Act.

The only policy argument in favor of extending the tracing requirement to direct listings is that issuers would be more willing to issue securities if their legal exposure is limited to plaintiffs who can prove tracing.

B. Moral Hazard Analysis

"Moral hazard" was originally a term limited to the context of insurance law.[372] Even one of the latest editions of Black's Law Dictionary (10th ed. 2014) defines it in that context:

> **Moral hazard (1881).** A hazard that has its inception in mental attitudes, such as dishonesty, carelessness, and insanity. The risk that an insured will destroy property or allow it to be destroyed (usu[ally] by burning) in order to collect the insurance proceeds is a moral hazard. Also, an insured's potential interest, if any, in the burning of the property is sometimes called a moral hazard.[373]

Likewise, *Words and Phrases* lists eighteen examples of "moral hazard," all of which pertain to insurance.[374]

More recently, "moral hazard" has referred to any situation in which a regulatory system deficiency has created an incentive to engage in dysfunctional behavior. For example, Richard Posner's *Economic Analysis of Law* refers to "moral hazard" not only in the context of insurance, but also in the context of contract law, bankruptcy law, and other situations.[375] Frank H. Easterbrook and

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preferences, rights, and limitations that are identical with those of other shares of the same class or series."); 12B FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 5715 (perm. ed., rev. vol. 2009) ("In any event, all shareholders of the same class stand on equal footing both as to rights and as to liabilities, and those rights cannot be changed except in the manner provided by law.").

372. *Moral Hazard*, BLACK'S LAW DICTIONARY (10th ed. 2014).

373. *Moral Hazard*, BLACK'S LAW DICTIONARY (10th ed. 2014).

374. 27A WORDS AND PHRASES 193-94 (perm. ed. 2007 & Supp. 2022).

375. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (7th ed. 2007). The author discusses "moral hazard" in the context of insurance contracts, contract law, liability for

Donald R. Fischel's *The Economic Structure of Corporate Law* refers to "moral hazard" in the contexts of corporate limited liability and insider trading.[376]

The evolution of moral hazard from an insurance concept to an economic concept is also described in academic articles. A 1996 article by Tom Baker in the Texas Law Review goes into economic theory in detail, but still regards moral hazard as primarily an insurance concept.[377] A 2009 article by Karl S. Okamoto in the UCLA Law Review analyzes the 2008 financial crisis in terms of moral hazard: "The assertion of this Essay is that the root cause of the Financial Crisis was systemic moral hazard."[378] A 2012 article by David Rowell and Luke B. Connelly in *The Journal of Risk and Insurance* views moral hazard in terms of economic incentives: "The discipline of economics has since assimilated the term 'moral hazard' within its own literature to consider the role of incentives in a broad range of principal-agent relationships."[379]

Barron's Dictionary of Finance and Investment Terms (10th ed. 2018) defines "moral hazard" as primarily an economic concept:

> **MORAL HAZARD:** the risk that an action or a provision in an agreement will produce a result contrary to its purpose. For example, the fact that bond rating agencies are compensated by the companies they rate creates the obvious moral hazard that their ratings will have a favorable bias toward those companies. Bank bailouts are considered to be a moral hazard because they appear to make the world safe for institutions "too big to fail" that were the cause of the reckless lending that made the bailouts necessary. The GREENSPAN PUT encouraged stock market speculation leading up to the tech and real estate bubbles. The term related originally to insurance, as the insured are more inclined to take risks.[380]

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negligence, criminal law, bankruptcy law, and welfare programs. *Id.* at 110, 128, 169, 237-238, 436, 501.

376. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). The authors discuss "moral hazard" in the context of corporate limited liability and insider trading. *Id.* at 49–50, 58–59, and 60–61, 260.

377. Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 248–55 (1996).

378. Karl S. Okamoto, *After the Bailout: Regulating Systemic Moral Hazard*, 57 UCLA L. REV. 183, 183 (2009).

379. David Rowell & Luke B. Connelly, *A History of the Term "Moral Hazard,"* 79 J. RISK & INS. 1051, 1069 (2012).

380. JOHN DOWNES & JORDAN ELLIOT GOODMAN, BARRON'S DICTIONARY OF FINANCE AND INVESTMENT TERMS 463 (10th ed. 2018).

The Investopedia entry for moral hazard sums it up succinctly: "Anytime a party in an agreement does not have to suffer the consequences of a risk, the likelihood of a moral hazard increases."[381] **In the context of direct listings, the elimination of Section 11 liability creates a moral hazard: the issuer is incentivized to conduct a direct listing, because the issuer does not have to risk the strict liability consequences of registration statement deficiencies.** In the context of traditional initial public offerings, a 2005 article by Christine Hurt in the Cardozo Law Review argued that an underwriter's efforts to build up a book of reliable institutional investors creates a moral hazard, to the extent such efforts disadvantage retail and other investors.[382]

X. ALTERNATIVES FOR LEGISLATIVE AND REGULATORY ACTION

The federal law of civil liability for securities law violations is a well-established structure based on Section 11 of the 1933 Act, Section 12(a)(2) of the 1933 Act, and Rule 10b-5 under the 1934 Act.[383] Elimination of the Section 11 tracing requirement creates a pathway for issuers to evade Section 11. If large numbers of issuers evade Section 11, the structure of federal civil liability for securities law violations would be impaired.

The 1933 Act was enacted when securities were paper certificates bearing the names of individual investors, but nowadays the securities industry features street name registration and net balance settlement systems.[384] There is a legal maxim, *"Ratio est legis anima, mutata legis ratione, mutatur et lex."* ("Reason is the soul of the law; when the reason of the law has been

381. Will Kenton, *Moral Hazard: Meaning, Examples, and How to Manage*, INVESTOPEDIA, https://www.investopedia.com/terms/m/moralhazard.asp (June 24, 2024).

382. Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 733 (2005).

383. Securities Act of 1933 § 11, 15 U.S.C. § 77k (1998); Securities Act of 1933 § 12, *id.* § 77l; Securities Exchange Act of 1934, 17 C.F.R. § 240.10b-5.

384. *Regulation of Clearing Agencies and Transfer Agents: Hearing on S. 2058 Before the Subcomm. on Sec. of the S. Comm. on Banking, Hous., and Urb. Affs.*, 93d Cong. 274-275 (1973); U.S. GOV'T ACCOUNTABILITY OFF., GGD-97-73, PAYMENTS, CLEARANCE, AND SETTLEMENTS: A GUIDE TO THE SYSTEMS, RISKS, AND ISSUES 49 (1997).

changed, the law is also changed.")[385] Thus, the law should change to keep up with these technological changes.

Now that the U.S. Supreme Court has extended the tracing requirement to direct listings, Congress could amend the 1933 Act to make Section 11 more difficult to evade. Three possible amendments should be considered. First, Congress could amend Section 11 to replace "such security" with "the security of such class" in Section 11.[386] This would abolish the tracing requirement completely. Second, Congress could amend Section 11 to provide for tracing based on percentages of the fungible mass of outstanding securities of a given class. Thus, if Consolidated Widget Corporation has 1,000,000 Class A shares outstanding, with 800,000 shares registered under the 1933 Act and 200,000 shares exempt under Rule 144, then each plaintiff's Section 11 claim would be reduced by 20%.[387] Third, Congress could amend Section 11 to provide for tracing by means of the latest blockchain technology. This would harmonize with the development of the Consolidated Audit Trail. Thus, if a plaintiff owns 100,000 Class A shares of Consolidated Widget Corporation, and blockchain technology shows that 70,000 shares are registered under the 1933 Act and 30,000 are exempt under Rule 144, the plaintiff's claim would be reduced by 30%. If another plaintiff owns 100,000 shares of the same class, and blockchain technology shows that 60,000 shares are registered and 40,000 shares are exempt, the claim would be reduced by 40%.[388] This change could be done administratively, but would be on firmer ground if authorized by Congress.

The first of the foregoing alternatives would enhance investor protection. However, various interest groups would likely oppose that alternative in Congress. The second and third alternatives would be more compromising and, therefore, more likely to survive the legislative process.

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385. This legal maxim could not be traced to any classical author but was included in BLACK'S LAW DICTIONARY. *See Ratio Est Legis Anima, Mutata Legis Ratione Mutatur Et Lex*, BLACK'S LAW DICTIONARY (12th ed. 2024).

386. The U.S. Supreme Court suggested this type of statutory amendment in *Pirani*. *See Slack Techs., LLC v Pirani*, 598 U.S. 759, 769-770.

387. The fungible mass method was discussed but rejected in *Kirkwood* and *Abbey*. *See* Kirkwood v. Taylor, 590 F. Supp. 1375, 1379-1380 (D. Minn. 1984); *Abbey v. Comput. Memories, Inc.*, 634 F. Supp. 870, 876 (N.D. Cal. 1986).

388. Counsel for Slack Technologies suggested this in his oral argument. *See* Oral Argument of Thomas G. Hungar on Behalf of the Petitioners, *supra* note 278, at 31.

Three administrative approaches to the Section 11 tracing problem should also be considered. The first administrative approach would be to assign one ticker symbol to the registered portion of a direct listing, and another ticker symbol to the exempt portion of a direct listing. Shareholders of the registered portion would have the right to sue under Section 11, while shareholders of the exempt portion would not and would necessarily seek remedies under other statutory sections.[389] Ticker symbols are assigned based on negotiations between SRO staff and corporate officers. The second administrative approach would be to make the exempt shares available for trading one business day after the registered shares are made available for trading, i.e. there would be a lockup period of one business day for the exempt shares.[390] This could be accomplished by changes in the SRO listing rules, to be approved by the SEC. The third administrative approach would be to let advances in blockchain technology create opportunities for tracing ownership of shares, in the context of developments in the Consolidated Audit Trail.[391]

The U.S. Supreme Court's *Pirani* decision has left the law of Section 11 liability in suboptimal condition. Restoring it to an optimal state could take two paths: either eliminating or modifying the tracing requirement legislatively or allowing technology and brokerage firm operations to bypass the tracing requirement administratively.

389. Brief for Amici Curiae The Honorable Jay Clayton and The Honorable Joseph A. Grundfest in Support of Petitioners, *supra* note 312, at 31–32.

390. *Id.* at 32–33.

391. *Id.* at 33.

APPENDIX: ROSTER OF IDENTIFIABLE DIRECT LISTINGS ON NYSE AND NASDAQ

Issuer	Symbol	Listing Date	Market Center	Selling Shareholder/Primary Direct List
Spotify Technologies	SPOT	20180403	NYSE	Selling Shareholder
Watford Holdings	WTRE	20190328	NASDAQ	Selling Shareholder
Slack Technologies	WORK	20190620	NYSE	Selling Shareholder
Asana	ASAN	20200930	NYSE and LTSE	Selling Shareholder
Palantir Technologies	PLTR	20200930	NYSE	Selling Shareholder
Thryv Holdings	THRY	20201001	NASDAQ	Selling Shareholder
Roblox	RBLX	20210310	NYSE	Selling Shareholder
Coinbase Global	COIN	20210414	NASDAQ	Selling Shareholder
SquareSpace	SQSP	20210519	NYSE	Selling Shareholder
ZipRecruiter	ZIP	20210526	NYSE	Selling Shareholder
Amplitude	AMPL	20210928	NASDAQ	Selling Shareholder
Warby Parker	WRBY	20210929	NYSE	Selling Shareholder
Bright Green	BGXX	20220517	NASDAQ	Selling Shareholder
Cool Company Ltd.	CLCO	20230315	NYSE	Selling Shareholder
Surf Air Mobility	SRFM	20230727	NYSE	Selling Shareholder

Sources of information: online listing announcements of the issuers.

NYSE New York Stock Exchange

NASDAQ	National Association of Securities Dealers Automated Quotations
LTSE	Long-Term Stock Exchange