No. 20-16419

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FIYYAZ PIRANI,
Plaintiff-Appellee,
v.
SLACK TECHNOLOGIES, INC., ET AL.,
Defendants-Appellants.

On Appeal from the U.S. District Court
for the Northern District of California
Case No. 3:19-cv-05857-SI
The Honorable Susan Illston

BRIEF OF *AMICUS CURIAE* FORMER SEC COMMISSIONER JOSEPH A. GRUNDFEST IN SUPPORT OF DEFENDANTS'-APPELLANTS' PETITION FOR REHEARING AND REHEARING *EN BANC*

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IPO(s)	Initial Public Offering(s)
NYSE	The New York Stock Exchange
Panel	Thomas, C.J.; Restani, J. (Ct. Int'l Trade); and Miller, J. (dissenting)
Petition	Defendants'-Appellants' Petition For Rehearing And Rehearing En Banc (Dkt. 59)
SEC	United States Securities and Exchange Commission
Securities Act	Securities Act of 1933
Slack	*Pirani v. Slack Techs., Inc.*, No. 20-16419, 2021 U.S. App. LEXIS 28319 (9th Cir. Sep. 20, 2021)

INTEREST OF *AMICUS CURIAE*

Amicus curiae is Joseph A. Grundfest, a former Commissioner of the United States Securities and Exchange Commission ("SEC") (1985-1990), and the William A. Franke Professor of Law and Business at Stanford Law School, where he is also senior faculty of the Rock Center on Corporate Governance. Professor Grundfest has published a detailed academic analysis of the tracing requirement and Section 11 liability,[1] and has taught the subject matter for decades.

The views expressed herein do not necessarily reflect the views of the institutions with which *amicus* is or has been affiliated.[2]

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[1] Joseph A. Grundfest, *Morrison, the Restricted Scope of Securities Act Section 11 Liability, and Prospects for Regulatory Reform*, 41 J. Corp. L. 1 (2015).

[2] A motion for leave to file this brief is being filed herewith. None of the parties to this case or their counsel authored this brief in whole or in part. None of the parties to this case or their counsel contributed money that was intended to fund preparing or submitting this brief. No one other than *amicus curiae* and his undersigned counsel contributed money that was intended to fund preparing or submitting this brief.

ARGUMENT

Leading defense counsel emphasize that the Panel's ruling diverges dramatically from established precedent, creates a novel circuit split, runs roughshod over statutory text, and is riddled with legal error.[3] They assert that the ruling will have immediate spillover effects on *all* forms of public offerings and cannot be cabined to Slack's direct listing. Leading plaintiffs' counsel concur that "[t]he *Slack* decision addressed an important issue of first impression . . . [that] will have far-reaching consequences impacting investor rights and the scope of the Securities Act."[4] When both sides agree that a Panel decision has profound implications for the future of securities law, the case for rehearing is compelling.

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[3] *E.g.*, *Ninth Circuit panel allows Slack securities claims to advance*, Davis Polk (Sept. 23, 2021), https://www.davispolk.com/insights/client-update/ninth-circuit-panel-allows-slack-securities-claims-advance; *Divided Ninth Circuit Finds Securities Act Standing for Purchases in Slack's Direct Listing*, Cleary Gottlieb (Sept. 30, 2021), https://www.clearygottlieb.com/news-and-insights/publication-listing/divided-ninth-circuit-finds-securities-act-standing-for-purchasers-in-slacks-direct-listing; Boris Feldman et al., *Ninth Circuit on Strict Liability for Direct Listings*, Harvard Law School Forum on Corporate Governance (Oct. 14, 2021), https://corpgov.law.harvard.edu/2021/10/14/ninth-circuit-on-strict-liability-for-direct-listings/.

[4] John Browne & Lauren Ormsbee, *Why Slack Decision Struck A Nerve With Corporate America*, Law360 (Nov. 4, 2021), https://www.law360.com/articles/1437619/why-slack-decision-struck-a-nerve-with-corporate-america.

I. The Panel's Ruling Threatens Important Capital Markets Innovations, as Well as Traditional Public Offerings

Although relatively rare, direct listings represent an important capital markets innovation. Only 12 have been conducted since 2018, compared to more than 400 traditional IPOs between 2018 and 2020. Direct offerings allow investors and employees to sell issuer shares directly to the public without the expense and delay of underwritten offerings. As is true of all public offerings, the shares sold in direct listings are registered with the SEC. No direct listing conducted to date limits the simultaneous sales of shares that are exempt from registration requirements under SEC rules. Consequently, in a direct offering, both registered and unregistered shares lawfully and simultaneously enter the market. Because modern securities transactions commingle same-class shares of a company regardless of whether they are issued pursuant to a registration statement or are exempt from registration, purchasers cannot know if they are acquiring registered or exempt securities.[5] This situation is not unique to direct listings; it is true also of underwritten public offerings.

Section 11 creates strict liability for issuers filing false registration statements in connection with public stock offerings. It provides a private right of

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[5] The mechanics of the modern clearance and settlement process that make it impossible to differentiate registered from unregistered securities are explained in detail in Grundfest, *supra* note 1, at 8–20.

action for buyers of "such securities," but limits damages to the proceeds of the offering. 15 U.S.C. § 77k(a) & (e). Until the Panel's ruling, every Circuit addressing the question interpreted "such securities" to mean shares registered under the allegedly defective registration statement, and limited standing to purchasers able to trace their shares to those issued pursuant to that registration statement. Concerned that commingling of shares makes it impossible for any purchaser in a direct listing to plead Section 11 standing, the Panel took the unprecedented step of unilaterally expanding Section 11 liability to cover both registered and *exempt* shares. The statute's plain text and design, however, make it abundantly clear that Section 11 liability can extend only to registered shares, and that Congress never intended to attach Section 11 liability to unregistered shares, no matter how or when they legally enter the market.

In reaching its contra-textual conclusion, the Panel commits multiple errors. Most prominently, the Panel expands damages beyond the statutory cap and magnifies Section 11 liability to an amount potentially larger than the value of the offering itself. This result can bankrupt issuers conducting either direct or underwritten offerings. The Panel's opinion also violates multiple canons of statutory construction, and ignores *sixty* other instances of "such security" in the statutory text. Finally, by expanding Section 11 liability to shares *exempt* from

registration, the Panel parts with ninety years of precedent and creates a novel and profound Circuit split likely to invite review and reversal by the United States Supreme Court.

The Court should grant *en banc* reconsideration and reverse.

II. The Panel's Ruling Conflicts with Ninth Circuit Precedent and Creates a Split with All Circuits That Have Addressed the Question

The Panel's ruling departs from Ninth Circuit precedent imposing a strict tracing requirement. *See, e.g.*, *In re Cent. Alum. Co. Sec. Litig.*, 729 F.3d 1104, 1107 (9th Cir. 2013) (affirming dismissal where plaintiffs could not trace their shares to the relevant offering); *Hertzberg v. Dignity Partners, Inc.*, 191 F.3d 1076, 1080 n.4 (9th Cir. 1999) (tracing is required "[i]f there is a mixture of pre-registration stock and stock sold under the misleading registration statement."); *In re Quarterdeck Office Sys. Sec. Litig.*, 1993 U.S. Dist. LEXIS 19806, at *9 (C.D. Cal. Sept. 30, 1993) (plaintiff unable to trace where 3% of public float were exempt shares).

Section 11 "provides a cause of action to any person who buys a security *issued under* a materially false or misleading registration statement" (emphasis added). *Century Aluminum*, 729 F.3d at 1107. Section 11's stringent tracing requirement governs even though it is "often impossible" to satisfy, even in

underwritten offerings. *Id.* Nevertheless, this Circuit agrees that the statutory term "such security" requires that plaintiffs trace their shares to the challenged registration statement because that "is the condition Congress [] imposed for granting access to the 'relaxed liability requirements'" afforded by the statute. *Id.*

The Panel's ruling also creates a novel and profound conflict with all Circuits that have interpreted Section 11's tracing requirement. In interpreting Section 11's "such security" language to mean a *registered* security, *Century Aluminum* relied on the Second Circuit's opinion in *Barnes v. Osofsky*, 373 F.2d 269 (2d Cir. 1967). *Barnes* looked to Section 11's statutory scheme and legislative history to conclude that "such security" cannot mean "a security of the same nature as that issued pursuant to the registration statement," but must refer to the *registered security itself*. *Id.* at 272–73.

Other Circuits concur that Section 11 requires strict tracing. *See, e.g.*, *APA Excelsior III L.P. v. Premiere Techs., Inc.*, 476 F.3d 1261, 1271 (11th Cir. 2007) (plaintiff must definitively show that "the security was issued under, and was the direct subject of, the prospectus and registration statement being challenged"); *Krim v. PCOrder.com*, 402 F.3d 489, 497 (5th Cir. 2005) (affirming dismissal where 0.15% of shares in the market were exempt, which prevented tracing); *DeMaria v. Andersen*, 318 F.3d 170, 176 (2d Cir. 2003) (plaintiff must have

purchased security "originally registered under the allegedly defective registration statement—so long as the security was indeed issued under *that* registration statement and not another"); *Lee v. Ernst & Young, LLP*, 294 F.3d 969, 976–77 (8th Cir. 2002) ("such security" means a security registered under the challenged registration statement; one must "directly trace his or her security to the allegedly defective registration statement"); *Joseph v. Wiles*, 223 F.3d 1155, 1159 (10th Cir. 2000) (aftermarket purchaser has Section 11 standing if he can prove his securities were sold pursuant to a false registration statement).

The Panel, however, eviscerates Section 11's tracing requirement and creates a fundamental conflict with all other Circuits that have addressed the question. If "such security" includes exempt shares that are not—and statutorily *need not* be—issued pursuant to a registration statement, then the tracing requirement is meaningless.

The Panel is wrong when it claims that this is an issue of first impression simply because it concerns tracing in the context of a direct listing. *Slack*, 2021 U.S. App. LEXIS 28319, at *12. The Panel offers no logical explanation as to why the distinction between direct listing and successive-registration cases matters. It does not explain why or how the fixed statutory term "such securities" has a dramatically different interpretation when applied to a direct offering than when

applied to other forms of underwriting. The tracing challenges caused by commingling are equally present when an issuer: (1) conducts multiple underwritten offerings; (2) conducts a traditional IPO in which not all shares are subject to lockups; and (3) launches a direct offering. Yet, the panel's treatment of the third situation differs dramatically from its treatment of the other two, despite the fact that they are analytically identical scenarios.

When the SEC approved the regulatory structure for primary direct listings, it rejected the very argument central to the Panel's opinion. "Although it is possible that aftermarket purchases following a Primary Direct Floor Listing may present tracing challenges, this investor protection concern is not unique to Primary Direct Floor Listings, nor . . . do we expect any such tracing challenges in this context to be of such magnitude as to render the proposal inconsistent with the Act. . . . Primary Direct Floor Listings will provide benefits to existing and potential investors relative to firm commitment underwritten offerings." SEC Release No. 34-90768, 85 Fed. Reg. 85807, 85816 (Dec. 22, 2020).[6]

[6] To the extent the Panel feared that the only way to avoid lawlessness in direct listings is to expand Section 11's reach to exempt securities, it ignored numerous anti-fraud causes of action available under the federal securities laws. Section 10(b) of the Securities Exchange Act of 1934 provides a cause of action for shareholders who are unable to trace. *Slack*, 2021 U.S. App. LEXIS 28319, at *28 (Miller, J., dissenting). The SEC can pursue fraud in a registration statement under both Section 10(b) of the Exchange Act and Section 17 of the Securities Act. In

Commingling of shares is the real impediment to tracing, and the proper solution is to address that obstacle directly, through regulation or legislation.[7] Judicial reinterpretation of a 90-year old statute to reach a conclusion that conflicts with every other Circuit that has addressed the question is not the solution.

III. The Panel Commits Multiple Errors

A. The Panel Expands Section 11 Damages Beyond the Statutory Cap

The Panel's opinion undermines Section 11's carefully constructed damages rule, and creates liability that can far exceed the statutory maximum. Remarkably, the Panel fails to analyze its logic's implications for Section 11 damages.

Section 11(e) explains that damages are defined by the difference between the IPO price and later sale price. Thus, if registered shares become completely worthless, the maximum damages for each individual share cannot exceed the share's sale price, and the issuer's Section 11 liability cannot exceed the total proceeds of the offering. *See* 15 U.S.C. § 77k(g) ("In no case shall the amount

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2020 alone, the SEC pursued 715 enforcement actions, 32% of which concerned securities offerings. SEC Division of Enforcement, *2020 Annual Report*, at 16 (Nov. 2, 2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf. Recoveries by the Commission can also be for the benefit of defrauded shareholders, and do not require scienter. *See* 15 U.S.C. § 7246(a); *Aaron v. SEC*, 446 U.S. 680, 702 (1980) (scienter need not be established "to enjoin violations of § 17 (a)(2) and § 17 (a)(3) of the [Securities] Act"). The Panel's concern that the tracing rule renders purchasers helpless in direct offering cases is incorrect.

[7] For examples of potential reforms, *see* Grundfest, *supra* note 1, at 64–67.

recoverable under this section exceed the price at which the security was offered to the public.").

However, by extending liability to both registered and exempt shares, the Panel's ruling multiplies the number of allegedly damaged shares beyond the number of shares included in the offering. In Slack's case, the direct listing offered 118 million shares for sale. Slack Tech., Inc. Prospectus, at i (June 20, 2019). Another 165 million shares qualified for exemptions from registration and entered the market simultaneously. *Id.* at 162. The Panel's ruling thus more than doubles Slack's Section 11 liability over a statutory maximum that is limited to the total proceeds of the registered offering. Moreover, because all of the proceeds raised in every direct listing conducted to date were paid to selling stockholders, and nothing was paid to the issuer, the Panel's ruling could deal a crippling blow to the direct listing process. The Panel's ruling yields results entirely irreconcilable with Section 11(e)'s statutory damages cap, and fails even to discuss these dramatic implications of its reasoning.

B. The Panel's Policy-Driven Interpretation of "Such Security" Ignores 60 Other Instances of This Phrase in the Statute's Text

The Panel claims it "look[ed] directly to the text of Section 11 and the words 'such security'" therein to reach its conclusion. The Panel's definition, however,

relies on an interpretation of NYSE rules, not the statutory text. *Slack*, 2021 U.S. App. LEXIS 28319, at *12–13. Had the Panel actually referred to the Securities Act, it would have found that the phrases "such security" and "such securities" appear at least *61 times*. *See* Appendix A (listing all occurrences of the phrases in the Securities Act).

The Securities Act is "a symmetrical and coherent regulatory scheme, one in which the operative words have a consistent meaning throughout." *Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995); *see also Cochise Consultancy, Inc. v. United States ex rel. Hunt*, 139 S. Ct. 1507, 1512 (2019) (fundamental canon of statutory interpretation is to "avoid interpretations that would attribute different meanings to the same phrase"). Throughout the Securities Act, "such security" refers to a specific security (or type of securities) at issue in the relevant provision. By reinterpreting "such security" in Section 11(a) to refer both to a specific type of security (registered securities) at issue *and* to other, similar (but exempt) securities, the Panel upends the Act's fundamental structure. Consider just three examples.

Section 5 of the Act requires that shares be registered before they can be sold, unless an exemption applies. "Unless a registration statement is in effect as to a security[,]" it is "unlawful . . . to sell such security" or "to carry or cause to be

carried through the mails or in interstate commerce . . . any such security for the purpose of sale or for delivery after sale[.]" 15 U.S.C. § 77e(a).

In Section 5, "such security" refers to securities that require registration before sale. These securities are distinct from exempt securities, which, under Section 4 of the Act (15 U.S.C. § 77d), may be sold without registration, even if they are otherwise entirely fungible. In Sections 4 and 5, Congress explicitly limited liability to securities that must be registered before sale, and "such security" in Section 5 logically can refer only to non-exempt securities. If the Panel is correct that "such security" means both registered and unregistered securities, then Section 5 is incoherent because it would extend Section 5 liability to shares that are explicitly exempted by Section 4. That cannot be correct.

Section 11(e) defines the Section 11 damages rule, and caps damages at the total proceeds of the registered offering. *Supra* at 9–10. In Section 11(e), "such security" refers to the specific share identified earlier in the sentence ("the security"), not a hypothetical share of a "similar" type. If the Panel's definition is correct, it then becomes impossible to calculate damages for a specific share. Indeed, "the necessity of determining a mathematical 'difference'" makes it "untenable" to argue that "the phrase 'the security' and the phrase 'such security' refers to different security lots[.]" *Colonial Realty Corp. v. Brunswick Corp.*, 257 F.

Supp. 875, 878–79 (S.D.N.Y. 1966) (declining to extend Section 11 to unregistered shares of the same class as registered shares). The Panel's broad reading of "such security" to refer to securities that are similar—but not identical—cannot be reconciled with Section 11(e)'s damages formula.

Section 12 creates liability for sellers of unregistered, non-exempt securities, or sellers of securities by way of a misleading prospectus. These sellers are liable "to the person purchasing such security" for "the consideration paid for such security with interest thereon[.]" 15 U.S.C. § 77*l*(a)(2). In Section 12, "such security" again refers to a specific security, and "limits liability to those who offer or sell *the security*[,]" not similar securities. *Cent. Bank, N.A. v. First Interstate Bank, N.A.*, 511 U.S. 164, 179 (1994) (emphasis added). The Panel's definition of "such security" would thus expand Section 12 liability to sellers of other types of arguably fungible securities.

The Panel's definition also cannot be reconciled with Section 12's damages rule. Section 12 damages are rescissionary: the purchaser recovers "upon the tender of such security." 15 U.S.C. § 77*l*(a)(2). The statute explicitly requires the return of the security at issue. The Panel's definition of "such security" would erroneously amend Section 12 to permit recovery upon the return of different securities.

C. The Panel Irrationally Imposes Section 11 Liability, Which Is Limited to Defective Registration Statements, on Exempt Transactions That Never Require Registration Statements

By departing from the statutory text, the Panel abandons a framework that has anchored the federal securities regime since its inception in 1933: It extends Section 11 liability for a misleading *registration* statement to securities that are expressly *exempt* from registration. This is a fundamental error.

The error is rooted in one statement: "unregistered shares sold in a direct listing are 'such securities' within the meaning of Section 11 because their public sale cannot occur without the only operative registration in existence." *Slack*, 2021 U.S. App. LEXIS 28319, at *13–14. This statement errs as a matter of law. These are not merely *un*registered securities; these securities are *exempt* from registration. This key distinction allows them to be sold (to anyone) without registration, and without Section 11 liability.

Section 5 of the Securities Act makes it unlawful to sell an unregistered security. 15 U.S.C. § 77e(a). Section 4(a)(1) exempts from Section 5's registration requirement all "transactions by any person other than an issuer, underwriter, or dealer." 15 U.S.C. § 77d(a)(1). To help identify sellers qualifying for this exemption, the SEC promulgated Rule 144. 17 C.F.R. § 230.144 (1972). As the SEC notes in its introductory statement to Rule 144, sellers who comply with the

rule's safe harbor are deemed not to be an "underwriter" for purposes of Section 4(a)(1), and the transaction is therefore exempt from registration requirements. *See* SEC Release No. 33-5223, 37 Fed. Reg. 591, 591–92 (Jan. 14, 1972). The SEC then amended Rule 144 in 2007 to expand the safe harbor provisions to allow even greater freedom in the sale of securities pursuant to an exemption. *See* SEC Release No. 33-8869, 72 Fed. Reg. 71546 (Dec. 17, 2007). Rule 144's safe harbor is thus today available both to affiliates and non-affiliates of reporting and non-reporting issuers, subject to different holding requirements, volume limitations, and availability of public information. *See generally* 17 C.F.R. § 230.144.

Rule 144 permits non-affiliates of non-reporting issuers (such as Slack), who have not been affiliates for at least three months, to sell their stock without registering the transaction. 17 C.F.R. § 230.144(b)(1)(ii). There are no volume restrictions and no limitations on who may buy the stock. These sales are not subject to the requirement that adequate, current information regarding the issuer be publicly available. *See* 17 C.F.R. § 230.144(c). The only requirement is that the non-affiliate seller holds the stock for at least one year. 17 C.F.R. § 230.144(d)(1)(ii). Purchasers are not subject to any holding period requirement before they can resell the stock.

At the time of Slack's direct listing, approximately 165 *million* shares could be sold by non-affiliates under this exemption. *See* Slack Tech., Inc. Prospectus, at 162. These 165 million unregistered shares legally available for sale without registration are 142% of the 118 million registered shares sold in Slack's direct listing. The 165 million exempt shares were not "sold in a direct listing" as the Panel mistakenly stated. These shares could, instead, have been sold to anyone, before, during, and after the direct listing, in a registered or unregistered offering.

The Panel completely ignored the fact that this massive volume of shares was exempt from registration. By extending Section 11 liability, which requires a false registration statement, to securities expressly exempt from registration, the Panel nullifies the very purpose of the Rule 144 exemption. As the SEC noted: "[T]he complexity of resale restrictions may inhibit sales by, and imposes costs on, non-affiliates. Because Rule 144 is relied upon by many individuals to resell their restricted securities, we believe that it is particularly helpful to streamline and reduce the complexity of the rule as much as possible while retaining its integrity." SEC Release No. 33-8869, 72 Fed. Reg. at 71550; *see also id.* at 71562. The SEC explained: "The amendments are intended to reduce regulatory requirements for the resale of securities and simplify the process of reselling such securities . . . . The reduction of the Rule 144 holding period requirement . . . should increase the

liquidity of privately issued securities, enabling companies to raise private capital more efficiently." *Id.* at 71564–65. But by making issuers strictly liable for sales exempt from registration, the Panel contravenes the objective the SEC expressly sought to advance through Rule 144.[8]

The Panel's purposive interpretation is unmoored from the statutory text and upsets a judicial and regulatory framework that has governed the federal securities regime for nearly ninety years. Compounding the problem, the Panel failed to provide any limiting principle to its dramatic reinterpretation of the term "such security." The Panel did not explain whether its interpretation also applies to traditional underwritten IPOs, and fails to provide a cogent rationale that would support any such distinction. The Panel did not explain what happens when a share exempt under Rule 144 is sold not at the time of the offering, but months later. Or what happens when a share that does not even qualify for the Rule 144 exemption

[8] Courts have repeatedly recognized that "Section 11 liability, which applies to misstatements or omissions in registration statements, is not available for [exempt] offerings." *In re Levi Strauss & Co. Sec. Litig.*, 527 F. Supp. 2d 965, 975 (N.D. Cal. 2007) (applying Rule 144A exemption); *In re Crazy Eddie Sec. Litig.*, 792 F. Supp. 197, 202 (E.D.N.Y. 1992) ("plaintiffs must produce evidence to show that their shares are traceable to the allegedly defective offerings and not to Crazy Eddie's initial public offering or registration-exempt sales made by members of the company's former management pursuant to Rule 144"); *accord In re Refco, Inc. Sec. Litig.*, 503 F. Supp. 2d 611, 625–26 (S.D.N.Y. 2007) ("District courts in the Second Circuit have consistently dismissed [Section 12] claims based on [exempt] offerings"; applying Rule 144A exemption).

until months after the offering (and therefore could *not* have traded when the registration statement was filed) is sold. The Panel did not explain what happens if an issuer files multiple registration statements, only one of which is allegedly false, and an exempt share is sold after the filing of the latest, correct registration statement. Nor does the Panel address situations in which shares become exempt (and thus available for sale) at the time of the allegedly false registration statement, but the non-affiliate third party does not sell until after a correct registration statement is filed. The range of scenarios that the Panel fails to address is almost endless, and highlights that the Panel's *ad hoc* rulemaking is untethered from any limiting principle.

CONCLUSION

The Panel's purposive interpretation of the phrase "such security" is inconsistent with the Securities Act's text, and it creates an unprecedented and profound Circuit split. The Court should grant *en banc* reconsideration and reverse.

DATED: November 15, 2021

Respectfully submitted,

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