No. 20-16419

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FIYYAZ PIRANI,
*Plaintiff-Respondent,*

v.

SLACK TECHNOLOGIES, INC., ET AL.
*Defendants-Appellants.*

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

**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**

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## CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rule of Appellate Procedure 26.1, the undersigned counsel for *amici curiae* Securities Industry and Financial Markets Association, Chamber of Commerce of the United States of America, and National Venture Capital Association makes the following disclosures:

1. The Securities Industry and Financial Markets Association ("SIFMA") does not have a parent company, and there is no publicly owned corporation that owns 10% or more of SIFMA's stock.

2. The Chamber of Commerce of the United States of America (the "Chamber") does not have a parent company, and there is no publicly owned corporation that owns 10% or more of the Chamber's stock.

3. The National Venture Capital Association ("NVCA") does not have a parent company, and there is no publicly owned corporation that owns 10% or more of NVCA's stock.

Dated: November 2, 2020

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## IDENTITY AND INTEREST OF *AMICI CURIAE*[1]

The Securities Industry and Financial Markets Association ("SIFMA") is a securities industry trade association that represents the interests of hundreds of securities firms, banks, and asset managers. SIFMA is also the United States regional member of the Global Financial Markets Association.

SIFMA's mission is to support a strong financial industry while promoting investor opportunity, capital formation, job creation, economic growth, and trust and confidence in the financial markets. To further that mission, SIFMA regularly files *amicus curiae* briefs in cases such as this one that raise issues of vital concern to securities industry participants. *See, e.g.*, *Halliburton Co. v. Erica P. John Fund, Inc.*, 573 U.S. 2585 (2014); *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336 (2005); *In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130 (9th Cir. 2017), *cert. dismissed sub nom. by Quality Sys., Inc. v. City of Miami Fire Fighters' & Police Officers' Ret. Trust*, 139 S. Ct. 589 (2018). This case involves an important issue concerning standing in private securities actions under the Securities Act of 1933, which is directly relevant to SIFMA's mission of promoting fair and efficient markets and a strong financial services industry.

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[1] Under Federal Rule of Appellate Procedure 29(a)(4)(E), the undersigned counsel certifies that no party's counsel authored this brief in whole or in part, and that no person or entity other than *amici*, their members, or their counsel contributed money to fund its preparation or submission.

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents approximately 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of concern to the nation's business community. This appeal concerns interests central to the Chamber's mission, as many of the Chamber's members are public companies with exposure to private securities actions.

The National Venture Capital Association ("NVCA") is a nonprofit association of venture capital investors. NVCA supports the formation of high-growth companies and seeks to ensure the United States remains the most competitive environment in the world for entrepreneurs. Venture capitalists are committed to funding America's most cutting-edge entrepreneurs. Often, private venture capitalists invest in start-up companies with the hope that, if the start-up is successful, they will be able to take the company public and earn a return on their investment. As a result, NVCA is directly interested in ensuring uniformity and predictability in the application of the federal securities laws. In addition, NVCA's members would be directly and adversely affected if the Court were to uphold the decision below because increased litigation of federal securities class actions has a potentially chilling effect on the willingness of the companies in which they invest to go public.

## SUMMARY OF ARGUMENT

Section 11 of the Securities Act of 1933 imposes strict liability for material misstatements or omissions in securities registration statements. 15 U.S.C. § 77k. The threat of Section 11 liability is significant, as statutory damages can range in the hundreds of millions of dollars. And even where liability does not attach, defending against Section 11 claims involves the expenditure of tremendous cost, time and energy—particularly after the United States Supreme Court held in *Cyan, Inc. v. Beaver County Employees' Retirement Fund*, 138 S.Ct. 1061 (2018), that Securities Act claims filed in state court cannot be removed to federal court. Accordingly, securities market participants and their constituents rely on consistent application of the few pleading and proof requirements inherent in the statute—including that only purchasers of securities *actually registered* under an allegedly false or misleading registration statement have standing to sue. Since the 1960s, courts have consistently enforced this requirement by insisting that plaintiffs "trace" their securities to the registration statement upon which they base their Section 11 claim. And market participants have come to rely on this consistency when assessing the risk of Section 11 liability and efficiently "pricing" that risk into capital markets transactions.

The district court's decision in this case—which erodes the tracing requirement by conferring standing upon anyone who purchased a security of "the same nature" as a registered security—departs from decades of precedent by adopting a rule that has been *rejected by every court to have considered it*. Although the district court purported to limit its decision to direct listings, that limitation makes no logical sense and therefore creates a threat that future courts could (wrongly) apply the district court's reasoning to further erode Section 11's statutory tracing requirement.

The markets and their regulators are better suited to address any tracing concerns as demonstrated by the live debate over whether to extend direct listings to permit companies to raise capital. But regulators and markets need consistent rules on which to base their decisions. The district court's decision, which deviates from decades of precedent, should be reversed.

## ARGUMENT

### I. MARKETS RELY ON CONSISTENT APPLICATION OF SECTION 11'S TRACING REQUIREMENT

As described in Defendants-Appellants' Opening Brief, Section 11 imposes a standing requirement, permitting only "person[s] acquiring such security" issued pursuant to a materially false or misleading securities registration statement to bring an action. Dkt. No. 10 ("Opening Br.") at 20 (citing 15 U.S.C. § 77k(a)). In 1967, the Second Circuit held that to satisfy this requirement, a plaintiff must "trace the lineage of their shares" to the particular offering that is the "direct subject" of the challenged registration statement. *Barnes v. Osofsky*, 373 F.2d 269, 271–73 (2d Cir. 1967) (citation omitted). As Defendants-Appellants describe, this "tracing" requirement has been adopted by every other circuit to have considered the question—including, most notably and recently, by this Court in *In re Century Aluminum Company Securities Litigation*, 729 F.3d 1104 (9th Cir. 2013). *See* Opening Br. at 20 (collecting cases). In other words, for over fifty years, "tracing" has been consistently applied by the Courts and left untouched by Congress. *See* Opening Br. at 23 ("[I]n the half-century since the Second Circuit decided *Barnes*, Congress has never taken up its invitation to 'reexamine' Section 11."). As a result, the requirement has been affirmed by federal courts in numerous contexts, including traditional IPOs, secondary offerings (*i.e.*, offerings of securities made after a company's stock is already publicly traded by virtue of an IPO), and employee benefit plans (*i.e.*, where securities are issued pursuant to an SEC Form S-4 to employees and other beneficiaries of stock compensation plans).[2]

[2] *E.g.*, *In re Century Aluminum*, 729 F.3d at 1109 (affirming tracing requirement in context of secondary offering); *In re Mirant Corp. Sec. Litig.*, No. 1:02-CV-1467, 2008 U.S. Dist. LEXIS 129994, at *47 (N.D. Ga. Aug. 5, 2008) (affirming tracing requirement in context of employee benefit plan).

Because tracing serves to define the class of persons who can sue under Section 11, it has become one of the most important rules that market participants rely upon to assess Section 11 liability risk associated with any particular capital transaction. Market participants regularly rely on the rule to assess, for example, how the size of an IPO, the duration of the "lockup period" following the IPO,[3] and the conduct and timing of secondary offerings following an IPO, will impact potential Section 11 liability. And market participants' assessment of potential liability, in turn, contributes to the timing, size and cost of a particular transaction—or whether to conduct the transaction at all.

A consistent tracing rule is more important now than ever, given the tidal wave of Section 11 cases flooding the federal and state courts. Indeed, in the year after the Supreme Court decided *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which permitted Securities Act claims to be litigated in either state or federal court, the number of state court Securities Act filings increased by 40 percent, and about 45 percent of those filings involved duplicative

[3] A "lockup period" is a period following an IPO within which persons holding shares that were not registered for sale in the IPO are not permitted to sell their shares. Particularly here in the Ninth Circuit, courts have found that persons who purchased securities after the expiry of a lockup period cannot trace their shares to the IPO registration statement. *E.g.*, *Doherty v. Pivotal Software, Inc.*, No. 3:19-cv-02589, 2019 WL 5864581, slip op. at *8–11 (N.D. Cal. Nov. 8, 2019).

actions filed in federal and state court.[4] One article posits that this flood of state-filed Securities Act claims is due, in large part, to a lower rate of dismissals—and therefore a higher rate of settlement—in state Securities Act class actions as compared to federal securities class actions,[5] in addition to undercutting Congress's mandate that courts "shall appoint the most adequate plaintiff" as lead plaintiff over all consolidated actions. 15 U.S.C. § 78u-4(a)(3)(B)(ii); 15 U.S.C. § 77z-1(a)(3)(B)(ii).

One significant side effect of these securities cases being filed in state courts has been a significant increase in the costs of Directors and Officers ("D&O") insurance.[6] "[P]remiums and self-insured retentions (like a deductible) have increased dramatically as insurers have cut back on the capacity they are willing to offer companies."[7] Premiums and deductibles, in some cases, have doubled (or

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[4] *See* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS: 2019 YEAR IN REVIEW 19–20, 25 (Jan. 2020), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2019-Year-in-Review (drawing from Stanford Law School Securities Class Action Clearing-house data).

[5] Michael Klausner, et al., *State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)*, 75 ABA BUS. LAW. 1769, 1777–79 (Winter 2019–2020).

[6] *See* Contessa Brewer & Katie Young, *Companies are paying big bucks to insure boards against liability as class-action suits soar*, CNBC (published Jan. 9, 2020, 1:54 PM EST | updated Jan. 9, 2020, 5:57 PM EST), https://www.cnbc.com/2020/01/09/companies-are-paying-big-bucks-to-insure-boards-against-liability-as-class-action-suits-soar.html.

[7] WOODRUFF SAWYER, *Insights – D&O Notebook, 2020 Mid-Year DataBox Report: Drop in Securities Class Action Filings Amidst a Hardening Insurance Market* 6

more), compared to previous policies. *Id.* This is largely due to the number of new filings increasing from 2015 to 2019 by 47%, with the number of open cases increasing by 63% in the same period—including a backlog of approximately 600 cases that have yet to reach a resolution. *Id.* The current average settlement is $42 million, with a median settlement of $12.3 million. *Id.* at 5.

This increase in litigation, coupled with soaring costs to insure against litigation, means that tracing is more important now than it has ever been. Issuers and their officers and directors, underwriters of securities offerings, and even venture capital firms, are all frequent targets of Section 11 lawsuits. These lawsuits are at best costly and distracting to defend and, at worst, threaten damages in the tens, hundreds, or even hundreds-of-millions of dollars. D&O insurance is costly, if it is even available. Tracing is one of the few tools that these market participants have to assess their potential Section 11 risk, "price" that risk efficiently into their transaction, and/or decide whether to enter into that transaction at all.

## II. THE DISTRICT COURT'S DEPARTURE FROM PRECEDENT UNDERMINES THE CERTAINTY THE MARKETS REQUIRE

As Defendants-Appellants describe, the district court's decision in this case departed from decades of precedent to adopt a rule that has been *rejected by every court to have considered it*. Opening Br. at 25. In addition to being legally

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(June 30, 2020), *available at* https://woodruffsawyer.com/wp-content/uploads/2020/08/2020-Mid-Year-Databox-Report.pdf.

indefensible, the decision could be erroneously followed by other courts, threatening to upend the certainty in the tracing rule upon which capital markets have come to rely.

***First***, although the district court attempted to limit the reach of its decision to "a direct listing in which shares registered under the Securities Act become available on the first day simultaneously with shares exempted from registration," Order at 13–14, that limitation is not logically defensible. The mere fact that shares are issued on the same day does not change the fact that some of those shares are registered under the allegedly faulty registration statement while others are not. As Defendants-Appellants explain, this "mixed market" scenario is the exact situation to which the tracing requirement is addressed. *See* Opening Br. at 23–24. The district court's reasoning, therefore, cannot be squared with the many cases that have upheld the tracing requirement in analogous situations, including secondary offerings, the expiration of lockup periods, and shares issued as part of an employee benefit plan and registered on Form S-8. *E.g.*, *In re Century Aluminum*, 729 F.3d at 1109 (secondary offering); *Lilley v. Charren*, 936 F. Supp 708, 715–16 (N.D. Cal. 1996) (Illston, J.) (lockup period); *Doherty*, 2019 WL 5864581, slip op. at *8–11 (lockup period); *In re Mirant*, 2008 U.S. Dist. LEXIS 129994, at *47 (employee benefit plan). If not corrected, other courts could be tempted to apply the district court's faulty rationale to these transactions and more.[8]

***Second***, the district court wrongly construed the "remedial" purpose of Section 11 to mean that liability *must* attach in order to effectuate that purpose. *See* Opening Br. at 27 (citing ER25). But that construction is unfounded, for as Defendants-Appellants explain, Section 11's harsh penalties were *designed* to apply only under very narrow circumstances. Opening Br. at 27–28. For that reason, Section 11 cannot be viewed in isolation, as "[t]he 1933 and 1934 Acts constitute interrelated components of the federal regulatory scheme governing transactions in securities." Opening Br. at 28 (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976)).

The result of this complementary statutory regime is that even when companies "go public" without the threat of Section 11 liability, investors remain protected by the antifraud provisions of the Securities Exchange Act of 1934, principally Section 10(b) and SEC Rule 10b-5 promulgated thereunder—neither of

[8] The same rationale applies to other situations that are less commonly litigated at present, but pose the same issues. For example, SEC Rule 144 permits any non-affiliated shareholder who has held stock for longer than one year before an IPO to sell unregistered shares on the first day of trading. Another example is resale shelf registrations. These are similar to direct listings in that insiders or affiliates who cannot sell per Rule 144 register their shares pursuant to a different registration statement, which then becomes effective shortly after the IPO—usually a couple months—and then shares can be sold to the public.

which involve Section 11's threat of strict liability. *See* 15 U.S.C. § 78j.[9] There are various real-world examples of transactions that do not invoke Section 11 liability because no registration statement is at issue, but that nonetheless remain subject to Rule 10b-5 liability. Corporate spinoffs are one example, where a parent company distributes stock of the business to be spun off to its stockholders to form a stand-alone, independent publicly traded company.[10] Another example is "uplistings" from over-the-counter trading markets to national exchanges like NASDAQ or the New York Stock Exchange. In both types of transactions, a company's stock becomes publicly traded, in many cases on more accessible markets, creating the same potential risks to investors. Yet, these types of transactions have been around for decades—a time period that has seen significant growth in Section 11 litigation—and neither Congress nor the SEC has found it necessary to extend Section 11 liability to these transactions.

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[9] Investors can also take comfort in the oversight provided by the Securities and Exchange Commission. The SEC's Division of Enforcement filed more than 100 standalone cases per year concerning securities offerings in fiscal years 2019 and 2018. *See* U.S. SECURITIES & EXCHANGE COMMISSION, DIVISION OF ENFORCEMENT 2019 ANNUAL REPORT 15, *available at* https://www.sec.gov/files/enforcement-annual-report-2019.pdf (last visited Nov. 2, 2020).

[10] *See* U.S. SECURITIES & EXCHANGE COMMISSION, *Fast Answers: Spin-Offs* (modified Sept. 21, 2011), https://www.sec.gov/fast-answers/answersspinoffshtm.html ("The spin-off company does not have to register the shares of the spin-off under the Securities Act of 1933 if it meets certain conditions. One of the conditions requires the parent company to provide adequate information about the spin-off to its shareholders and the trading markets.").

If the district court's decision is not reversed, other district courts could be encouraged to deviate from precedent on the same misguided grounds. As a result, every time a defendant seeks to apply the tracing rule in defense of a plaintiff's claims, that defendant will be uncertain whether the court will apply the established rule (upon which the defendant likely relied when conducting the transaction on which the claims are based) or some judge-made exception crafted specifically to the facts of the transaction. Even worse, proliferation of judge-made rules will take years to filter through the appellate courts, potentially creating splits amongst them and yielding further confusion in the district courts. This Court should act now to reverse the district court, reaffirm the tracing rule, and preserve the predictability and certainty on which markets have come to rely.

## III. CONGRESS, REGULATORS AND THE MARKETS ARE BETTER EQUIPPED TO ADDRESS ANY CONCERNS OVER TRACING

If the tracing rule is a problem—and Congress does not seem to believe that it is—then Congress, securities regulators, self-regulatory organizations such as the New York Stock Exchange, and market participants are better equipped than courts to address it. *See Krim v. pcOrder.com, Inc.*, 402 F.3d 489, 498 (5th Cir. 2005) ("It is not within [courts'] purview to rewrite the statute[.]"); *Barnes*, 373 F.2d at 273 ("[W]e are unpersuaded that, by departing from the more natural meaning of the words, a court could come up with anything better"; rather, "the time may have come for Congress to reexamine" the relevant statutes) (citation omitted); *see also*

*Morrison v. Nat'l Austl. Bank Ltd.*, 561 U.S. 247, 261 (2010) (cautioning against "judicial-speculation-made-law—divining what Congress would have wanted if it had thought of the situation before the court"). There is no reason to believe that Congress or regulators cannot or will not act, as appropriate, to protect investors. On the contrary, the regulatory process is alive and well with respect to the reach of liability under the Securities Act, as demonstrated by the unfolding debate about direct listings and whether to expand them to Primary Direct Floor Listings.[11] Moreover, even if Congress or regulators did not act, market participants could implement solutions, such as technological measures that would enhance the traceability of shares. Indeed, the Council of Institutional Investors ("CII") lobbied for this solution in connection with NYSE's consideration of Primary Direct Floor Listings. *See* Petition of CII, File No. SR-NYSE-2019-67 (Sept. 8, 2020) at 12.[12]

In sum, by substituting its judgment for that of Congress, securities regulators, and market participants, the district court set a dangerous precedent that threatens to disrupt the efficient operation of capital markets.

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[11] A Primary Direct Floor Listing would allow companies to raise capital by issuing new shares in a direct listing. *See* Anat Alon-Beck, *Investment Bankers As Underwriters: Barbarians or Gatekeepers?* FORBES (Oct. 13, 2020, 12:56 PM EDT), https://www.forbes.com/sites/anatalonbeck/2020/10/13/investment-bankers-as-underwriters-barbarians-or-gatekeepers/#7eb2cfb64af7.

[12] *See also Amicus* Brief of the Cato Institute (Dkt. No. 17), Section III.B (describing new means for tracing, including application of blockchain technology).

## CONCLUSION

For the foregoing reasons, this Court should reverse the district court's order and remand for further proceedings.

Dated: November 2, 2020

Respectfully submitted,

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*I certify that all parties listed concur with the filing of this brief.

## CERTIFICATE OF COMPLIANCE WITH NINTH CIRCUIT RULE 29-2

I certify, pursuant to Ninth Circuit Rule 32-1(e) and Federal Rule of Appellate Procedure 32(g)(1), that the attached brief is an amicus brief and complies with the word limit of Fed R. App. P. 29(a)(5). The attached brief contains 3,212 words.

Dated: November 2, 2020

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