No. 20-16419

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

FIYYAZ PIRANI,
Plaintiff and Appellee,

v.

SLACK TECHNOLOGIES, INC., ET AL.,
Defendants and Appellants.

On Appeal from the United States District Court
for the Northern District of California,
Case No. 3:19-cv-05857-SI
(Hon. Susan Illston)

MOTION OF THE CATO INSTITUTE FOR LEAVE TO FILE *AMICUS CURIAE* BRIEF IN SUPPORT OF PETITION FOR REHEARING AND REHEARING EN BANC

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November 15, 2021

MOTION FOR LEAVE TO FILE BRIEF AS *AMICUS CURIAE* IN SUPPORT OF PETITION FOR REHEARING AND REHEARING EN BANC

Pursuant to Ninth Circuit Rule 29-2(a), the Cato Institute respectfully moves for leave to file an *amicus curiae* brief in support of Defendants-Appellants in this pending petition for rehearing and rehearing en banc. All parties were provided with timely notice of *amicus*'s intent to file as required under Federal Rule of Appellate Procedure 29(a)(2). Defendant-Appellants' counsel consented to this filing. Plaintiff-appellee's counsel withheld consent.

This case interests *amicus* because the panel decision's departure from decades of securities-law precedent threatens to expand Section 11's jurisdiction beyond its intended boundaries, in the process disincentivizing an alternative to traditional initial public offerings that shows great wealth-creating potential. Cato's commitment to free and prosperous markets compels it to ask the court, through a rehearing or a rehearing en banc, to reverse the panel's erasure of Judge Friendly's tried-and-true "tracing" requirement from direct listings.

Cato has no direct interest, financial or otherwise, in the outcome of this case.

For the foregoing reasons, Cato respectfully requests that it be allowed to file an *amicus curiae* brief.

Respectfully submitted,

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RULE 26.1 CORPORATE DISCLOSURE STATEMENT

The Cato Institute is a nonprofit entity operating under § 501(c)(3) of the Internal Revenue Code. *Amicus* is not a subsidiary or affiliate of any publicly owned corporation and does not issue shares of stock. No publicly held corporation has a direct financial interest in the outcome of this litigation due to *amicus*'s participation.

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INTEREST OF *AMICUS CURIAE*[1]

The Cato Institute is a nonpartisan public policy research foundation founded in 1977 and dedicated to advancing the principles of individual liberty, free markets, and limited government. Cato's Center for Monetary and Financial Alternatives reveals the shortcomings of today's monetary and financial regulatory systems and identifies and promotes alternatives more conducive to a stable, flourishing, and free society. Cato's Robert A. Levy Center for Constitutional Studies helps restore the principles of constitutional government that are the foundation of liberty. Toward those ends, Cato publishes books and studies, conducts conferences, produces the annual *Cato Supreme Court Review*, and files *amicus* briefs.

A rehearing or rehearing en banc interests *amicus* because the panel's erasure of Judge Friendly's tried-and-true "tracing" requirement for direct listings threatens to expand Section 11's jurisdiction beyond its intended boundaries, disincentivizing an alternative to the traditional initial public offering type that shows great wealth-creating potential.

[1] Fed. R. App. P. 29 Statement: No counsel for either party authored this brief in whole or in part. No person or entity other than *amicus* made a monetary contribution to its preparation or submission. Pursuant to Ninth Circuit Local Rule 29(a)(2), all parties have been notified of the filing of this brief. Counsel for plaintiff-appellee withheld consent, so *amicus* has filed a motion for leave to file this brief.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

In *Barnes v. Osofsky*, Judge Henry Friendly wrote that to prove a violation of Section 11 of the Securities Act of 1933—prohibiting issuers from making material misstatements or omissions in connection with a registered offering—a claimant must first "trace" their shares to the offering in which the alleged misrepresentations or omissions were made. 373 F.2d 269 (2d Cir. 1967). In a 2-1 decision, the panel upended this longstanding and ubiquitous rule in favor of an expansive reading that all but removes this tracing requirement, usurping Congress's exclusive role in enacting securities laws. *Amicus* supports Defendants-Appellants' petition for rehearing and rehearing en banc.

ARGUMENT

Imposing Section 11's strict-liability standard without requiring plaintiffs to prove they bought shares registered by the challenged registration statement disregards the plain meaning of the statute, which limits liability to "such securit[ies]" sold in a registered offering. 15 U.S.C. § 77k. Pursuant to the Federal Rules of Appellate Procedure and this Court's rules, a rehearing en banc is warranted because the panel "directly conflicts" with opinions of multiple courts of appeals that require plaintiffs to trace their shares to a registered offering. Def.-App. Pet. for Rehear'g at 1–2. The panel's ruling severely impedes the "overriding need for national uniformity" in securities law where most offerings are national in nature.

Fed. R. App. P. 35(a), (b); Cir. R. 35-1. What's more, the panel's overbroad reading of Section 11 threatens the viability of direct listings, a promising new wealth-creation vehicle, and may have negative consequences beyond direct listings.

I. SECTION 11'S LEGISLATIVE HISTORY SUPPORTS REQUIRING CLAIMANTS TO TRACE THEIR SHARES TO A REGISTRATION STATEMENT

Barnes v. Osofsky's widely adopted holding, that a claimant must trace their shares to the registration statement containing the alleged misstatement or omission, ensures that Section 11 is applied as Congress intended. In *Barnes*, Judge Friendly found that applying the "broader reading" of Section 11 to all purchasers, regardless of whether or not they could trace the purchase of their shares to the registration statement, "would be inconsistent with the over-all statutory scheme." *Id.* at 272.

Courts considering Section 11's tracing requirement have widely followed Judge Friendly's lead. *See generally* Hillary A. Sale, *Disappearing Without a Trace, Sections 11 and 12(a)(2) of the 1933 Securities Act*, 75 Wash. L. Rev. 429 (2000) (survey of post-*Barnes* judicial treatment of the tracing requirement). *See, e.g.*, *Bradley v. ARIAD Pharms.*, 842 F.3d 744, 755 (1st Cir. 2016); *Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 495 (5th Cir. 2005). One district court offered perhaps the best explanation for Congress's prerogative here:

> [R]igid application of the tracing requirement is a product of Congress['s] decision to balance the low-burden substantive proof [with a] high-burden standing requirement, and courts should not abrogate the congressional intent

> by expanding the 'virtually absolute' liability to claims of purchasers whose securities cannot be traced.

In re FleetBoston Fin. Corp. Sec. Litig., 253 F.R.D. 315, 347 (D. N.J. 2008). In other words, Congress intended Section 11 to promote truthfulness to the extent necessary to achieve competitive fairness and preserved the role of organic market forces beyond that point.

Congressional hearings ahead of the Securities Act's passage reveal Congress's effort to ensure substantive disclosure without pricing too many transactions out of the marketplace. See, e.g., *Federal Securities Act, Hearing Before the Committee on Interstate and Foreign Commerce on H.R. 4314*, 73d Cong., Sess. 1, 140 (1933) (former FTC Commissioner Huston Thompson rejecting the idea of requiring FTC approval for all offerings, warning that doing so "would slow up the business").

Traceability is integral to this design. During pre-enactment hearings in the House, it was observed that Section 11 would "accord a remedy to all purchasers who may reasonably be affected by any statements in the registration statement," but that "fundamentally, [Section 11] entitle[s] 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." H.R. Rep. No. 85, 73d Cong., 1st Sess., 9 (1933). *See Barnes*, 373 F.2d. at 273 (reasoning that these quotes from the congressional record "can be read to relate only to the extension of liability

to open-market purchasers of the *registered* shares"—that is, those that are traceable (emphasis added)).

Eliminating the tracing requirement, as the panel did, undermines the Act's balance of transparency through disclosure with burdens that may inhibit growth potential: "[R]igid application of the tracing requirement is a product of Congress['s] decision to balance the low-burden substantive proof [with a] high-burden standing requirement." *See FleetBoston*, 253 F.R.D. at 347. In his forceful dissent to the panel's ruling, Judge Miller writes "that failure of proof is significant and . . . outcome-determinative." Op. 22. "Strict liability is strong medicine," Judge Miller reasons, "so the statute tempers it by limiting the class of plaintiffs who can sue." *Id.* In short, the panel's broad reading is more than a "violent departure from the words that a court could . . . properly adopt," as Judge Friendly warned. *Barnes*, 373 F.2d at 271.

II. REMOVING THE TRACING REQUIREMENT THREATENS ALTERNATIVE OFFERINGS AND MAY HAVE BROADER ECONOMIC CONSEQUENCES

A. Harm to Direct Listings

Most clearly, the panel's decision threatens the viability of direct listings, which offer startups' self-starters and angel investors the chance to reap returns on their high-risk investments. Direct listings offer them the liquidity of a public market and enable them to sell their shares at a market price, with less red tape and overhead

along the way than a traditional initial public offering ("IPO"). Attracted by these attributes, a number of companies, particularly in the tech sector, have taken this route since 2018. *See* Jennifer J. Schulp, IPOs, SPACs, and Direct Listings, Oh My!," *Real Clear Policy*, May 21, 2021, https://bit.ly/2YuR9yC.

The addition of direct listings to the menu of alternative routes to becoming a publicly listed company benefits companies, their shareholders, and the economy at large. Alternatives to traditional IPOs may better serve niche issuers, who may have different capital structures or different objectives than the larger companies—though they could certainly benefit large-cap private firms as well. A variety of methods for public listing is consistent with the Securities Act, which was not designed to limit issuers to one offering type. Indeed, the Act's pro-disclosure, non-preclearance approach assumes any number of offering types, simply asking issuers and their representatives be honest salesmen. In short, the more offering types the merrier.

Maintaining the existing regulatory scheme, including the liability limits built into Section 11, is crucial to supporting the direct listing as a viable alternative. Instead, the panel's decision subjects direct listings to liability risks under Section 11 that exceed those of an IPO, by uniquely permitting plaintiffs to pursue a Section 11 claim regardless of whether they can trace their purchase to a registration statement. This raises the costs of pursing a direct listing, limiting some companies to the choices of staying private or pursing a traditional IPO.

In following *Barnes*, other circuits recognized that, compared to Congress, the SEC, and the exchanges, the courts are ill-equipped to see through the complex interplay between regulations and economic incentives at work in Section 11. *See* Def.-App. Pet. for Rehear'g at 1–2 (listing the circuits that have a tracing requirement). It is up to lawmakers and regulators to alter Section 11, should they find that statute's balance is not being served for direct listings. Judges are not a part of the equation. As the Fifth Circuit put it in *Krim*:

> 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.

402 F.3d at 598.

While there may be no way for a direct listing to serve its purpose *and* maintain easy traceability of the shares sold pursuant to its registration statement, direct listings are not *designed* to benefit from the tracing requirement inherent to Section 11 (if they were, they might have emerged in some form soon after Judge Friendly's 1967 ruling). Rather, "[i]n a direct listing, some shares are sold under the registration statement while other are not." Benjamin J. Nickerson, *The Underlying Underwriter: An Analysis of the Spotify Direct Listing*, 86 U. Chi. L. Rev. 985, 1006–07 (2019). Plain and simple, and hardly nefarious.

Moreover, it is not a foregone conclusion that tracing is impossible in a direct listing. New technologies (and novel application of existing technologies) might

well make it easier for claimants to trace the purchase history of their shares in direct listings and similar offerings. Blockchain, for example, may provide such a means, allowing ownership of a particular share to be traced from its issuance to its current holder. *See generally* Sean Belcher, *Tracing the Invisible: Section 11's Tracing Requirement and Blockchain*, 16 Colo. Tech. L.J. 145 (2018). Still, before Congress or technological innovation steps in, it is not for the courts to intervene and make a policy-based adjustment to settled law when an offering's design so happens to make tracing difficult or infeasible.

B. Broader Economic Consequences

The potential damage resulting from the panel's decision is not limited to the present case, or even to direct listings. Because public offerings in the United States are rarely, if ever, limited to purchasers in select states, this ruling will govern nearly all issuers seeking a direct listing from hereon; plaintiffs will seek to file suit in the Ninth Circuit to avoid tracing requirements in the First, Second, Third, Fifth, Eighth, Tenth, and Eleventh Circuits. The panel's decision could cause nationwide slowdown or even halt in direct listings, just as this IPO alternative is beginning to assert its potential.

The availability of direct listings has also begun to spur innovation in traditional IPOs, which have long been governed by custom and tradition that may not serve all companies. *See, e.g.*, Tom Zanki, "IPO Lockup Periods Begin to Loosen

Amid Market Pressure," *Law360*, Sept. 17, 2021, https://bit.ly/30sLHx7; Preston Brewer, "Innovation May Make IPO 'Price Pops' Fizzle Out," *Bloomberg Law*, Apr. 20, 2021, https://bit.ly/3omZxsU. A slowdown to direct listings may also slow or reverse changes to the traditional IPO process that are being brought about by competition in listing alternatives.

The panel's decision might also affect traditional IPOs more directly. By resting its decision on exchange rules, the panel does not clearly limit the effect of its decision to direct listings. As Defendant-Appellants write: "If what matters is that a registration statement made all shares saleable on an exchange . . . Section 11 liability would extend *forever* unless an issuer sold new shares under a second registration statement." Def.-App. Pet. for Rehear'g at 19 (emphasis original).

But, perhaps most concerning, the higher liability promised by the panel's decision for direct listings, and the uncertainty for traditional IPOs, will give investors in early ventures a reason to think twice before buying in. Early-stage investors, who already take great risks with their capital, will subtract from their possible gains the compoundable costs of increased down-the-road liability exposure. All of this initial uncertainty has a price tag. Given the explosive attraction of IPO alternatives, it is not a cheap one. *See* Tom Zanki, "Slack's Direct Listing Ruling Could Have Far-Reaching Impact," *Law360*, Oct. 22, 2021, https://bit.ly/3bJxX32. Rather than supporting economic growth, and bolstering

startup businesses, the panel's opinion, at odds with Section 11's design, has the potential to depress early-stage investment.

CONCLUSION

For the foregoing reasons, as well as those presented by Defendant-Appellants, the court should grant the petition for rehearing and reverse the panel's Section 11 ruling.

Respectfully submitted,

DATED: November 15, 2020

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CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of 9th Cir. R. 29-2(c)(2) because it contains 2,175 words, excluding the parts exempted by Fed. R. App. P. 32(f).
2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface in Times New Roman, 14-point font.

/s/ *Jennifer J. Schulp*
November 15, 2021

CERTIFICATE OF SERVICE

I hereby certify that I electronically filed the foregoing with the Clerk of Court, who will enter it into the CM/ECF system, which will send a notification of such filing to the appropriate counsel.

/s/ *Jennifer J. Schulp*
November 15, 2021