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Direct Listings and the Weakening of Investor Protections

Brent J. Horton
Fordham University

DIRECT LISTINGS AND THE WEAKENING OF INVESTOR PROTECTIONS

BRENT J. HORTON*

ABSTRACT

In 2018, the New York Stock Exchange (NYSE) amended its rules to allow a company to directly list on the Big Board without engaging in an initial public offering (IPO). This process—called a direct listing—allowed a company to list its stock faster and cheaper, and, at least theoretically, at a more accurate price when compared to the traditional IPO. However, this first version of the NYSE's direct listing rule only allowed the company to list, not raise capital. This limited its usefulness to companies.

In 2020, the NYSE again amended its rules, this time to allow a company to list and raise capital. Commentators called this new-and-improved direct listing a "game changer" because it did away with any shortcoming (i.e., inability to raise capital) associated with the prior 2018 direct listing rule. In short, the direct listing could overtake the IPO in coming years.

The primary claim of this Article is that when the SEC approved direct listings (the SEC must approve all rule changes proposed by the NYSE), it improperly put the advantages to companies before investor protection. While the SEC should give significant weight to a proposed rule change's advantages to companies, it should not use such weighing to countenance the weakening of core investor protections.

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 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.

The repercussions of the SEC's approval of direct listings are already beginning to show. Pirani v. Slack *involves a Section 11 action brought by investors who purchased shares in Slack Technologies Inc.'s direct listing. The Northern District of California found that the investors could pursue their claim despite being unable to trace their shares*

* Associate Professor and Area Chair, Law & Ethics, Fordham University, Gabelli School of Business. LL.M. in Corporate Law, New York University School of Law; J.D., Syracuse University College of Law. Thank you to Fordham University for research support. Thanks are also in order to Sris Chatterjee, Jeffrey P. Mahoney, and Andrew F. Tuch for their comments on prior drafts.

to the direct listing (a holding contrary to IPO precedent), and the Ninth Circuit affirmed the holding. However, Slack has announced it is going to petition the Supreme Court for certiorari. Further, with the number of direct listings growing exponentially (one in 2018, one in 2019, two in 2020, and four in 2021), more such cases are undoubtedly on the way.

Important Note to the Reader: *This Article contains a postscript to address two significant events that occurred in December 2022, just prior to publication: the New York Stock Exchange further amended its direct listing rules to require underwriters in some circumstances, and the Supreme Court agreed to hear* Pirani v. Slack.

INTRODUCTION

The drafters of the Securities Act of 1933 (Securities Act) created a now well-trodden process for taking a company public: the initial public offering (IPO).[1] Before a company offers shares to the public, it must first prepare a registration statement explaining its business, finances, and any risks to its long-term success, and then file the registration statement with the Securities and Exchange Commission (SEC).[2] The company then waits for the SEC to approve the registration statement—a process that takes months—after which it can sell shares to the public.[3] (To be precise, the company provides prospective investors with a shortened version of the registration statement, called a prospectus.[4])

The corporation's indispensable partner throughout the above-described process is the underwriter.[5] While the process is new to the company (and probably its management), the underwriter has travelled this road many times.[6] The underwriter helps the company prepare its registration statement and, more importantly, engages in the book-building process whereby it measures interest—and if that interest is lacking, drums it up (that is to say, it markets the shares).[7]

However, in 2018, the New York Stock Exchange (NYSE) amended its Listed Company Manual to create an alternative to the IPO called

1. *See generally* Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-aa).

2. *Id.* §§ 77e(c), 77g, 77aa.

3. *See id.* § 77e(a).

4. Regarding the connection between the registration statement and the prospectus: The prospectus "reproduces the first twenty-seven items contained in the registration statement . . . . This shorter version of the registration statement (sometimes called a 'statutory prospectus' because it contains items specified in the statute) is the only information that may be provided to prospective investors." Brent J. Horton, *In Defense of a Federally Mandated Disclosure System: Observing Pre-Securities Act Prospectuses*, 54 AM. BUS. L.J. 743, 749-50 (2017).

5. *See* Michael Hovarth, *An Insider Guide to Going Public: The Number of Companies Going Public Has Reached Record Levels*, FIN. TIMES (London), Nov. 20, 2000, at 6 ("[C]hoosing the right underwriter can establish a company as a winner in the public markets."); Donald C. Langevoort, *Information Technology and the Structure of Securities Regulation*, 98 HARV. L. REV. 747, 761 (1985) ("A first-time issuer, in particular, may wish to buy advice [from an underwriter] on the mechanics of distribution.").

6. *See* Hovarth, *supra* note 5, at 6. Goldman Sachs, Citi, JPMorgan, Morgan Stanley, Bank of America Securities, Credit Suisse, and Barclays underwrite offerings totaling hundreds of billions of dollars every year. *See Dealogic Investment Banking Scorecard*, WALL ST. J. MONEYBEAT, http://graphics.wsj.com/investment-banking-scorecard/ [https://perma.cc/DEX4-58DD] (last visited Apr. 11, 2023).

7. Hovarth, *supra* note 5, at 6.

a selling shareholder direct floor listing (Shareholder Direct Listing).[8] The first distinguishing characteristic of the Shareholder Direct Listing is that it is "underwriter-less."[9] The aforementioned *indispensable* underwriter is replaced by a *superfluous* financial advisor.[10] The financial advisor plays a much-diminished role, lacking the ability to engage in book building or marketing.[11] As will be discussed below, in a Shareholder Direct Listing, traditional underwriting activities are not needed because the price is determined by auction, and there is very little need to market the securities of a well-known unicorn.[12]

The second distinguishing factor of the Shareholder Direct Listing, as the name implies, is that the shares being sold are those held by the company's existing shareholders (not the company).[13] That is to say, there is no capital raise.[14] The company itself cannot issue and sell new shares.[15]

Companies going public by Shareholder Direct Listing include Spotify in 2018, Slack in 2019, and Palantir and Asana in 2020.[16] In 2021 alone, it was used by Roblox, SquareSpace, ZipRecruiter, and Warby Parker.[17] In this Article, I focus on direct listings pursuant to the NYSE Listed Company Manual.[18] However, it should be noted that some companies have gone public on Nasdaq using a similar process.[19] They include Watford Holdings, Ltd. in 2019, Thryv Holdings, Inc. in 2020, and Coinbase Global, Inc. and Amplitude, Inc. in 2021.[20] The listings for these twelve companies are depicted in Chart 1.

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8. *See infra* Section I.B.

9. John C. Coffee, Jr., *The Spotify Listing: Can an "Underwriter-less" IPO Attract Other Unicorns?*, THE CLS BLUE SKY BLOG (Jan. 16, 2018), http://clsbluesky.law.columbia.edu/2018/01/16/the-spotify-listing-can-an-underwriter-less-ipo-attract-other-unicorns/ [https://perma.cc/7BYA-TXN2].

10. *See infra* Section I.B.1.a.

11. *See infra* Section I.B.1.a.

12. *See infra* Section I.B.

13. *See infra* Section I.B.1.b.

14. *See infra* Section I.B.1.b.

15. *See infra* Section I.B.1.b.

16. Jay R. Ritter, Initial Public Offerings: Underwriting Statistics Through 2022, at 8 tbl. 13a (Jan. 6, 2023), https://site.warrington.ufl.edu/ritter/files/IPOs-Underwriting.pdf [https://perma.cc/73VM-4V9B]. For in-depth information regarding the Shareholder Direct Listings of Spotify and Slack, see Brent J. Horton, *Spotify's Direct Listing: Is it a Recipe for Gatekeeper Failure?*, 72 SMU L. REV. 177 (2019).

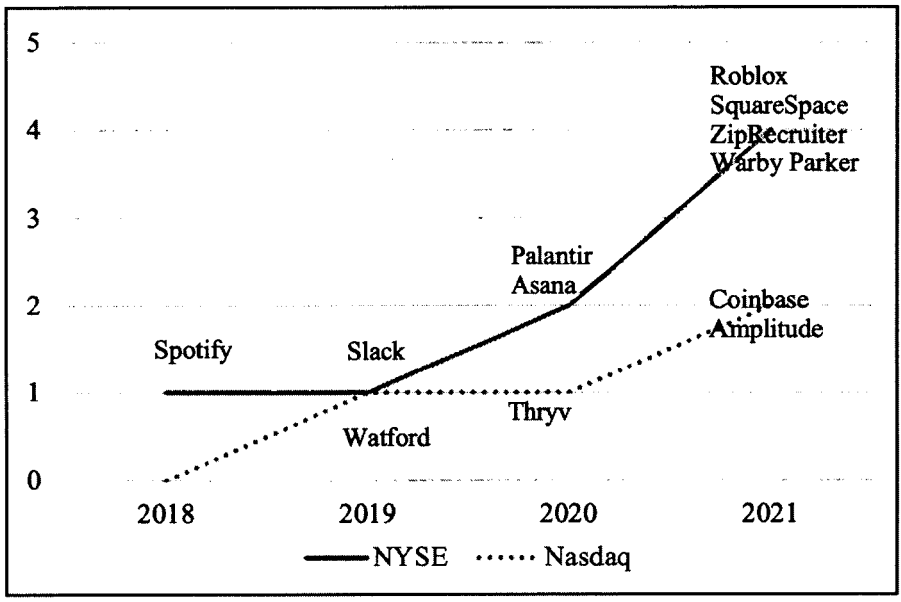
17. Ritter, *supra* note 16, at 8 tbl. 13a.

18. That is because the NYSE process is used by more recognized companies.

19. *See* Catherine M. Clarkin et al., *Updated Nasdaq Requirements for Direct Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 18, 2019), https://corpgov.law.harvard.edu/2019/03/18/updated-nasdaq-requirements-for-direct-listings/ [https://perma.cc/8CQG-CHGX].

20. *See* Ritter, *supra* note 16, at 8 tbl. 13a (noting the date of listing of each company).

Chart 1: Shareholder Direct Listings



Why are Shareholder Direct Listings growing exponentially in popularity? Because Shareholder Direct Listings are faster, cheaper, and more accurately priced.[21] It is likely that their use will continue to grow in the future, given that, in 2020, the NYSE again amended its Listed Company Manual to remove the only downside to a Shareholder Direct Listing: that the company itself cannot raise capital.[22] This new iteration of the rule—called a primary direct floor listing (Primary Direct Listing)—allows both shareholders and the company to sell shares.[23] While no companies have yet used the Primary Direct Listing to raise capital, it has the potential to be a "game changer."[24]

The primary claim of this Article is that when the SEC approved the proposed rule changes to the NYSE Listed Company Manual to allow for Direct Listings (both Shareholder and Primary Direct Listings[25]) it improperly put the advantages to companies (faster, cheaper, and more accurate pricing) above investor protection.[26] While

21. *See infra* Section I.B.2.

22. *See infra* Section I.C.

23. *See infra* Section I.C.

24. Cydney S. Posner, *NYSE Proposal for Primary Direct Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 2, 2020), https://corpgov.law.harvard.edu/2020/01/02/nyse-proposal-for-primary-direct-listings/ [https://perma.cc/GQ9K-PRLF].

25. When referring to "Shareholder Direct Listings" and "Primary Direct Listings" together, this Article will simply use the term "Direct Listings."

26. The SEC's supervision of the various exchanges, including the NYSE, is provided for in the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified at 15 U.S.C. §§ 78a-78pp). *See* Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78s (stating that all NYSE Rule changes must be approved by the SEC); *see also infra* Section I.D (discussing the approval process in detail).

the SEC should, of course, give significant weight to the advantages of a proposed rule change to the companies it regulates, it cannot use such weighing to justify weakening core investor protections of the Securities Act.

How do Direct Listings weaken core investor protections of the Securities Act? First, the Securities Act furnishes a process whereby a traditional underwriter will act as a conduit for the sale of a new issuance of securities.[27] The underwriter's reputation is on the line, so it will carefully scrutinize the company (and the registration statement), and, in so doing, it will act as a gatekeeper to the public markets.[28] Yet, in a Direct Listing, there is no traditional underwriter to act as a gatekeeper.[29] Without a gatekeeper, it is easier for a troubled company to foist its securities on the public at inflated valuations.[30]

Second, the Securities Act's remedy for investors harmed when a troubled company foists its securities on the public (without properly explaining its troubles) is damages under Section 11 of the Securities Act.[31] The authors of the Securities Act intended that Sections 5, 7, and 11 would work together.[32] More precisely, Section 5 requires the filing of a registration statement, which is then used to offer shares to the public (technically, a shortened version of the registration statement called a prospectus is used to offer shares to the public);[33] Section 7 lists the information that must be included in that registration statement;[34] and Section 11 holds the issuer, underwriter, and others responsible if there is a misstatement or omission.[35] Yet, in a Direct Listing, it is nearly impossible for an investor to bring a Section 11 action due to the way that Section 11's tracing requirement operates.[36] And

27. Securities Act of 1933 § 2(a)(11), 15 U.S.C. § 77b(a)(11); *see also* Lowinger v. Morgan Stanley & Co. LLC, 841 F.3d 122, 131 (2d Cir. 2016) ("[Underwriters] are conduits for the distribution of securities in an offering to the public in which their participation begins and ends with the offering.").

28. *See infra* Part II. Whether an investment bank carries out the traditional underwriting activities is a separate question from whether it could still be found to be a statutory underwriter. That is to say, an investment bank could provide services that fall short of traditional underwriting activities but still be found a statutory underwriter. *See infra* Section III.B.

29. *See infra* Section I.B.1.a.

30. *See infra* Section II.D.

31. 15 U.S.C. § 77k.

32. *See* Langevoort, *supra* note 5, at 765 ("For all the Act's interpretive complexity, its structure is very simple.").

33. Securities Act of 1933 § 5, 15 U.S.C. § 77e; *see also supra* note 4.

34. 15 U.S.C. § 77g.

35. *Id.* § 77k.

36. *See infra* Section III.A.

even if the investor can bring suit under Section 11, the potential defendants—and thus the potential for recovery—are limited.[37] To quote Noah Webster, "a law without a penalty is mere advice."[38]

In short, in a Direct Listing, the company and its officers and directors will feel emboldened to play "fast and loose" with the facts to go public at an inflated valuation.[39] This presents a real danger to investors.

This Article will proceed in four Parts. Part I will compare and contrast the traditional IPO, the Shareholder Direct Listing, and the Primary Direct Listing. Part II will explain why the absence of a traditional underwriter increases the chance that a company will go public at an inflated valuation, leaving retail investors "holding the bag."[40] Part III will explain how those retail investors left "holding the bag" are deprived of an adequate remedy. Part IV will coalesce around a point that becomes increasingly evident as this Article progresses: when the SEC approved the NYSE's proposed change to its Listed Company Manual, it did not properly balance the advantages of Direct Listings against protecting investors and the public. The unfortunate result is the weakening of investor protections.

Finally, the reader should observe that law governing Direct Listings is quickly developing. As such, a Postscript was added to this Article reflecting that in December 2022, just prior to publication, there were two significant events: (1) the New York Stock Exchange further amended its rules to require companies to retain and identify underwriters in Primary Direct Listings (but Shareholder Direct Listings are still underwriter-less); and (2) the Supreme Court agreed to hear *Pirani v. Slack*, a case that features prominently later in this Article.

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37. *See infra* Section III.B.

38. NOAH WEBSTER, SKETCHES OF AMERICAN POLICY 44 (1785) (emphasis omitted).

39. Francis McConville et al., *Slack's Direct Listing Tests Limits of Securities Act*, LAW360 (Dec. 10, 2019, 2:50 PM), https://www.law360.com/articles/1224848/print?section=california [https://perma.cc/G899-989X] ("[T]here is arguably a strong incentive to inflate a company's valuation prior to taking it public [by direct listing]."). This was the concern of multiple comments in opposition to NYSE's proposed rule change to allow Primary Direct Floor Listings. *See* Christopher A. Iacovella, Am. Sec. Ass'n, Comment Letter on Notice of Filing of Proposed Rule Change to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings 3 (Mar. 5, 2020) [hereinafter ASA Letter], https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6911312-211231.pdf [https://perma.cc/YP6Z-B9WG] ("[D]irect listings without the appropriate protections could provide a strong incentive and an easier path for company insiders to cash out at inflated valuations, leaving 'Mr. and Mrs. 401k' holding the bag."); Jeffrey P. Mahoney, Council of Institutional Invs., Comment Letter on Notice of Filing of Proposed Rule Change to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings 3 (July 16, 2020) [hereinafter July CII Letter], https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-7435112-220582.pdf [https://perma.cc/N8JX-UPRJ] ("CII believes the NYSE Proposal to expand direct listings may lessen investor protections in a number of ways . . . .").

40. *See* ASA Letter, *supra* note 39, at 3.

I. COMPARING IPOS AND DIRECT LISTINGS

A. IPOs

As mentioned in the Introduction, the IPO is a well-trodden process for taking a company public.[41] But it is long and expensive.[42] Private companies are willing to endure this long and expensive process for two reasons. First, it allows companies to raise more capital than they can raise privately. Second, it provides an exit opportunity for early investors.

1. *Raise Capital*

Before going public, the typical business startup will raise capital privately—many times and from a variety of parties.[43] Early capital may come from friends and family, followed by several rounds of capital from different venture capital (VC) firms.[44] However, the money available from friends, family, and even VC firms *usually* cannot compare to the money available through the public markets[45]—money that can be used for capital expenditures (a new factory), or research and development (a new product).[46]

As a result, once a startup grows to a certain size, it will often go public. For example, in 2004, Google raised $1.2 billion in its IPO.[47] In 2020, lodging-booking platform Airbnb raised $3.5 billion.[48] And, in 2021, electric vehicle maker Rivian raised $12 billion.[49]

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41. *See* Carlos Berdejó, *Going Public After the JOBS Act*, 76 OHIO ST. L.J. 1, 10 (2015) (describing the IPO process); Jeff Schwartz, *The Twilight of Equity Liquidity*, 34 CARDOZO L. REV. 531, 537-43 (2012) (same).

42. *See* Berdejó, *supra* note 41, at 10; Schwartz, *supra* note 41, at 537-43.

43. Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 164-65 (2019).

44. *Id.*

45. I use the term "usually" because over the past decade it has become much more common to raise large amounts of capital in private placements. Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 447 (2017); *see also* Telis Demos, *Airbnb Raises $1.5 Billion in One of Largest Private Placements*, WALL ST. J. (June 26, 2015, 9:01 PM), https://www.wsj.com/articles/airbnb-raises-1-5-billion-in-one-of-largest-private-placements-1435363506 [https://perma.cc/U94B-MHBM] (describing Airbnb using private placements to reach unicorn status).

46. *See* Matt Phillips, *Dropbox Has Strong Debut, Quelling Silicon Valley Jitters*, N.Y. TIMES, Mar. 24, 2018, at B1 ("[A]ccess to the capital available in public markets has become all the more important . . . to raise money to accelerate growth . . . .").

47. Eugene Choo, *Going Dutch: The Google IPO*, 20 BERKELEY TECH. L.J. 405, 405 (2005).

48. Patrick M. Corrigan, *Footloose with Green Shoes: Can Underwriters Profit from IPO Underpricing?*, 38 YALE J. ON REG. 908, 912 (2021).

49. Ben Foldy, *Rivian Makes Hot Debut, Biggest U.S. IPO Since '14*, WALL ST. J., Nov. 11, 2021, at A1.

2. Exit Opportunity

Raising capital privately, including several rounds from VC firms, leads to a complicated capital structure for a young company.[50] Further complicating the picture are grants of stock given to attract top talent and align their incentives with the success of the company.[51]

While early investors are a diverse group of VC firms and key employees, they all have one thing in common—they are looking for an exit opportunity.[52] An IPO provides a long-awaited opportunity for those early investors to cash out.[53] Once the shares are listed on a public exchange, they are liquid, meaning that they can readily be sold.[54] "A market is considered more liquid when shares can be sold without causing a major drop in price (i.e., there must be a large number of units traded on the given exchange, or more precisely, a large float)."[55]

Early investors can make a lot of money when a company goes public by IPO. For example, in 2004, when Google went public at $85 per share, the company itself raised $1.2 billion.[56] However, that amount was dwarfed by the money that could be made by early investors.[57] After the lock-up expired, 38.5 million shares owned by early investors became tradable, providing those sellers with the above-mentioned exit opportunity.[58] At that point, Google shares were trading at $172.55.[59]

B. Shareholder Direct Listings

As stated above, the first reason that a company engages in an IPO is to raise capital. However, some companies—called unicorns because of their relative rarity—can raise large amounts of capital without an

50. Pollman, *supra* note 43, at 170-75.

51. Swapnil Shinde, *Startup Employee Equity: What Every Founder Should Know*, FORBES (Aug. 5, 2021, 7:40 AM), https://www.forbes.com/sites/theyec/2021/08/05/startup-employee-equity-what-every-founder-should-know/?sh=525af4cb5af9 [https://perma.cc/ZQ6T-XLMZ].

52. de Fontenay, *supra* note 45, at 451 n.21 ("We are accustomed by now to thinking of private firms as being dependent on the public equity markets as one crucial means of exit for their equity holders (particularly for venture capital and private equity funds, but also for founders and employees) . . . .").

53. *Id.*

54. Horton, *supra* note 16, at 183 (citing Alessio M. Pacces, *Illiquidity and Financial Crisis*, 74 U. PITT. L. REV. 383, 390 (2013)).

55. *Id.* (citing Ariel Yehezkel, *Foreign Corporations Listing in the United States: Does Law Matter? Testing the Israeli Phenomenon*, 2 N.Y.U. J.L. & BUS. 351, 370 (2006)).

56. Choo, *supra* note 47, at 405.

57. Early investors Sequoia Capital and Kleiner Perkins Caufield & Byers were free to sell their shares for $4.42 and $3.89 billion, respectively. *Id.* at 434-35, 435 n.130.

58. *Id.* at 425.

59. *Id.*

IPO, instead using private placements.[60] While unicorns are rare, they are growing in number as more private investors are willing to bet huge sums of money on start-ups.[61] In fact, in 2011, private placements overtook public offerings in terms of capital raised.[62] In 2017, the difference was $300 billion in favor of private placements ($2.4 trillion versus $2.1 trillion).[63]

However, while unicorns face little pressure to raise capital, investors that hold shares in a unicorn still want to exit by selling their shares, and it is difficult to do so when the corporation is private. That is to say, the investors still want the liquidity that comes with being publicly traded.[64] What if a unicorn could simply list its shares on an exchange so that those investors could easily cash out—without an IPO?

The NYSE asked this very question in 2017.[65] Its answer was to amend the rules contained in its Listed Company Manual to allow for Shareholder Direct Listings.[66] To be precise, in March 2017, the NYSE proposed amending the rules to allow some companies to list immediately "upon effectiveness of an Exchange Act registration statement without a concurrent [IPO or] Securities Act registration."[67]

The SEC Division of Trading and Markets approved the proposed rule change to allow for Shareholder Direct Listings on February 2, 2018.[68] Note that the approval of NYSE rule changes is not handled by

60. A unicorn is a private company with a valuation greater than $1 billion. Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 584 (2016). They are called unicorns because of their relative rarity. *Id.* at 583.

61. de Fontenay, *supra* note 45, at 447.

62. Jean Eaglesham & Coulter Jones, *Powering U.S. Business: Private Capital—Firms Raise More This Way than Through Stocks and Bonds, Changing Corporate Governance*, WALL ST. J., Apr. 3, 2018, at A1.

63. *Id.*; *see also* SCOTT BAUGUESS ET AL., U.S. SEC. & EXCH. COMM'N, CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009-2017, at 8 (2018) (demonstrating that, in 2017, Regulation D offerings outpaced registered debt and equity offerings, combined).

64. Absent public status, the most common way for a shareholder to sell shares is through a Rule 144 sale after a holding period of six months or one year. *See* 17 C.F.R. § 230.144 (2022). However, most Rule 144 sales take place on the over-the-counter markets, which are less efficient. Marc I. Steinberg & Joseph P. Kempler, *The Application and Effectiveness of SEC Rule 144*, 49 OHIO ST. L.J. 473, 491 (1988).

65. *See* Maureen Farrell et al., *Spotify's Splashy Debut Pressures Banks*, WALL ST. J., Apr. 4, 2018, at A1 ("The New York Stock Exchange . . . worked closely with Spotify over the past year to enable the unorthodox listing . . . .").

66. NYSE Listed Company Manual § 102.01B n.(E), NYSE, https://nyse.wolterskluwer.cloud/listed-company-manual [https://perma.cc/UB9B-3YQY] (last visited Apr. 11, 2023) [hereinafter Listed Company Manual].

67. *See* Notice of Filing of Proposed Rule Change to Amend Section 102.01B of the NYSE Listed Company Manual, 82 Fed. Reg. 16082, 16083 (Mar. 31, 2017) (proposing changes to section 102.01B of the Listed Company Manual).

68. Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, to Amend Section 102.10B of the

the full commission (the five commissioners), but instead is delegated to the Division of Trading and Markets.[69] Compare this to the recent climate disclosure rules, which was approved by the Commission in a 3-to-1 vote.[70] The SEC Division of Trading and Markets asked for, and received, one change from the NYSE prior to granting approval: the directly listing company would be required to file a Securities Act registration statement with the SEC, removing the original language that companies could "list immediately upon effectiveness" of an Exchange Act registration statement "without any concurrent . . . Securities Act . . . registration."[71]

1. Distinguishing Features

There are two distinguishing features to remember about the Shareholder Direct Listing. First, there is no traditional underwriter. Second, there is no capital raise. I will discuss each point in turn below.

(a) No Traditional Underwriter

In a Shareholder Direct Listing, there is no traditional underwriter carrying out traditional underwriter activities.[72] Traditional underwriter activities include (1) communicating with institutional investors to "build the book"[73] and later (2) purchasing the offered shares

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NYSE Listed Company Manual, 83 Fed. Reg. 5650 (Feb. 8, 2018) (approving changes to section 102.01B of the Listed Company Manual).

69. Cody L. Lipke, *Direct Listing: How Spotify Is Streaming on the NYSE and Why the SEC Should Press Play*, 12 J. BUS. ENTREPRENEURSHIP & L. 149, 176 (2019). The SEC states of the Division of Trading and Markets:

> [It] assists the Commission in executing its responsibility for maintaining fair, orderly, and efficient markets. The staff of the Division provide day-to-day oversight of the major securities market participants: the securities exchanges; securities firms; self-regulatory organizations (SROs) including the Financial Industry Regulatory Authority (FInRA), the Municipal Securities Rulemaking Board (MSRB), clearing agencies that help facilitate trade settlement; transfer agents (parties that maintain records of securities owners); securities information processors; and credit rating agencies.

About Trading and Markets, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/about-trading-and-markets [https://perma.cc/5K6E-X4NM] (Mar. 1, 2023).

70. Matthew Goldstein & Peter Eavis, *The S.E.C. Moves Closer to Enacting a Sweeping Climate Disclosure Rule*, N.Y. TIMES (Mar. 21, 2022), https://www.nytimes.com/2022/03/21/business/sec-climate-disclosure-rule.html [https://perma.cc/C6BD-BEJN].

71. Horton, *supra* note 16, at 193-94 (quoting Letter from Jeffrey P. Mahoney, Council of Institutional Invs., to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Feb. 22, 2018), https://www.sec.gov/comments/sr-nyse-2017-30/nyse201730-3128154-161930.pdf [https://perma.cc/SRJ9-R7AA]). The change allowed the SEC to gain the support of important stakeholders, including the Council of Institutional Investors (CII). *See id.*

72. Greg Rodgers et al., *Evolving Perspectives on Direct Listings After Spotify and Slack*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 17, 2019), https://corpgov.law.harvard.edu/2019/12/17/evolving-perspectives-on-direct-listings-after-spotify-and-slack/ [https://perma.cc/U4XD-KF42].

73. Hovarth, *supra* note 5, at 6; Langevoort, *supra* note 5, at 752.

from the issuer for sale to those institutional investors (two activities that inevitably put the investment bank's reputation on the line).[74] Instead, in a Shareholder Direct Listing, the investment bank acts in a diminished role as a financial advisor.[75] It does not "build the book" and does not purchase shares.[76]

On the other hand, one similarity is that both the traditional underwriter in an IPO and the investment advisor in a Shareholder Direct Listing can assist the issuer in preparing the registration statement.[77] However, as will be discussed in more detail below, a traditional underwriter in an IPO—due to potential liability under Section 11 of the Securities Act—is careful to conduct a reasonable investigation of the facts contained in the registration statement.[78] The investment advisor in a Shareholder Direct Listing—who likely does not face liability under Section 11 of the Securities Act—is less incentivized to conduct a reasonable investigation.[79] Thus, while both the traditional underwriter in an IPO and the investment advisor in a Shareholder Direct Listing can assist the issuer in preparing the registration statement, the level of due diligence is likely lower for the latter.[80]

There is one additional role that an investment advisor in a Shareholder Direct Listing may play. The financial advisor may be called upon to provide input to the NYSE's designated market maker (DMM) for the purpose of determining the reference price.[81] However, ultimately, the price is the responsibility of the DMM, who will match buy and sell orders.[82] The below chart summarizes the difference in activities between an investment bank acting as a traditional underwriter and a financial advisor.

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74. Hovarth, *supra* note 5, at 6; Langevoort, *supra* note 5, at 752.

75. Rodgers et al., *supra* note 72.

76. *Id.* ("[T]he financial advisers in a direct listing should not engage in any book-building activities [or] participate in investor meetings . . . .").

77. *Id.*

78. *See infra* Part III.

79. *See infra* Section III.B.

80. *See infra* Section III.B.

81. *See* GIBSON DUNN, A CURRENT GUIDE TO DIRECT LISTINGS 4 (2021), https://www.gibsondunn.com/wp-content/uploads/2021/01/a-current-guide-to-direct-listings-january-2021.pdf [https://perma.cc/JNV3-HTMT] ("[NYSE Rules] require that the listing company appoint a financial advisor to . . . assist the applicable exchange's market maker or specialists, as applicable, in setting a price range or initial reference price . . . ."). What is less clear is whether the financial advisor can play a role in the overall valuation of the company for purposes of meeting the $250 million threshold. Said valuation must be provided by a valuation agent pursuant to the NYSE's Listed Company Manual. *See* Listed Company Manual, *supra* note 66, § 102.01B. However, valuation agent is not defined. In practice, it appears that this role can be filled by one of the financial advisors for the Direct Listing. *See* Benjamin J. Nickerson, *The Underlying Underwriter: An Analysis of the Spotify Direct Listing*, 86 U. CHI. L. REV. 985, 1001 (2019) ("Spotify retained Morgan Stanley, one of its financial advisors, to act as its independent valuation agent in connection with the listing.").

82. Rodgers et al., *supra* note 72.

Table 1: Differences Between Underwriter and Financial Advisor[83]

	Underwriter	Financial Advisor
Can it help prepare the registration statement?	Yes (with accompanying Securities Act liability)	Yes (but likely without accompanying Securities Act liability)
Can it engage in book building?	Yes	No
Can it market and sell?	Yes	No (may help with preparing investor presentations, but will not participate in the actual investor meetings)
Can it set the opening price?	Yes (in consultation with issuer)	No (however, the financial advisor does advise the exchange's DMM)
Does it serve as a conduit for the shares?	Yes	No

(b) No Capital Raise

The second distinguishing factor of the Shareholder Direct Listing, as the name suggests, is that only existing shareholders can sell their shares.[84] The company itself does not raise capital. Shareholder Direct Listings are simply a means to provide liquidity to investors that participated in earlier private rounds of funding, many of whom are looking for an exit event.[85]

Here, it is important to note that there are really two kinds of existing shareholders for purposes of a Shareholder Direct Listing: (1) those with shares that do need to be registered to be sold (because they do not qualify for sale pursuant to Rule 144) and (2) those with shares that do not need to be registered to be sold (because they do qualify for sale pursuant to Rule 144).[86] This distinction will become

83. Information compiled from Horton, *supra* note 16, at 183-85, 195, 201-07; Hovarth, *supra* note 5, at 6; and Rodgers et al., *supra* note 72.

84. Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, to Amend Section 102.10B of the NYSE Listed Company Manual, 83 Fed. Reg. 5650, 5651 (Feb. 8, 2018).

85. Horton, *supra* note 16, at 188-89.

86. 17 C.F.R. § 230.144 (2022); *see also* Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 379 (N.D. Cal. 2020) ("[Directly listed] shares of . . . common stock became available for purchase on the NYSE immediately . . . from two simultaneous entry points: under the Securities Act registration statement and under the SEC Rule 144 exemption from registration."), *aff'd* 13 F.4th 940 (9th Cir. 2021).

important when we discuss tracing later in this Article.[87] That being said, in a Shareholder Direct Listing, both types of existing shareholders can freely sell their shares on the public market once the company receives a ticker symbol and starts trading (either pursuant to the registration statement or pursuant to Rule 144).[88] That is to say, both types of existing shareholders benefit from the liquidity provided by the Shareholder Direct Listing.[89]

2. Advantages

The Shareholder Direct Listing does present several advantages over the traditional IPO. It is faster, cheaper, and more accurately priced, and it democratizes investing.

(a) Faster

The first advantage of Shareholder Direct Listing is that it is faster. While the listing company is still required to file a Securities Act registration statement, a review of the last eight NYSE Shareholder Direct Listings reveals that the time from filing an S-1 to approval by the SEC averaged sixty days.[90] This is faster than the seventy-six days reported for a traditional IPO.[91]

However, what truly makes the Shareholder Direct Listing faster (for existing shareholders looking to sell) is that—unlike an IPO[92]—there is no lock-up period during which the selling shareholders are prohibited from selling their shares.[93] For an IPO, the lock-up period is usually ninety to one hundred and eighty days.[94] Its purpose is to prevent too many shares from flooding the market on the first day of trading, which would depress the price.[95] In a Shareholder Direct

87. *See infra* Section III.A.

88. *Pirani*, 445 F. Supp. 3d at 379.

89. *Id.*

90. *See infra* Table 2.

91. Seventy-six days is an educated guess based on a survey of the relevant literature. *See* C. Steven Bradford, *Transaction Exemptions in the Securities Act of 1933: An Economic Analysis*, 45 EMORY L.J. 591, 605 (1996) (74 days from S-1 to effective date); U.S. SEC. & EXCH. COMM'N, REPORT OF THE ADVISORY COMMITTEE ON THE CAPITAL FORMATION AND REGULATION PROCESSES app. A, tbl.2 (1996) (78.1 days from S-1 to effective); *see also* Jeremy McClane, *Boilerplate and the Impact of Disclosure in Securities Dealmaking*, 72 VAND. L. REV. 191, 235 (2019) (101 days from S-1 to actual offering).

92. Richard Peterson, *Firms Look to Lock Up Stock Post-IPO*, CNET (Jan. 12, 2002, 4:12 PM), https://www.cnet.com/tech/tech-industry/firms-look-to-lock-up-stock-post-ipo/ [https://perma.cc/EMU8-KRRS] (over ninety percent of IPOs contain a lock-up).

93. Alexander Osipovich, *NYSE's New Alternative to an IPO Wins a Green Light from SEC*, WALL ST. J., Aug. 27, 2020, at B1 ("[T]he process allows companies to avoid some customary restrictions of IPOs, such as lockup periods that prevent insiders from selling their stock for a set period.").

94. Alon Brav & Paul A. Gompers, *The Role of Lockups in Initial Public Offerings*, 16 REV. FIN. STUD. 1, 3 (2003).

95. *Id.*

Listing, there is no lock-up agreement, and thus, selling shareholders can cash out their shares ninety to one hundred and eighty days faster than they could if the company engaged in a traditional IPO.

(b) Cheaper

The second advantage of Shareholder Direct Listing is that it is cheaper.[96] This is largely attributable to the fact that there is no traditional underwriter.[97] Instead, as discussed above, the investment bank acts as a financial advisor with fewer responsibilities.[98] Fewer responsibilities means fewer fees.

Shareholder Direct Listings may also be cheaper because the investment bank faces a much-reduced chance of liability under Section 11.[99] As such, it does not need to self-insure against Section 11 liability.[100] A review of the last eight NYSE Shareholder Direct Listings reveals that a financial advisor is paid on average $28.2 million, which is less than what an underwriter is paid for handling a traditional IPO.[101]

(c) More Accurate Pricing

The third advantage of a Shareholder Direct Listing is that the pricing is more accurate than that associated with an underwritten IPO, at least theoretically.[102] In a traditional IPO, the underwriter will talk with large institutional investors that will receive the initial allocation of IPO shares.[103] The underwriter is trying to gauge how many shares

96. Alexander Osipovich, *NYSE's Direct-Listing Plan Is Put on Hold*, WALL ST. J., Sept. 2, 2020, at B10 ("[Direct listing is a] cheaper alternative to the IPO for companies seeking to go public.").

97. Coffee, *supra* note 9.

98. *See supra* Section I.B.1.a.

99. *See infra* Part III.

100. *See* David I. Michaels, *No Fraud? No Problem: Outside Director Liability for Shelf Offerings Under Section 11 of the Securities Act of 1933*, 28 REV. BANKING & FIN. L. 339, 379 (2008-2009) ("Underwriters, as institutional gatekeepers, can self-insure the risk associated with Section 11 liability by raising their fees across-the-board.").

101. *See infra* Table 2. Compare the underwriting fees earned by investment banks for the two largest 2021 IPOs. The underwriting syndicate, led by Goldman Sachs, was paid $169.7 million for handling the Rivian IPO. Rivian Automotive, Inc., Prospectus (Form 424(b)(4)) (Nov. 9, 2021). The underwriting syndicate, led by Allen & Co., was paid $95.5 million for handing the Coupang IPO. Coupang Inc., Prospectus (Form 424(b)(4)) (Mar. 10, 2021).

102. There is some evidence, based on limited experience, that the Shareholder Direct Listing does indeed result in better pricing. *See* Rodgers et al., *supra* note 72 ("Spotify's and Slack's shares experienced low volatility compared to other large technology IPOs in the past decade.").

103. *Id.*

the institutional investors are willing to purchase and at what price.[104] These soft commitments are recorded in a figurative book, giving rise to the term "building the book."[105]

Based on the data contained in the "book," the underwriter and issuer work together to determine a price to the public.[106] This is a notoriously unreliable process, often resulting in underpricing of the offering and a first day "pop."[107] A "pop" is when the short-term secondary market price rises following the IPO. It follows that there was sufficient demand to justify a higher price, meaning that the company, figuratively speaking, left money on the table.[108]

The process is different for a Shareholder Direct Listing. One commentator explained:

> By contrast, in a direct listing, the price per share in the opening trade on the first day of trading is determined based on buy and sell orders submitted from a much broader pool of potential investors and sellers through the facilities of a stock exchange. In theory, due to the increased size of the [pool of investors and sellers] and the fact that bids can be more exactly calibrated for size and price, the resulting stock price set by this public market should be a truer market-driven price than one set through the book-build process.[109]

Amplitude went public by Shareholder Direct Listing on Nasdaq in 2021.[110] Its CEO said that avoiding underpricing was one reason he chose a Shareholder Direct Listing for Amplitude.[111] He did not want Amplitude's selling shareholders, many of whom were early investors, to "giv[e] up a huge amount of value for no reason."[112] Once the shares

104. Berdejó, *supra* note 41, at 11.

105. Rodgers et al., *supra* note 72.

106. Berdejó, *supra* note 41, at 11.

107. Donald C. Langevoort & Robert B. Thompson, *IPOs and the Slow Death of Section 5*, 102 KY. L.J. 891, 910 (2013-2014).

108. *Id.*

109. Rodgers et al., *supra* note 72; *see also* James J. Angel, Geo. Univ., Comment Letter on Notice of Filing of Proposed Rule Change to Amend Section 102.01B of the NYSE Listed Company Manual 3 (July 28, 2017), https://www.sec.gov/comments/sr-nyse-2017-12/nyse201712-2150650-157741.pdf [https://perma.cc/SZ3Y-D7VZ] ("The NYSE has been opening stocks of all kinds for over two hundred years . . . . The NYSE operates an auction that is overseen by experienced humans and they usually do a reasonable job. If they somehow get the offering price 'wrong,' the secondary market trading will quickly find the market price at which supply equals demand within a few minutes if not a few seconds.").

110. *See* Ritter, *supra* note 16, at 8 tbl. 13a.

111. Luisa Beltran, *Direct Listings Jump. Why This Path to Going Public Is Getting Noticed*, BARRON'S (Dec. 1, 2021, 9:02 AM), https://www.barrons.com/articles/direct-listings-vs-ipo-paths-to-going-public-51638305261?tesla=y [https://perma.cc/J6GT-KMEM].

112. *Id.*

began trading, the price rose less than ten percent.[113] By way of comparison, Amazon's first day pop was over thirty percent.[114] (And one notorious outlier: eBay's first day pop was over one hundred and sixty percent.[115])

(d) Democratizes Investing

Another advantage of the Shareholder Direct Listing is that it democratizes investing.[116] In a traditional IPO, the underwriter builds its book with orders from large institutional investors.[117] On the day of the IPO, the underwriter sells to the large institutional investor, and the large institutional investor sells to the retail investor at a significant markup.[118]

However, in a Shareholder Direct Listing, the intermediaries are removed from the process.[119] Any existing shareholder can sell to any purchaser.[120] One commentator referred to this as "open access" and explained that "prospective purchasers of shares [can] place orders with their broker of choice, at whatever price and size they believe[] [is] appropriate and that order [will] be part of the opening trade."[121]

3. Success

Since 2018, the use of Shareholder Direct Listings has taken off. As Chart 1 above shows, across NYSE and Nasdaq, there was one in 2018, two in 2019, three in 2020, and six in 2021.[122] Table 2 provides details on those listings that took place on NYSE, including trading symbol, date of listing, company profile, valuation pre-listing, capital raised privately pre-listing, financial advisor, amount paid to financial advisor(s), and time from filing to listing.

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113. *Id.*

114. *See* Deborah Lohse, *Small Stock Focus: Rambus and Amazon.com Warm Up IPO Market; Computer Issues Bounce Back from 2-Day Slump*, WALL ST. J., May 16, 1997, at C7:2 (noting Amazon went public at $18 and closed at $23.50).

115. Shelly K. Schwartz, *eBay: Return of the IPO*, CNN MONEY (Sept. 24, 1998, 5:05 PM), https://money.cnn.com/1998/09/24/technology/ebay/ [https://perma.cc/8NUR-9QBR].

116. *Choose Your Path to Public*, NYSE, https://www.nyse.com/direct-listings [https://perma.cc/8NUR-9QBR] (last visited Apr. 11, 2023) [hereinafter NYSE, *Choose Your Path*] ("This uninhibited price discovery reduces the cost of capital and democratizes access and opportunity for all investors.").

117. Rodgers et al., *supra* note 72; Iris Tian, *Disintermediation of the IPO Industry: The Viability of Auctioned IPO as an Alternative Under the Changing Underwriting Paradigm*, 15 VA. L. & BUS. REV. 271, 275 (2021) (describing exclusion of retail investors from the book-building process).

118. Christine Hurt, *Moral Hazard and the Initial Public Offering*, 26 CARDOZO L. REV. 711, 715-16 (2005).

119. Rodgers et al., *supra* note 72.

120. *Id.*

121. *Id.*

122. Ritter, *supra* note 16, at 8 tbl. 13a.

Table 2: NYSE Direct Listings[123]

	Spotify[124]	Slack[125]	Palantir[126]	Asana[127]	Roblox[128]	Squarespace[129]	ZipRecruiter[130]	Warby Parker[131]
Trading Symbol	SPOT	WORK	PLTR	ASAN	RBLX	SQSP	ZIP	WRBY
Date of Listing	Apr. 3, 2018	June 20, 2019	Sept. 30, 2020	Sept. 30, 2020	Mar. 10, 2021	May 19, 2021	May 26, 2021	Sept. 29, 2021
Company Profile	Music streaming service	Business platform	Software developer	Work management platform	3D digital world creator	Website builder	Job-search website	Eyeglass retailer
Valuation Pre-Listing	$20 billion[132]	$13 billion[133]	$20 billion[134]	$1.5 billion[135]	$29.5 billion[136]	$10 billion[137]	$2.4 billion[138]	$3 billion[139]

123. Because the focus of this Article is on NYSE, Table 2 does not include companies that listed on Nasdaq. *See supra* Introduction and Chart 1.

124. Spotify Tech., S.A., Registration Statement (Form F-1) (Feb. 28, 2018).

125. Slack Technologies, Inc., Registration Statement (Form S-1) (Apr. 26, 2019).

126. Palantir Technologies Inc., Registration Statement (Form S-1) (Aug. 25, 2020).

127. Asana, Inc., Registration Statement (Form S-1) (Aug. 24, 2020).

128. Roblox Corp., Registration Statement (Form S-1) (Nov. 19, 2020).

129. Squarespace, Inc., Registration Statement (Form S-1) (Apr. 16, 2021).

130. ZipRecruiter, Inc., Registration Statement (Form S-1) (Apr. 23, 2021).

131. Warby Parker Inc., Registration Statement (Form S-1) (Aug. 24, 2021).

132. Maureen Farrell & Anne Steele, *Spotify Registers for NYSE Listing*, WALL ST. J., Jan. 4, 2018, at B3.

133. Erin Griffith, *Slack Quietly Joins the Stampede of Start-Ups Bound for the Market*, N.Y. TIMES, Feb. 5, 2019, at B5.

134. Cade Metz et al., *What's a Palantir? The Tech Industry's Next Big I.P.O.*, N.Y. TIMES (Aug. 26, 2020), https://www.nytimes.com/2020/08/26/technology/palantir-ipo.html [https://perma.cc/MY6P-WFZL].

135. Lucas Matney, *Asana Files to Go Public Via Direct Listing*, TECHCRUNCH (Feb. 3, 2020, 8:44 PM), https://techcrunch.com/2020/02/03/asana-files-to-go-public-says-it-will-do-so-via-a-trendy-direct-listing/ [https://perma.cc/WG99-U7SZ].

136. Lucas Matney, *Roblox Raises at $29.5 Billion Valuation, Readies for Direct Listing*, TECHCRUNCH (Jan. 7, 2021, 10:30 AM), https://techcrunch.com/2021/01/07/robloxs-raises-at-29-5-billion-valuation-as-it-readies-for-direct-listing/ [https://perma.cc/W8VK-MBA2].

137. Corrie Driebusch, *Hot Market for IPOs Suddenly Feels a Chill*, WALL ST. J., May 15, 2021, at A1.

138. Luisa Beltran, *ZipRecruiter Gets $18 Reference Price for Direct Listing, Valuing the Online Job Marketplace at $2.4 Billion*, BARRON'S (May 25, 2021, 6:12 PM), https://www.barrons.com/articles/ziprecruiter-gets-18-reference-price-for-direct-listing-valuing-the-online-job-marketplace-at-2-4-billion-51621980756 [https://perma.cc/5T3W-6KUW].

139. *Warby Parker Is Going Public*, L.A. TIMES, Aug. 25, 2021, at A8.

	Spotify	Slack	Palantir	Asana	Roblox	Squarespace	ZipRecruiter	Warby Parker
Capital Raised Privately Pre-Listing	$2.7 billion[140]	$1 billion[141]	$3 billion[142]	$213 million[143]	$855 million[144]	$578.5 million[145]	$219 million[146]	$536 million[147]
Financial Advisor(s)	Goldman Sachs, Morgan Stanley, and Allen & Co.	Goldman Sachs, Morgan Stanley, and Allen & Co.	Morgan Stanley, Credit Suisse, Goldman Sachs, . . .	Morgan Stanley, J.P. Morgan, Credit Suisse, . . .	Goldman Sachs, Morgan Stanley, and BofA	Goldman Sachs, J.P. Morgan, Barclays Capital, . . .	Goldman Sachs, J.P. Morgan, Barclays Capital, . . .	Goldman Sachs, Morgan Stanley, Allen & Co., . . .
Amount paid to financial advisor(s)	$35 million	$22 million	$38.3 million	$14.5 million	$48 million	$28 million	$19.5 million	$20.4 million
Time from Filing to Effective Date[148]	23 days	42 days	125 days	120 days	103 days	24 days	21 days	24 days

Table 2 data compiled from company's registration statement unless otherwise specified.

C. Primary Direct Listings

In 2019, fresh off the success of the Shareholder Direct Listing, the NYSE proposed changing its rules even further to do away with the one shortcoming inherent in Shareholder Direct Listings—the

140. Katie Roof, *Spotify Opens at $165.90, Valuing Company at Almost $30 Billion*, TECHCRUNCH (Apr. 3, 2018, 12:49 PM), https://techcrunch.com/2018/04/03/spotify-opens-at-165-90-valuing-company-at-30-billion/ [https://perma.cc/4HKX-SUXH].

141. Griffith, *supra* note 133, at B5.

142. Metz et al., *supra* note 134.

143. Matney, *supra* note 135.

144. Matney, *supra* note 136.

145. Ari Levy, *Squarespace CEO Is Worth $2.4 Billion After Web Company He Built in College Debuts on NYSE*, CNBC (May 19, 2021, 3:49 PM), https://www.cnbc.com/2021/05/19/squarespace-ceo-worth-2point4-billion-after-web-company-holds-nyse-debut.html [https://perma.cc/9HZX-CFJQ].

146. Beltran, *supra* note 138.

147. *Warby Parker is Going Public*, *supra* note 139, at A8.

148. Measured from date of filing of first Registration Statement (Form S-1) to date of Effectiveness Order.

inability to raise capital.[149] In addition to Shareholder Direct Listings (which, as a practical matter, are only available to unicorns because they do not need to raise capital), NYSE proposed Primary Direct Listings, whereby a company could raise capital.[150] (I will refer to these as Primary Direct Listings but they are also referred to in the literature as "Direct Listings with a capital raise"[151] or "Direct Listings 2.0."[152])

In December 2019, the NYSE proposed to the SEC the following rule change (new language underlined and removed language bracketed):

> (E) Generally, the Exchange expects to list companies in connection with a firm commitment underwritten IPO, upon transfer from another market, or pursuant to a spin-off. However, the Exchange recognizes that some companies that have not previously had their common equity securities registered under the Exchange Act, but which have sold common equity securities in [a] one or more private placements, may wish to list their common equity securities on the Exchange at the time of effectiveness of a registration statement filed solely for the purpose of allowing existing shareholders to sell their shares, where such company is listing without a related underwritten offering upon effectiveness of a registration.statement registering only the resale of shares sold by the company in earlier private placements (a "Selling Shareholder Direct Floor Listing"). In addition, in certain cases, a company that has not previously had its common equity securities registered under the Exchange Act may wish to list its common equity securities registered under the Exchange Act may wish to list its common equity securities on the Exchange at the time of effectiveness of a registration statement pursuant to which the company will sell shares itself in the opening auction on the first day of trading on the Exchange in addition to or instead of facilitating sales by selling shareholders (any such listing in which either (i) only the company itself is selling shares in the opening auction on the first day of trading or (ii) the company is selling shares and selling shareholders may also sell shares in such opening auction, is referred to herein as a "Primary Direct Floor Listing"). Consequently, the Exchange will, on a case by case basis, exercise discretion to list companies [whose stock is not previously registered under the Exchange Act, where such a company is listing without a related underwritten offering upon effectiveness of a registration statement

149. Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, 85 Fed. Reg. 39246 (June 30, 2020) (proposing further changes to section 102.01B of the Listed Company Manual to allow for Primary Direct Listings).

150. *Id.*; *see also* Allison Hareen Lee & Caroline A. Crenshaw, *Statement on Primary Direct Listings*, U.S. SEC. & EXCH. COMM'N (Dec. 23, 2020), https://www.sec.gov/news/public-statement/lee-crenshaw-listings-2020-12-23 [https://perma.cc/R5M7-F547] ("[T]he company would sell shares itself in the opening auction on the first day of trading on the exchange . . . instead of [only] facilitating sales by selling shareholders.").

151. *See* NYSE, *Choose Your Path*, *supra* note 116 ("Companies across all industries will be able to do a Direct Listing with a capital raise.").

152. David Lopez et al., *Direct Listings 2.0—Primary Direct Listings*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 20, 2020), https://corpgov.law.harvard.edu/2020/09/20/direct-listings-2-0-primary-direct-listings/ [https://perma.cc/27HV-NYJX].

registering only the resale of shares sold by the company in earlier private placements] that are listing in connection with a Selling Shareholder Direct Floor Listing or a Primary Direct Floor Listing.[153]

By using a Primary Direct Listing, a company will get all the advantages of an IPO (including the ability to raise capital) *and* all the advantages previously associated with a Shareholder Direct Listing (faster, at lower cost, and with more accurate pricing).[154] These facts led the *Wall Street Journal* to comment that "[t]he new type of direct listing could appeal to Silicon Valley venture capitalists who have long complained about underwriting fees and other costs associated with IPOs."[155] Other commentators called it a "game changer."[156]

The SEC Division of Trading and Markets initially approved the NYSE's proposal to change the rules in its Listed Company Manual to allow for Primary Direct Listings on August 26, 2020,[157] and later affirmed that approval on December 22, 2020.[158] Like the Shareholder Direct Listing, the rule change for Primary Direct Listings provided that only large companies could take advantage of a Shareholder Direct Listing, by requiring that the company receive a valuation of at least $250 million.[159] While $250 million is a significant size, it does contradict the contention that only unicorns can take advantage of Shareholder Direct Listings.[160]

Table 3 illustrates the differences between an IPO, a Shareholder Direct Listing, and a Primary Direct Listing.

153. Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, 85 Fed. Reg. 39246, Exhibit 5 (June 30, 2020). The exhibit is a separate PDF, available at https://www.sec.gov/rules/sro/nyse/2020/34-89148-ex5.pdf [https://perma.cc/L72S-AQJG].

154. *See supra* Section I.B.2.

155. Osipovich, *supra* note 93, at B1.

156. Posner, *supra* note 24.

157. Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, 85 Fed. Reg. 54454 (Sept. 1, 2020) [hereinafter 2020 Initial Approval].

158. Order Setting Aside Action by Delegated Authority and Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings, 85 Fed. Reg. 85807, 85817 (Dec. 29, 2020) [hereinafter 2020 Final Approval].

159. Notice of Filing of Proposed Rule Change to Amend Section 102.01B of the NYSE Listed Company Manual, 82 Fed. Reg. 16082, 16083 (Mar. 31, 2017).

160. *See* Fan, *supra* note 60, at 584 (defining a unicorn as having a valuation over $1 billion).

Table 3: Comparison of IPOs, Shareholder Direct Listings, and Primary Direct Listings

	IPO	Shareholder Direct Listing	Primary Direct Listing
Year approved	Formal structure created by Securities Act of 1933	2017	2020
Number of examples	Thousands	8 (on NYSE) 4 (on Nasdaq)	0
Can existing shareholders sell shares?	Yes (but lock-up)	Yes	Yes
Can the company sell shares (i.e., capital raise)?	Yes	No	Yes
Is there an underwriter?	Yes	No	No
Method of determining opening price	Book-Building	Auction	Auction
Relative speed	Slower (and lock-up bars existing shareholders from selling for 90-180 days)	Faster (and no lock-up)	Faster (and no lock-up)
Relative cost	More Expensive	Less Expensive	Less Expensive
Is there potential for Securities Act § 11 liability?	Yes	Likely Not	Likely Not
Is there potential for Exchange Act § 10 liability?	Yes	Yes	Yes

D. SEC Approval of Direct Listings, Controversy

As stated above, the SEC Division of Trading and Markets approved the proposed changes to the NYSE's Listed Company Manual. In 2018, it approved the changes to allow for Shareholder Direct Listings.[161]

161. Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, to Amend Section 102.10B of the NYSE Listed Company Manual, 83 Fed. Reg. 5650, 5651 (Feb. 8, 2018).

In 2020, it approved the changes to allow for Primary Direct Listings.[162] Here, I will explain the approval process in more detail, including objections that the SEC received.

The NYSE is a self-regulatory organization (SRO) for purposes of the Securities Laws.[163] That means that while the NYSE has autonomy in supervising day-to-day trading on its platforms, its rules, and any changes to its rules, must be approved by the SEC.[164]

The rule approval requirement exists because the Exchange Act tasks the SEC with supervising the various exchanges, including the NYSE.[165] The Exchange Act provides that the SEC must approve the initial NYSE rules, as well as any changes to those rules.[166] When the NYSE wants to change a rule, it must first send the rule change to the SEC, which after notice and comment, will approve such rule change only if it is consistent with the underlying purposes of the Exchange Act.[167] This largely involves the SEC balancing the primary purpose of the Exchange Act against the secondary purposes of the Exchange Act.[168] The primary purpose of the Exchange Act is, of course, investor protection.[169] The secondary purposes include facilitating trading, perfecting the mechanism of a free and open market, and removing discrimination between investors.[170]

The SEC approved the proposed rule change to allow for Shareholder Direct Listings in 2018.[171] The approval was largely without controversy. The same cannot be said of the SEC's approval of Primary

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162. 2020 Initial Approval, 85 Fed. Reg. at 54461; 2020 Final Approval, 85 Fed. Reg. at 85817.

163. Securities Exchange Act of 1934 § 3(a)(26), 15 U.S.C. § 78c(a)(26).

164. 15 U.S.C. § 78s(b).

165. *Id.* § 78b (stating the purposes of the Exchange Act).

166. *Id.* § 78s(b)(1).

167. *Id.*

168. *See* Higgins v. SEC, 866 F.2d 47, 49 (2d Cir. 1989) (citing 15 U.S.C. § 78f(b)(5)) (noting how in approving NYSE rule changes, statute and regulation require the SEC to balance facilitation of trading with investor protection).

169. Securities Exchange Act of 1934 § 6(b)(5), 15 U.S.C. § 78f(b)(5); *see also* Mary L. Schapiro, Chair, U.S. Sec. & Exch. Comm'n, Opening Remarks of Chairman Mary L. Schapiro (Nov. 19, 2009), *in* U.S. SEC. & EXCH. COMM'N, TWENTY-EIGHTH ANNUAL SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION: FINAL REPORT 10, 10-11 (2009), https://www.sec.gov/info/smallbus/gbfor28.pdf [https://perma.cc/S5V3-JMWY] (explaining that the mission of the SEC is three-pronged: first and foremost, protect investors; second, maintain fair, orderly, and efficient markets; and third, facilitate capital formation); Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, Protecting the Retail Investor (Mar. 21, 2014) (transcript available at https://www.sec.gov/news/speech/mjw-speech-032114-protecting-retail-investor [https://perma.cc/7EGB-MPN]) ("Each part of our mission circles back to the first—to protect investors—because if our markets are not fair and safe, they will not attract investors to provide the capital companies are seeking.").

170. 15 U.S.C. § 78f(b)(5).

171. Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 3, to Amend Section 102.10B of the NYSE Listed Company Manual, 83 Fed. Reg. 5650, 5651 (Feb. 8, 2018).

Direct Listings in 2020.[172] That approval sparked greater controversy. The reason: while lawyers and commentators understood that Shareholder Direct Listings exposed investors to increased risk, the number of such listings (and thus, the number of exposed investors) was likely to be few (Shareholder Direct Listings were only of use to companies that did not need to raise capital, called unicorns because of their rarity).[173] However, the number of exposed investors would greatly increase with Primary Direct Listings[174] because Primary Direct Listings allow companies to raise capital, and thus have the potential to overtake IPOs.[175]

The risks that Primary Direct Listings pose to investor protections became even more evident when Latham & Watkins (the law firm that had represented Spotify in its Shareholder Direct Listings under the prior rule[176]) wrote an article in *Corporate Counsel*, where the authors emphasized that Primary Direct Listings could be used to avoid certain investor protections:

> [An] important advantage of the direct listing [is] 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. To establish standing under Section 11, a plaintiff must "trace" the shares it purchased to the challenged registration statement. . . .
>
> . . . .
>
> . . . [F]ew (if any) purchasers [in a direct listing] will be able to trace their stock to the challenged registration statement [because] . . . both registered and unregistered stock are immediately sold into the market in a direct listing.[177]

The fact that certain investor protections (specifically Section 11 of the Securities Act) may not be available to purchasers in a Primary Direct Listing—and that was being touted as a reason to conduct a Primary Direct Listing—spurred an immediate objection from the

172. 2020 Initial Approval, 85 Fed. Reg. 54454, 54461 (Sept. 1, 2020); 2020 Final Approval, 85 Fed. Reg. 85807, 85817 (Dec. 29, 2020).

173. *See* Horton, *supra* note 16, at 177.

174. Petition of Council of Institutional Investors for Review of an Order, Issued By Delegated Authority, Granting Approval of a Proposed Rule 10, Release No. 34-898, File No. SR-NYSE-2019-67 (Sept. 8, 2020) [hereinafter Petition for Review], https://www.sec.gov/rules/sro/nyse/2020/34-89684-petition.pdf [https://perma.cc/RZC3-3T6S] (stating that the rule change could vastly increase the number of direct listings).

175. *Id.* at 2, 8-10.

176. *Latham & Watkins Advises Financial Advisers in Coinbase Direct Listing*, LATHAM & WATKINS (Apr. 14, 2021), https://www.lw.com/en/news/2021/04/latham-watkins-advises-financial-advisers-coinbase-direct-listing [https://perma.cc/LRT2-S8NX].

177. Andrew Clubok et al., *Complex and Novel Section 11 Liability Issues of Direct Listings*, CORP. COUNS., Dec. 20, 2019, at 1-2, https://www.lw.com/admin/upload/SiteAttachments/CC01022020XXXXXLATHAM.pdf [https://perma.cc/74HC-MNTH].

Council of Institutional Investors (CII).[178] In a letter to the SEC dated January 16, 2020, CII stated, "If . . . public companies are successful in limiting their liability [under Section 11] to investors for damages caused by untrue statements of fact or material omissions of fact within registration statements associated with direct listings, we cannot support direct listings as an alternative to IPOs."[179]

The CII was not alone in its concern. The American Securities Association (ASA) wrote the following on March 5, 2020:

> A core component of the securities laws—and an indispensable tool necessary to protect investors—is the imposition of liability of on [sic] issuers and underwriters under Section 11 . . . of the Securities Act for any material misrepresentations or omissions they make related to an IPO. Interestingly, it remains unclear . . . whether issuers that pursue a direct listing, or the financial advisors that assist them, would retain liability under Section 11 . . . . This question is critical to maintain investor trust and confidence in the markets and it is one that the SEC must address before allowing the expanded use of direct listings.[180]

Despite these concerns, the SEC initially approved Primary Direct Listings on August 26, 2020.[181] Almost immediately—on September 8, 2020—the CII filed a Petition for Review, asking that the SEC reverse its approval, noting proponents " 'trumpeted' . . . the 'potential [of direct listings] to deter private plaintiffs from bringing claims under Section 11 of the Securities Act of 1933' " and questioning if "the Commission endorse[d] expanding the number of offerings [that can be made by direct listing] knowing that this could be the outcome."[182] And despite the objections from the CII and the ASA, the SEC affirmed its original approval of Primary Direct Listings on December 29, 2020.[183]

The Parts that follow will go into more detail about the risks that Direct Listings pose to investors. Part II will focus on the fact that there is no traditional underwriter to act as a gatekeeper to the public markets, increasing the risk that troubled companies will be offered to

178. Jeffrey P. Mahoney, Council of Institutional Invs., Comment Letter on Notice of Filing of Proposed Rule Change to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings (Jan. 16, 2020), https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-203855.pdf [https://perma.cc/G8L2-P84N]; *see also* July CII Letter, *supra* note 39, at 2 (reiterating concern).

179. July CII Letter, *supra* note 39, at 3 (footnotes omitted).

180. *See* ASA Letter, *supra* note 39, at 1-2.

181. 2020 Initial Approval, 85 Fed. Reg. 54454, 54461 (Sept. 1, 2020).

182. Petition for Review, *supra* note 174, at 11 (citing Clubok et al., *supra* note 177); *see also* Letter from J. Matthew DeLesDernier, Assistant Sec'y, Sec. & Exch. Comm'n, to John Carey, Senior Dir., NYSE Grp. Inc. (Aug. 31, 2020), https://www.sec.gov/rules/sro/nyse/2020/34-89684-carey-letter.pdf [https://perma.cc/59FX-R7QS] (providing notice of receipt of notice of intention to petition for review of delegated action and staying delegated action).

183. 2020 Final Approval, 85 Fed. Reg. 85807, 85817 (Dec. 29, 2020) (approving changes to section 102.01B of the Listed Company Manual). This was actually an affirmation of an earlier approval provided by the SEC on August 26, 2020. 2020 Initial Approval, 85 Fed. Reg. at 54454-55.

the public at inflated valuations. Part III will focus on how Direct Listings weaken Section 11 of the Securities Act, reducing the likelihood that when investors are harmed, they will be able to recover damages.

II. THE FIRST DANGER: NO TRADITIONAL UNDERWRITER REVIEW

So far, this Article has focused on the mechanics of Direct Listings and how they offer many advantages over traditional IPOs. However, Direct Listings also pose significant dangers. The first danger, addressed in this Part, is that absent traditional underwriter review, there is an increased risk that troubled companies will be foisted on the public at inflated valuations.

A. The Key Role of the Underwriter in Conducting Merit Review

To understand the key role that traditional underwriters play in the going-public process, it is necessary to understand what is *not* required by the Securities Act. The Securities Act does not require that the SEC conduct merit review of offerings.[184] That is to say, the SEC does not approve (or even comment on) the quality of a company offering securities, or approve (or even comment on) the quality of the securities themselves.[185] Instead, the SEC simply confirms that a registration statement is filed containing various items of information related to the company and the securities.[186] A.A. Sommer, Jr., who was SEC Commissioner from 1973 to 1976, famously referred to the Securities Act as " 'the rotten egg' statute" because, under the Securities Act, "it is perfectly alright to sell rotten eggs to the public as long as you say clearly that they are rotten—and perhaps tell why and how they became rotten."[187]

However, while the Securities Act's drafters did not task the SEC with conducting merit review, it does not follow that they thought there would be no merit review. In fact, while the drafters of the Securities Act did not expressly require an underwriter to review the merits of the offering, a closer look at the Act reveals that such underwriter review is exactly what the Securities Act's drafters had in mind. First, consider that the term underwriter appears forty-four times in the

184. Horton, *supra* note 4, at 747; *see also* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1801 (2011) (discussing the fact that Congress rejected merit review in favor of a disclosure model). *But see* Daniel J. Morrissey, *The Road Not Taken: Rethinking Securities Regulation and the Case for Federal Merit Review*, 44 U. RICH. L. REV. 647, 679 (2010) (asking whether Congress should have adopted merit review, as opposed to a disclosure model).

185. Horton, *supra* note 4, at 747.

186. *Id.*

187. A.A. Sommer, Jr., Comm'r, Sec. & Exch. Comm'n, Annual Reports: More than Pretty Pictures?, Address Before the National Investor Relations Institute 1-2 (Oct. 24, 1973) (transcript available at https://www.sechistorical.org/collection/papers/1970/1973_1024_SommerAnnualReports.pdf [https://perma.cc/5KS4-DG62]).

Securities Act,[188] including (1) listing the underwriter as the conduit through which the issuer will sell securities to the public,[189] and (2) including prominently the underwriter in the all-important list of liable parties if the offering fails (assuming the plaintiff can find a misstatement in the registration statement).[190]

Indeed, the essential role of the underwriter in the IPO—i.e., protecting the public from troubled companies or offerings—is well-recognized by Securities Law scholars. In 1985, Professor Langevoort wrote of the underwriter's role, noting how "securities regulation has long relied on underwriters to serve a policing function."[191] And ten years prior to that, Professor Dooley explained that underwriters regularly use their substantial clout to withhold an offering where their merit review "reveals serious deficiencies in the issuer's financial condition or unusual elements of risk."[192] As we will see below, that is exactly what happened when J.P. Morgan and Goldman Sachs discovered serious conflicts of interest and financial irregularities at WeWork.[193]

Given the foregoing, the assertion by NYSE in support of its proposed amendment to its Listed Company Manual (an assertion accepted by the SEC) that "underwriter participation in the public capital-raising process is not required by the Securities Act,"[194] while perhaps technically true, is contrary to the intent of the Securities Act's drafters, the understanding of securities law scholars, and almost ninety years of practice.

B. The Two Phases of Underwriter Merit Review and What Motivates Them

Underwriters conduct two phases of merit review.[195] The first phase of merit review occurs even before the underwriter agrees to

188. A search of the Securities Act of 1933 reveals that the term underwriter is used forty-four times. *See* Securities Act of 1933 §§ 1-Schedule A, 15 U.S.C. §§ 77a-aa. That is far too many times for the underwriter to be considered non-essential.

189. 15 U.S.C. § 77b(a)(11).

190. *Id.* § 77k(a)(5).

191. Langevoort, *supra* note 5, at 765; *see also* Mitu Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 737 (1998) ("[U]nderwriters . . . have an incentive to police potential wrongdoing by the company.").

192. Michael P. Dooley, *The Effects of Civil Liability on Investment Banking and the New Issues Market*, 58 VA. L. REV. 776, 786 (1972).

193. *See infra* Section II.C.

194. 2020 Final Approval, 85 Fed. Reg. 85807, 85814 (Dec. 29, 2020).

195. *See* Horton, *supra* note 16, at 203-04, 206-07(discussing the two phases of underwriter merit review); Dooley, *supra* note 192, at 785-86 (1972) (same).

underwrite the offering.[196] The underwriter will not commit to the offering until it is satisfied with the quality of the company and the quality of the offering. The underwriter interviews the company's senior management and analyzes stacks of financial statements.[197] Some companies do not make it through this first phase of merit review. In fact, many companies do not win the support of a prestigious underwriter and are forced to rethink their plans of a public offering.[198]

This first phase of merit review is motivated by the underwriter's desire to preserve (and grow) its reputation.[199] The scrutiny allows the underwriter to avoid sponsoring an offering that will likely flop.[200] The underwriter does not want to market a flop to the large institutional investors with whom it has long-term working relationships.[201] If it does, it may find that those working relationships disappear.

The second phase of merit review occurs after the underwriter agrees to underwrite the offering.[202] Here, the underwriter will scrutinize the registration statement for accuracy while constantly battling "the tendency of . . . management to exaggerate prospects."[203] It may stop the offering at this point as well (or, at the very least, insist on more accurate disclosures in the registration statement).[204] This second phase of merit review is motivated by the underwriter's desire to avoid liability.[205] Section 11 of the Securities Act imposes liability on

196. Dooley, *supra* note 192, at 785-86; *see also* Sharon Hannes, *Private Benefits of Control, Antitakeover Defenses, and the Perils of Federal Intervention*, 2 BERKELEY BUS. L.J. 263, 309 (2005) ("[A]ll issuers value the services of the best underwriters, while those underwriters select only the best issuers to represent.").

197. Dentons, *Canada: Focus on Technology, September 2006—Technology Initial Public Offerings—Part 2*, MONDAQ (Oct. 10, 2006), http://www.mondaq.com/article.asp?article_id=43150 [https://perma.cc/U4KM-LL3Y]; *see also* Chitru S. Fernando et al., *Two-Sided Matching: How Corporate Issuers and Their Underwriters Choose Each Other*, 25 J. APPLIED CORP. FIN. 103, 103-04 (2013) (discussing what indicators of success underwriters look for).

198. Dooley, *supra* note 192, at 785-86.

199. Fernando et al., *supra* note 197, at 103-04.

200. *Id.*

201. James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903, 953 (1996); *see also* Jeffrey J. Hass, *Small Issue Public Offerings Conducted Over the Internet: Are They "Suitable" for the Retail Investor?*, 72 S. CAL. L. REV. 67, 96-97 (1998) ("[T]he merit review performed by underwriters centers around profit: Will the proposed offering prove profitable to . . . its investor clientele . . . ?").

202. Joseph K. Leahy, *The Irrepressible Myths of* BarChris, 37 DEL. J. CORP. L. 411, 476 (2012).

203. *Id.* at 476 (quoting Nicholas Wolfson, *Investment Banking*, *in* ABUSE ON WALL STREET: CONFLICTS OF INTEREST IN THE SECURITIES MARKETS 365, 369-70 (1980)).

204. *Id.* at 482.

205. Dooley, *supra* note 192, at 786.

the underwriter for any material misstatement in the registration statement *unless* it can show that it had performed a reasonable investigation giving rise to a reasonable belief that the statements were true.[206]

The burden of conducting a reasonable investigation is a heavy one. Courts expect a great deal from the underwriter because of its expertise and investigative resources.[207] The illustrative case here is *Escott v. BarChris*.[208] The details of the case are well known. In short, BarChris, a builder of bowling alleys, sold debentures via a registration statement that overstated earnings, understated liabilities, and failed to disclose several material risk factors.[209] Among the defendants was the underwriter Drexel & Co.[210] The district court held that Drexel's acceptance of management's assertions, without confirming the details through a separate investigation of company records, was insufficient to establish it had performed a reasonable investigation giving rise to a reasonable belief that the statements in the registration statement were true.[211]

C. *Underwriter Review at Work—WeWork, Inc.*

An example of an underwriter properly acting as a gatekeeper is presented by the failed IPO of WeWork, Inc.[212] WeWork had two primary underwriters.[213] The first underwriter was J.P. Morgan.[214] As J.P. Morgan helped WeWork prepare its registration statement, it discovered severe conflicts of interest, including the CEO leasing properties back to the company.[215] Because J.P. Morgan faced possible liability if such matters were not disclosed in the registration statement, it insisted WeWork do so.[216] WeWork reluctantly agreed.[217]

The second underwriter was Goldman Sachs.[218] Its CEO, David M. Solomon, stated that WeWork's troubled business model became clear as Goldman conducted its due diligence in preparation for the

206. Securities Act of 1933 § 11(b)(3), 15 U.S.C. § 77k(b)(3).

207. Dooley, *supra* note 192, at 786.

208. Escott v. BarChris Constr. Corp., 283 F. Supp. 643 (S.D.N.Y. 1968).

209. *Id.* at 679-80.

210. *Id.* at 692-97.

211. *Id.*

212. Donald C. Langevoort & Hillary A. Sale, *Corporate Adolescence: Why Did "We" Not Work?*, 99 TEX. L. REV. 1347, 1357 (2021).

213. *Id.* at 1372.

214. Andrew Ross Sorkin, *Behind WeWork Leader's Rise and Fall: A Wall St. Bank Playing Many Angles*, N.Y. TIMES (Sept. 26, 2019), https://www.nytimes.com/2019/09/25/business/wework-jpmorgan.html [https://perma.cc/ZKY2-Q9TP].

215. *Id.*

216. *Id.*

217. *Id.*

218. Langevoort & Sale, *supra* note 212, at 1372.

offering.[219] The "reality," Solomon said, was that the company could not be profitable.[220] Goldman insisted that the troubled financial picture be reflected in the registration statement (or at least not completely omitted).[221]

The conflicts of interest, coupled with a troubling financial picture presented in WeWork's registration statement led to—at the eventual insistence of the underwriters—the withdrawal of the offering.[222] Solomon stated, "I think that's a great example of the process working."[223]

One outstanding question is what motivated J.P. Morgan and Goldman Sachs to force withdrawal of the offering: was it an altruistic recognition of their role as gatekeeper to the public markets, or simple self-preservation in the face of potential liability under Section 11 of the Securities Act? Professors Donald Langevoort and Hillary Sale are quite clear on their thoughts: "[O]nly when faced with . . . their own potential for strict liability, and the market rejection of an arguably . . . false[] prospectus, were they forced to recalibrate and withdraw the offering."[224]

However, for our purposes, the motivation does not really matter. Whatever the motivation, the fact is that the underwriters adequately—if not gracefully—played their gatekeeping role. They prevented WeWork from being foisted on the public (although WeWork would go public two years later at a greatly decreased valuation via SPAC).[225]

Unfortunately, in a Direct Listing, the traditional underwriter—and traditional underwriter review—is absent.[226] Thus, the question becomes, are any of the other players, including the financial advisor, properly incentivized to step up and provide such review? I think the answer is no.

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219. Oscar Williams-Grut, *Goldman Sachs CEO Defends Work on Failed WeWork IPO*, YAHOO! FIN. (Jan. 21, 2020), https://www.yahoo.com/now/davos-2020-unicorns-wework-ipo-david-solomon-stacey-cunningham-goldman-145306829.html [https://perma.cc/FM2H-P2ZZ].

220. *Id.*

221. *Id.*

222. Jean Eaglesham & Eliot Brown, *WeWork's IPO Filings Filled with Mistakes*, WALL ST. J., Oct. 8, 2019, at A1.

223. *See* Williams-Grut, *supra* note 219.

224. Langevoort & Sale, *supra* note 212, at 1374.

225. Dave Sebastian, *WeWork Stock Climbs in Debut—Shared-Office Company Goes Public via SPAC After Failed Attempt, Ouster of Co-Founder*, WALL ST. J., Oct. 22, 2021, at B1.

226. Thus, as pointed out by the ASA in opposing Primary Direct Listings:

> Certain companies, such as WeWork, demonstrate the real risks companies would pose to Main Street investors if they were permitted to sell shares at unvetted valuations. In other words, direct listings without the appropriate protections could provide a strong incentive and an easier path for company insiders to cash out at inflated valuations, leaving [retail investors] holding the bag.

See ASA Letter, *supra* note 39, at 3.

D. No Adequate Replacement for Underwriter Review

Interestingly, the SEC, when it approved Primary Direct Listings, took the position that there are other parties that could take over the underwriter's gatekeeping role.[227] It wrote that, in addition to financial advisors, "issuers, officers, directors, and accountants, with their attendant liability, play important roles in assuring that disclosures provided to investors are materially accurate and complete."[228] The SEC's statement is oddly divorced from reality. First, it ignores the fact that prior to 2005, the SEC had itself *required* that an underwriter shepherd "at the market" offerings through the registration process.[229] This rule was later relaxed, but it certainly points to the fact that the SEC understands that underwriters play an important screening role in the offering process.[230]

Second, the alternate gatekeepers that the SEC listed (financial advisors, issuers, officers, directors, and accountants) cannot adequately review the merits of the offering. Consider first the investment bank acting as a financial advisor. A financial advisor plays a greatly diminished role (as compared to a traditional underwriter).[231] Unfortunately, in that diminished role, the financial advisor is not incentivized to fully scrutinize the merits of the offering.[232] There is less reputational risk for a financial advisor (as compared to a traditional underwriter) because it is not selling securities to its normal cadre of institutional investors.[233] Nor is it even marketing such securities to them.[234]

227. 2020 Final Approval, 85 Fed. Reg. 85807, 85815 (Dec. 29, 2020).

228. *Id.*

229. In 1983, Rule 415 was amended to read as follows:

> In the case of a registration statement pertaining to an at the market offering of equity securities by or on behalf of the registrant . . . the securities must be sold through an underwriter or underwriters, acting as principal(s) or as agent(s) for the registrant; and . . . the underwriter or underwriters must be named in the prospectus which is part of the registration statement.

Shelf Registration, Securities Act Release No. 6499, 48 Fed. Reg. 52889, 52896 (Nov. 23, 1983) (amending 17 C.F.R. § 230.415); *see also* Langevoort, *supra* note 5, at 773 ("In rule 415, the SEC went so far as to require that issuers have their 'at the market' equity offerings underwritten if they wish to take advantage of the simplified procedure.").

230. *See* Securities Offering Reform, Securities Act Release No. 33-8591, 70 Fed. Reg. 44722, 44776 (Aug. 3, 2005) ("Under our revised Rule, an issuer that is registering a primary equity shelf offering pursuant to Rule 415(a)(1)(x) can register an 'at-the-market' offering of equity securities without identifying an underwriter in its registration statement.").

231. *See* Horton, *supra* note 16, at 203 chart 5.

232. *See id.*

233. *Id.* at 204 (quoting Bohn & Choi, *supra* note 201, at 953).

234. Indeed, it actively avoids doing so for fear that it may be deemed a statutory underwriter. *See, e.g.*, Spotify Technology S.A., Prospectus at 186 (Form 424(b)(4)) (Mar. 23, 2018) [hereinafter Spotify Prospectus] ("[T]he financial advisors have not been engaged to participate in investor meetings . . . ."); Letter from Dana G. Fleischman, Lathan & Watkins LLP, to Josephine J. Tao, Assistant Dir., Div. of Trading & Mkts, U.S. Sec. & Exch. Comm'n 9 (Mar. 23, 2018) [hereinafter Tao Letter] ("Notably, the Advisory Engagement Letters do not

Further, the financial advisor is not motivated by liability risk because, as will be discussed in detail below, a financial advisor is likely not a proper Section 11 defendant.[235]

On the other hand, Professors Seligman and Tuch write that when interviewed, financial advisors claim that they do conduct due diligence, just in case they are found to be statutory underwriters.[236] That begs the question: how much due diligence? Professors Seligman and Tuch write that they are skeptical that it rises to the level of what a traditional underwriter in an IPO would provide, and the parties may need to opt-in to "customary diligence."[237]

With regard to issuers, officers, and directors, it is doubtful that they can police themselves.[238] They have a strong incentive to inflate valuations by "exaggerat[ing] prospects."[239] The company—as was the case in *BarChris*—may be so hard-pressed for capital that the management is not concerned about its reputation (after all, their reputation will be harmed if the company fails) and may even be willing to risk potential liability.[240]

Regarding the accountants, certainly they have reputational incentives to conduct due diligence.[241] However, they are only responsible for the balance sheets, income statements, retained earnings, and cash flows.[242] They are not responsible for the many other important parts of the registration statement, such as risk factors or use of proceeds.

Admittedly, the financial advisor, officers and directors, and accountants may do significant work in preparing the registration statement; however, that work is not a replacement for underwriter due diligence.

III. THE SECOND DANGER: GUTTING SECTION 11

Above, we discussed how a Direct Listing will face less scrutiny than a traditional IPO due to the absence of a traditional underwriter.

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engage any of the Financial Advisors to act in an underwriting capacity in respect of any offers or sales made by the Registered Shareholders pursuant to the Form F-1 and expressly provide that the Financial Advisors will not further assist the Company in the planning of, or actively participate in, investor meetings.").

235. *See infra* Part III.

236. Andrew F. Tuch & Joel Seligman, *The Further Erosion of Investor Protection: Expanded Exemptions, SPAC Mergers and Direct Listings*, 108 IOWA L. REV. 303, 371-72 (2022).

237. *Id.* at 371.

238. Langevoort, *supra* note 5, at 773 ("[T]he issuer has a decided conflict of interest . . . .").

239. *See* Leahy, *supra* note 202, at 476.

240. Comment, *BarChris: Due Diligence Refined*, 68 COLUM. L. REV. 1411, 1421 (1968).

241. In a related context, Judge Easterbrook wrote that "[a]n accountant's greatest asset is its reputation for honesty." DiLeo v. Ernst & Young, 901 F.2d 624, 629 (7th Cir. 1990).

242. Securities Act of 1933 § 11(b)(3), 15 U.S.C. § 77k(b)(3).

Some companies may take advantage of that.[243] They may go public at inflated valuations (or valuations that do not reflect the true risk involved).[244] If that happens, is there a remedy for harmed investors? Again, the answer is likely no.

Here, a comparison is in order. In a traditional IPO, where the registration statement provides information (or omits information) that leads to an inflated company value, a lawsuit under Section 11 of the Securities Act is the remedy for a purchaser.[245] The purpose of the Securities Act is to make sure that investors receive accurate information.[246] Accordingly, under Section 5, the issuer must file with the SEC a registration statement setting out its finances, risks it faces, and much more.[247] (That registration, minus some attachments, is the prospectus that the investor receives.[248]) Section 11 was included in the framework to guarantee that the information contained in the registration statement is accurate.[249] Section 11 states that where the registration statement contains an untrue statement of material fact, the issuer, underwriter, and others, must pay damages to harmed investors.[250]

However, in the case of a Direct Listing, a harmed investor faces two impediments to recovery under Section 11. The first impediment is the tracing requirement. The second impediment is the absence of the underwriter as a defendant. I will discuss each in turn.

A. The Tracing Requirement

Latham & Watkins, the law firm that represented Spotify in its Shareholder Direct Listing, touted the process as a means to "deter private plaintiffs from bringing claims under Section 11."[251] It points out that in a Direct Listing, "few (if any) purchasers will be able to trace their stock to the challenged registration statement" because "both registered and unregistered stock are immediately sold into the market in a direct listing."[252]

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243. *See* ASA Letter, *supra* note 39.

244. *See id.*

245. 15 U.S.C. § 77k; *see also* Escott v. BarChris Constr. Corp., 283 F. Supp. 643, 652 (S.D.N.Y. 1968).

246. Horton, *supra* note 4, at 743.

247. 15 U.S.C. § 77e.

248. Horton, *supra* note 4, at 747-48 (citing Securities Act of 1933 §§ 5(b), 10(a)(1), 15 U.S.C. §§ 77e(b), 77j(a)(1)).

249. *See* Barnes v. Osofsky, 373 F.2d 269, 272 (2d Cir. 1967) ("Section 11 deals with civil liability for untrue or misleading statements or omissions in the registration statement; its stringent penalties are to insure full and accurate disclosure through registration.").

250. 15 U.S.C. § 77k.

251. *See* Clubok et al., *supra* note 177, at 1-2. This point was emphasized by CII in its opposition to Primary Direct Listings. Petition for Review, *supra* note 174, at 11.

252. Clubok et al., *supra* note 177, at 1-2.

Here, an explanation is in order. Section 11 provides that where a registration statement contains a misstatement of material fact, "any person acquiring *such security* . . . may. . . sue" the issuer, the underwriter, and several others.[253] Courts interpret "such security" as those securities registered by the registration statement.[254] This is consistent with Section 5's statement that "it shall be unlawful . . . to offer . . . any security, unless a registration statement has been filed as to *such security*."[255] Where a plaintiff brings a Section 11 action, courts require the plaintiff to trace her securities back to the registration statement containing the alleged misstatement.[256] That is to say, the term "such security" created the tracing requirement.[257]

From 1933 to the 1960s, tracing was not much of an issue.[258] Paper stock certificates were physically delivered for each stock trade.[259] Professor Geis points out that "[n]umbered stock certificates . . . passed from seller to buyer like the deed to a house or title to a car."[260] The certificate number (usually printed on the upper left hand corner) allowed the buyer to trace the pedigree of their share back to a particular offering.[261]

However, in the 1960s, the increasing number of stock sales meant that brokerages could no longer keep up with the requirement to physically transfer stock certificates.[262] Professor Geis writes that, "[d]uring the height of this paperwork crisis, traders closed the stock markets every Wednesday just so the brokers could inspect the unruly piles of certificates . . . and route them to their new owners."[263]

To solve the problem, the SEC and traders agreed that all shares would be held in one place—what Geis calls share immobilization.[264]

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253. 15 U.S.C. § 77k (emphasis added).

254. *See Barnes*, 373 F.2d at 271-72 (noting the natural reading of Section 11(a) is "[any person] acquiring a security issued pursuant to the registration statement"); *see also* Therese H. Maynard, *Liability Under Section 12(2) of the Securities Act of 1933 for Fraudulent Trading in Postdistribution Markets*, 32 WM. & MARY L. REV. 847, 890 (1991) ("[S]ection 11 uses the phrase 'such security' to refer to those securities that are the subject of an effective registration statement.").

255. Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c) (emphasis added).

256. Hillary A. Sale, *Disappearing Without a Trace: Sections 11 and 12(a)(2) of the 1933 Securities Act*, 75 WASH. L. REV. 429, 443-44 (2000) (citing Barnes v. Osofsky, 373 F.2d 269, 270 (2d Cir. 1967)).

257. *Id.* at 443.

258. Peter Oh, *Tracing*, 80 TUL. L. REV. 849, 853 (2006).

259. *Id.*

260. George S. Geis, *Traceable Shares and Corporate Law*, 113 NW. U. L. REV. 227, 232 (2018).

261. *Id.*

262. *Id.* at 232.

263. *Id.*

264. *Id.* at 232-33.

The SEC and traders created the Depository Trust & Clearing Corporation (DTCC) to warehouse certificates.[265] DTCC holds seventy to eighty percent of all publicly traded shares individually or through a nominee.[266]

From that point forward, the sale of a share did not require the actual stock certificates to be transferred from the seller to the buyer (nor was the owner's name on the certificate changed).[267] Instead, the sale of the share now results in the buyer having a claim to a portion of the shares held as a "fungible bulk," but not to any specific shares.[268] This is akin to a buyer of apples being able to trace the apples back to particular farm (the company) but not back to a specific tree (the offering).

Under this new reality, a purchaser in a successive public offering (SPO) will often find it difficult to trace her shares back to the SPO's registration statement, and thus will lack standing to bring a Section 11 action.[269] By SPO, I mean a situation where the company sold common shares to the public under its first registration statement (the IPO registration statement) and, several years later, sells common shares again under a second registration statement (the SPO registration statement).[270]

1. Applied to Successive Public Offerings

The first major case dealing with the application of Section 11 to SPOs was *Barnes v. Osofsky*, decided by the Second Circuit in 1967.[271] In that case, Aileen, Inc. had initially gone public in 1961.[272] The IPO registration statement registered approximately 200,000 common

265. *Id.* at 233.

266. *Id.* at 233 n.23 (citing Larry T. Garvin, *The Changed (and Changing?) Uniform Commercial Code*, 26 FLA. ST. U. L. REV. 285, 315 (1999)).

267. *Id.* at 232-35.

268. *Id.*; *see also* Oh, *supra* note 258, at 853 (noting how the implementation of the book-entry system "erased from securities any vestige that they belong to a specific purchaser or come from a particular offering").

269. Petzschke v. Century Aluminum Co. (*In re Century Aluminum Co. Sec. Litig.*), 729 F.3d 1104, 1106-07 (9th Cir. 2013).

270. Many courts use the term "secondary offering" to describe a situation where "the company's stock was already publicly traded under a previously filed registration statement, and the company filed a new registration statement so that it could sell more stock." Pirani v. Slack Techs., Inc., 13 F.4th 940, 952 (9th Cir. 2021) (Miller, J., dissenting); *see also In re Century Aluminum*, 729 F.3d at 1106 (using the term "secondary offering"). I avoid that term because it can be confused with secondary trading, which refers to day-to-day trading on the public markets. I instead use "successive public offerings" or "SPO."

271. Barnes v. Osofsky, 373 F.2d 269 (2d Cir. 1967).

272. *Id.* at 270. The case actually states that prior to 1963, a total of 205,966 of Aileen, Inc. shares were traded on the American Stock Exchange, and "most" of them were covered by a 1961 registration statement. *Id.*; *see also* SEC News Digest, Aug. 8, 1961, at 3 (confirming the registration statement for Aileen, Inc. was effective August 8, 1961). There is no mention of a prior registration statement, so I am assuming that the 1961 registration statement was the initial registration statement of these shares.

shares.[273] Those common shares were traded on the American Stock Exchange (AMEX).[274] In 1963, Aileen, Inc. offered another 200,000 common shares to the public pursuant to an SPO registration statement, bringing the number of common shares traded on AMEX to approximately 400,000.[275] The plaintiffs had bought common shares after the filing of the SPO registration statement and were bringing a Section 11 action, alleging that the document overstated sales volume.[276]

The Second Circuit found that because the common shares offered in 1961 and the common shares offered in 1963 were comingled, the plaintiffs could not trace their shares back to the SPO registration statement (as opposed to the IPO registration statement).[277] The Second Circuit held that such a result was mandated by the more natural reading of Section 11's "such security" as "a security issued pursuant to the registration statement," and not as "a security of the same nature as that issued pursuant to the registration statement."[278] The Second Circuit recognized that while this may lead to a somewhat unfair result ("a rather accidental impact as between one open-market purchaser of a stock already being traded and another"), it is what a natural reading of the statute required.[279]

In *In re Century Aluminum*,[280] decided in 2013, the Ninth Circuit followed the reasoning in *Barnes v. Osofsky*. Century Aluminum went public with an offering of common stock.[281] By the end of 2008, forty-nine million shares of Century Aluminum common stock were being actively traded on the public markets.[282] In early 2009, the company engaged in an SPO of an additional twenty-four million shares of common stock.[283]

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273. *Barnes*, 373 F.2d at 270. I am referring to this as the IPO registration statement because I can find no mention of the common shares being registered prior to 1961.

274. *Id.*

275. *Id.*

276. *Id.*

277. *See* Barnes v. Osofsky, 373 F.2d 269, 270-73 (2d Cir. 1967). There is an exception where a plaintiff can make a seven-part showing that includes the following:

> (1) a broker indicating interest on behalf of a customer; (2) a customer who receives a copy of the "red herring," or preliminary, prospectus; (3) a purchase order with a notation indicating an offering purchase; (4) a purchase price matching the offering price; (5) a lack of a commission; (6) a confirmation slip with language regarding the offering; and (7) a special code for the transaction at the brokerage firm.

Sale, *supra* note 256, at 448 (footnotes omitted).

278. *Barnes*, 373 F.2d at 271-72.

279. *Id. at* 273.

280. *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104 (9th Cir. 2013).

281. *History*, CENTURY ALUMINUM, https://centuryaluminum.com/company/history/default.aspx [https://perma.cc/H5G9-WMEX] (last visited Apr. 11, 2023).

282. *In re Century Aluminum*, 729 F.3d at 1106.

283. *Id.*

The plaintiffs purchased shares, allegedly issued in the 2009 offering, only to thereafter have the company restate its earnings downward.[284] The plaintiffs brought an action under Section 11, claiming a material misstatement in the registration statement (i.e., that it contained overly rosy earnings numbers).[285] Unfortunately for the plaintiffs, the Ninth Circuit affirmed dismissal of the action for failure to state a claim on which relief could be granted (due to lack of standing).[286]

One plaintiff alleged that he directed his broker to purchase the shares, and the broker executed the transaction through Citigroup, which was in a joint venture with Morgan Stanley (one of the underwriters).[287] The Ninth Circuit stated that while the plaintiff's allegations are consistent with the idea that the shares he purchased were traceable to the SPO, "they are also consistent with Citigroup having filled the order with previously issued shares it was holding."[288]

The Ninth Circuit recognized that this was a harsh—and perhaps inequitable—outcome, but one that the text of the statute required. The court opined:

> [Plaintiffs are required] to trace the chain of title for their shares back to the [successive public] offering, starting with their own purchases and ending with someone who bought directly in the [successive public] offering. Courts have long noted that tracing shares in this fashion is "often impossible," because "most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares," and "many brokerage houses do not identify specific shares with particular accounts but instead treat the account as having an undivided interest in the house's position." Though difficult to meet in some circumstances, this tracing requirement is the condition Congress has imposed for granting access to the "relaxed liability requirements" § 11 affords.[289]

Thus, the purchaser of shares in an SPO will often find it impossible to bring a Section 11 action.[290]

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284. *Id.*

285. *Id.*

286. *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1109 (9th Cir. 2013) ("Plaintiffs' failure to plead the traceability of their shares means they lack statutory standing under § 11, but failure to allege statutory standing results in failure to state a claim on which relief can be granted." (emphasis omitted)).

287. *Id.*

288. *Id.*

289. *Id.* at 1106-07 (citation omitted) (first quoting Barnes v. Osofsky, 373 F.2d 269, 271-72 (2d Cir. 1967); then quoting Abbey v. Computer Memories, Inc., 634 F. Supp. 870, 875 (N.D. Cal. 1986)).

290. *In re Century Aluminum*, 729 F.3d at 1107. There are two very limited exceptions to this rule in the SPO context. The first is where there are two public offerings but the plaintiff purchases more shares than were offered privately. *See In re* Mirant Corp. Sec. Litig., No. 1:02-CV-1467, 2008 U.S. Dist. LEXIS 129994, at *45-46 (N.D. Ga. Aug. 5, 2008).

2. Applied to an IPO

As the Ninth Circuit stated in *In re Century Aluminum*, "[w]hen all of a company's shares have been issued in a single offering under the same registration statement, this 'tracing' requirement generally poses no obstacle."[291] This statement assumes two facts: that the offering is an IPO and that there is a lock-up period.[292] An IPO (or initial public offering) is, of course, the first public offering of a corporation's shares.[293] A lock-up generally accompanies the IPO.[294] Pursuant to the lock-up, all privately issued shares are restricted, meaning they cannot be sold without "a legal opinion proving exemption from registration requirements and . . . removal of the restricted legend or filing of registration statement concerning the stock in order to sell the shares on the public stock market."[295]

Returning to our main point, there is no tracing issue if the offering is an IPO and the investor purchases shares during the lock-up period.[296] Because it is the IPO, there are no publicly traded shares

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If that is so, then some of the shares purchased must have been offered by the offending registration statement. *See id.* at *46-47. That was the case in *In re Mirant Corp.*, where the court held as follows:

> [T]he undisputed evidence reflects that only 2,072 non-IPO shares issued pursuant to the EBP Registration Statement entered the market prior to March 13, 2001, the day that Plaintiff Kellner purchased 8,000 shares of Mirant stock. Therefore, Plaintiff Kellner can demonstrate with certainty that at least 5,298 of his shares are directly traceable to the IPO Registration Statement.

Id. at *45-46. Second, a minority of courts find the tracing requirement met where it is statistically likely that the shares were offered pursuant to the registration statement in question. *See In re* Snap Inc. Sec. Litig., 334 F.R.D. 209, 223-24 (C.D. Cal. 2019). In *Snap*, the court noted the following:

> Both parties acknowledge that only 100,000 of the more than 200 million shares in the market were not traceable to the IPO—meaning approximately 99.95% of the shares in the market during the relevant period are traceable to the IPO. . . . As a policy matter, barring use of statistical tracing in litigation following a major IPO would mean that waiving the lock-up period for even nominal number of pre-IPO investors would effectively inoculate a corporation against nearly all potential Section 11 liability it might face for misstatements or omissions in its registration statement.

Id. (emphasis omitted). However, most courts find that showing a high probability that the shares purchased were covered by the registration statement is not enough. *See* Krim v. PcOrder.com, Inc., 402 F.3d 489, 496, 498 (5th Cir. 2005) (affirming dismissal of Section 11 claims for lack of subject matter jurisdiction where plaintiffs could not prove shares traceable to offering but had submitted expert evidence showing there was a 99.85% statistical likelihood that shares were from offering).

291. *In re Century Aluminum*, 729 F.3d at 1106.

292. Pirani v. Slack Techs., Inc., 13 F.4th 940, 950-51 (9th Cir. 2021) (Miller, J., dissenting).

293. Prior to the IPO, the corporation's shares are privately traded.

294. *Pirani*, 13 F.4th at 950-51 (Miller, J., dissenting); *see also* Peterson, *supra* note 92 (noting over ninety percent of IPOs contain a lock-up).

295. Dartell v. Tibet Pharms., Inc., No. 14-3620, 2016 U.S. Dist. LEXIS 21541, at *13 (D.N.J. Feb. 22, 2016).

296. *In re* LendingClub Sec. Litig., 282 F. Supp. 3d 1171, 1179-80 (N.D. Cal. 2017) (finding no tracing problem where shares were purchased during lock-up, prior to comingling).

offered by a previous registration statement (avoiding the SPO problem posed in *In re Century Aluminum*), and privately held shares cannot be sold because they are subject to the lock-up.[297] Thus, the shares being purchased are inescapably those tied to the registration statement. There are no others available.

A good example of the foregoing is seen in *Sudunagunta v. NantKwest, Inc.*[298] Formed in 2007, NantKwest was a development-stage immunotherapy company.[299] Over the years, it issued shares to various investors (including its founders) through private-placements and as employee compensation.[300] Prior to its IPO, 61,265,902 shares were outstanding.[301]

In 2015, NantKwest went public, offering 8,288,000 shares.[302] Plaintiffs who purchased shares on the public markets brought a lawsuit claiming that the company failed to disclose certain items of executive compensation and related-party transactions in its registration statement.[303] The defendants moved to dismiss the action, arguing based on *In re Century Aluminum* that the plaintiffs could not trace their purchase to the allegedly misleading registration statement.[304] The court disagreed, pointing out that this was the first public offering by NantKwest, so there were no publicly traded shares under a prior registration statement, and those shares that were privately traded were subject to a lock-up, meaning they could not be sold.[305]

Note that a different issue arises where the plaintiff purchases shares traceable to the registration statement but then actively trades the shares after the lock-up period expires.[306] In such a case, the question becomes whether the plaintiff retained the shares.[307] This, in turn,

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297. *See, e.g.*, *In re* Prestige Brands Holdings, Inc., No. 05 Civ. 6924, 2007 U.S. Dist. LEXIS 66199, at *16 (S.D.N.Y. Sept. 5, 2007) (refusing to dismiss plaintiff's Section 11 claim for lack of standing where IPO shares were purchased during lock-up period); Perry v. Duoyuan Printing, Inc., 10 Civ. 7235, 2013 U.S. Dist. LEXIS 121034, *29-30 (S.D.N.Y. Aug. 22, 2013) (same).

298. Sudunagunta v. NantKwest, Inc., No. CV-16-1947, 2018 U.S. Dist. LEXIS 137084, *4 (C.D. Cal. Aug. 13, 2018).

299. *Id.* at *5.

300. *Id.* at *5-6.

301. NantKwest, Inc., Prospectus at 69, 72 (424(b)(4)) (July 27, 2015).

302. *Id.* at 1.

303. *Sudunagunta*, 2018 U.S. Dist. LEXIS 137084, at *6-7.

304. Sudunagunta v. NantKwest, Inc., No. CV-16-1947, 2018 U.S. Dist. LEXIS 137084, *13-14 (C.D. Cal. Aug. 13, 2018).

305. *Id.* at *14-16. The question in *Sudagunta* was somewhat complected by the fact that there were some privately held shares that were not subject to the lock-up, and thus, theoretically, could account for some of the shares purchased by the plaintiffs. *Id.* at *7. The court rejected this attempt to muddy the waters, stating that "it is *highly* unlikely that the shares Lead Plaintiffs purchased were Non-IPO Shares. . . . Over 99.5% of the lock-up period trading volume related to IPO-registered shares rather than the Non-IPO Shares." *Id.* at *14-15.

306. *In re* LendingClub Sec. Litig., 282 F. Supp. 3d 1171, 1180 (N.D. Cal. 2017).

307. *Id.*

depends on accounting method. If the transactions are afforded "last-in, first-out" (LIFO) treatment, that bolsters traceability, while the "first-in, first-out" (FIFO) method undercuts traceability.[308]

3. Applied to a Shareholder Direct Listing—Pirani v. Slack

We now reach the question of how Section 11 tracing applies in the context of a Shareholder Direct Listing, as was the case in *Pirani v. Slack*.[309] On June 20 2019, Slack went public through a Shareholder Direct Listing.[310] It was the second Shareholder Direct Listing under NYSE's still new rules (the first was Spotify).[311]

Slack sells a business communication platform that facilitates team collaboration.[312] Unfortunately, in the months that followed its Shareholder Direct Listing, the newly public company was plagued by various service disruptions causing it to incur significant expenses.[313] That is because its service contracts provided that in the event of service disruptions, it would post a credit to the customer's account, even if the customer did not suffer from the disruption.[314]

During the period of these disruptions (which lasted from June to September), Slack's shares lost thirty-five percent of their value.[315] Pirani, who had purchased Slack shares during the Shareholder Direct Listing,[316] commenced a lawsuit under Section 11 of the Securities Act.[317] He claimed that Slack's registration statement did not disclose the "generous terms of Slack's service agreements."[318]

Slack moved to dismiss the plaintiff's Section 11 lawsuit for failure to state a claim. They argued that the plaintiff did not have standing because he could not trace the shares to the Shareholder Direct Listing's registration statement.[319] That is to say, Slack moved to dismiss based on the "such security" language in Section 11.[320]

Slack's argument was a potent one. During the Shareholder Direct Listing, some shareholders were selling registered shares because those shares were covered by the registration statement (in this

308. *Id.*

309. Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 379 (N.D. Cal. 2020), *aff'd*, 13 F.4th 940 (9th Cir. 2021).

310. *Pirani*, 13 F.4th at 944.

311. *See supra* Table 2; Horton, *supra* note 16, at 196.

312. *Pirani*, 445 F. Supp. 3d at 372.

313. *Pirani*, 13 F.4th at 944.

314. *Id.*

315. *See* Pirani v. Slack Techs., Inc., 13 F.4th 940, 944 (9th Cir. 2021).

316. Pirani had purchased 30,000 shares on the first day that Slack went public and an additional 220,000 shares in the months that followed. *Id.*

317. *Id.*

318. *Id.*

319. *Id.* at 944-45.

320. *Id.* at 945.

Section, I will refer to these as "Registered Shares").[321] Other shareholders were selling unregistered shares because those shares could be sold pursuant to Rule 144 (in this Section, I will refer to these as "144 Shares").[322] Only those that purchased Registered Shares could properly bring a Section 11 action. Unfortunately, there is no way for a purchaser to prove they purchased Registered Shares, as opposed to 144 Shares, because both were being offered at the same time. However, the Ninth Circuit held that the plaintiff had met the tracing requirement and could move forward with their Section 11 cause of action.[323] In so holding, the Ninth Circuit made three errors.

First, the Ninth Circuit held—incorrectly in my view—that Section 11's reference to "such security" only required that plaintiffs be able to trace their shares back to the offering, not the registration statement itself.[324] To reach this conclusion, the Ninth Circuit found that the term "such" was intended to tie the security to an offering and

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321. Slack Technologies, Inc., Registration Statement at 50 (Form S-1) (Apr. 26, 2019). Further, Slack's memorandum in support of its motion to dismiss states the following:

> Plaintiff will never be able to establish statutory standing because both registered and unregistered Slack shares were available for sale when Slack went public. Indeed, there were *far more* unregistered shares available than registered ones. While there were "118,429,640 registered shares," there also were "164,932,646 unregistered shares available for sale *"immediately* after [Slack's] registration" that were *not required to be registered* under SEC Rule 144 . . . ("SEC Rule 144 [] provides a safe harbor under certain conditions, exempting sellers from the registration requirements imposed by the 1933 Act."). These 164,932,646 registration-exempt shares could be sold regardless of whether Slack filed the Registration Statement; Slack's direct listing merely provided holders of these shares a way to access the public markets. Thus, as of the date Slack went public, *only 41.8%* of Slack's publicly available shares were issued under the Registration Statement.

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 at 15, Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367 (N.D. Cal. 2020) (No. 3:19-cv-05857), 2019 U.S. Dist. Ct. Motions LEXIS 47888, at *13-14 (citations omitted).

322. Here, a brief aside is in order. Where a non-affiliated investor purchases shares of a company in a private transaction, Rule 144 allows the investor to sell those shares to the public after the investor has held them for one year. 17 C.F.R. § 230.144(d)(1)(ii) (2022). The rationale for the rule is that by holding the shares for one year, the investor establishes investment intent, as opposed to intent to distribute. Sara Hanks, *Direct Regulation S Offerings and the SEC's "Problematic Practices" Release*, 2 STAN. J.L. BUS. & FIN. 303, 323 (1996) ("[T]he Rule 144 holding period serves as proxy for the purchaser's investment intent."). Slack's registration statement made clear that while 281 million shares would be available for sale, it covered only 118 million of those shares (and indeed, Slack paid a registration fee based on 118 million shares only). Slack Technologies, Inc., Amendment No. 3 to Form S-1 Registration Statement at 1, 51 (Form S-1/A) (May 31, 2019). The remaining 163 million shares were unregistered and being sold pursuant to Rule 144. *Id.* at 51 ("Approximately 281,935,953 of these shares may be . . . immediately sold either by the Registered Stockholders pursuant to this prospectus or by our other existing stockholders under Rule 144 since such shares held by such other stockholders will have been beneficially owned by non-affiliates for at least one year.").

323. Pirani v. Slack Techs., Inc., 13 F.4th 940, 946-47 (9th Cir. 2021).

324. *Id.* at 946 (citing *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1106 (9th Cir. 2013).

then went on to explain that "offering" in the present context referred to any sale of shares sold on or after June 20, 2019 (the date of Slack's Shareholder Direct Listing).[325] That is a strained reading of the statute. Section 11(a) does not even contain the term "offering."[326] The Second Circuit's decision in *Barnes v. Osofsky*[327] (while not binding on the Ninth Circuit[328]) is strongly persuasive here. In *Barnes*, the Second Circuit noted that, with regard to the phrase "any person acquiring such security," the term "such" has no referent.[329] However, the Second Circuit went on to adopt the natural reading of "such security" in Section 11(a), "[any person] acquiring a security issued pursuant to the *registration statement*," and rejected the broader reading, "a security of the same nature as that issued pursuant to the registration statement."[330] This was a position later adopted by the Ninth Circuit in *In re Century Aluminum*.[331]

Second, the Ninth Circuit held that "Slack's unregistered shares [i.e., 144 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."[332] That is not correct. Even without the direct listing, the 144 Shares could have been sold pursuant to Rule 144. The direct listing simply made the sale easier because the company was then listed on NYSE, increasing liquidity.[333] Only with regard to the registered shares is it fair to say that "their public sale cannot occur without the only operative registration in existence."

Third, the Ninth Circuit equates Shareholder Direct Listings and IPOs—a significant analogy given that tracing issues seldom arise in IPOs—because both represent the first time that a company's shares will be publicly traded.[334] The two are not equal. In an IPO, the privately held shares are subject to a lock-up (isolating 144 Shares from

325. *Id.* at 946-47.

326. *See* Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a).

327. Barnes v. Osofsky, 373 F.2d 269, 271-72 (2d Cir. 1967).

328. While the Ninth Circuit is not bound by precedent from the Second Circuit, it has cited as precedent *Barnes v. Osofsky* in the past, including in its seminal tracing case, *In re Century Aluminum*, 729 F.3d at 1109, and even in *Pirani v. Slack* itself, *Pirani*, 13 F.4th at 946-47.

329. *Barnes*, 373 F.2d at 271.

330. *Id.* at 271-72 (emphasis added).

331. *In re Century Aluminum*, 729 F.3d at 1106-08.

332. Pirani v. Slack Techs., Inc., 13 F.4th 940, 947 (9th Cir. 2021).

333. *See supra* Section I.B.1.b.

334. *Pirani*, 13 F.4th. at 947, 949.

those that are registered), while in a Shareholder Direct Listing, the privately held shares are *not* subject to a lock-up (commingling 144 Shares with registered shares).[335]

Even the plaintiff acknowledged that a traditional application of the tracing requirement required dismissal of their action.[336] As such, they requested that the Ninth Circuit abandon precedent and instead examine whether the decision "would contravene Congress' purpose in enacting the Securities Act."[337] This is despite the long-held doctrine that "[t]he plain words and meaning of a statute cannot be overcome by a legislative history."[338]

The Ninth Circuit acceded to the plaintiff's request.[339] It began by recognizing—as the plaintiff had—that in the context of a Shareholder Direct Listing, a traditional application of the tracing requirement would always result in dismissal of a Section 11 action because "registered and unregistered shares are released to the public at once."[340] However, it refused to dismiss the case because doing so would "create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception."[341] That is to say, the Ninth Circuit was concerned that most companies would choose to go public by Direct Listing (either Shareholder or Primary[342]) to avoid the specter of Section 11 liability for material misstatements, and that in turn would allow them to freely exaggerate their prospects (even if short of outright fraud[343])—rendering Section 11 nothing but a historical relic.[344]

That may be so, but it is not the Ninth Circuit's job to rewrite a statute to save it from textual infirmity. In *Barnes v. Osofsky*, the Second Circuit rejected such a temptation, stating that while its interpretation of the tracing requirement meant that it was a narrow class of

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335. *See* 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, *supra* note 321, at 7-15.

336. Plaintiff-Appellee's Answering Brief at 2, Pirani v. Slack Techs., Inc., 13 F.4th 940 (9th Cir. 2021) (No. 20-16419) (stating that both the registered and Rule 144 shares would "hit the public market at the same time," rendering it "impossible for any purchasers to trace their shares back to the Registration Statement").

337. *Id.*

338. Gemsco, Inc. v. Walling, 324 U.S. 244, 260 (1945).

339. Pirani v. Slack Techs., Inc., 13 F.4th 940, 948 (9th Cir. 2021).

340. *Id.*

341. *Id.*

342. In fact, the Ninth Circuit seemed to be thinking forward, to cases involving Primary Direct Listings, noting that its comments regarding the dangers to investors are "particularly true now that the NYSE rule has been amended to allow a company to sell its own shares and raise capital through a Primary Direct Floor Listing." *Id.* at 948 n.6.

343. Crossing the line from mere exaggeration to intent to defraud would subject defendants to liability under the Exchange Act's antifraud division. *See* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b).

344. *Pirani*, 13 F.4th at 948.

persons that had standing to bring a Section 11 action, that simply meant that "the time may have come for Congress to reexamine [Section 11] in the light of thirty years' experience."[345] (*Barnes* was relied on by *In re Century Aluminum* to hold that "such security" required purchasers to trace their shares back to the allegedly offending registration statement.[346]) Judge Miller, dissenting in *Pirani v. Slack*, wrote, "What appears to be driving today's decision is not the text or history of [S]ection 11 but instead the court's concern that it would be bad policy for a [S]ection 11 action to be unavailable when a company goes public through a direct listing."[347]

Slack filed a petition for rehearing en banc.[348] Its petition was denied on May 2, 2022.[349] Slack immediately announced it would petition the Supreme Court for a Writ of Certiorari.[350] I think there is a fair chance that the Supreme Court will grant the petition. The Ninth Circuit's decision in *Pirani v. Slack* arguably creates a circuit split.[351] In short, until this matter is resolved—possibly by the Supreme Court—the ability of the purchaser of shares in a Direct Listing to bring a Section 11 action is very much in doubt.

4. Applied to a Primary Direct Listing

The CII raised the specter of the tracing issue in its opposition to Primary Direct Listings.[352] It pointed out that the issue had already arisen in the context of Shareholder Direct Listing in *Pirani v. Slack*,

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345. Barnes v. Osofsky, 373 F.2d 269, 273 (2d Cir. 1967).

346. *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1107 (9th Cir. 2013) (citing *Barnes*, 373 F.2d at 271-72).

347. *See* Pirani v. Slack Techs., Inc., 13 F.4th 940, 953 (9th Cir. 2021) (Miller, J., dissenting).

348. Order Denying Plaintiff's Motion to Lift Stay at 2, Pirani v. Slack Techs., Inc., No. 19-cv-05857 (N.D. Cal. Dec. 9, 2021), 2021 U.S. Dist. LEXIS 236139, at *2 ("Slack has petitioned for rehearing and rehearing en banc, and on November 29, the Ninth Circuit ordered Pirani to respond to Slack's petition."); *see also* John Browne & Lauren Ormsbee, *Why Slack Decision Struck a Nerve with Corporate America*, LAW360 (Nov. 4, 2021, 6:02 PM), https://www.law360.com/articles/1437619/why-slack-decision-struck-a-nerve-with-corporate-america [https://perma.cc/VE4T-Q96G] ("The defendants' petition for rehearing and rehearing en banc argues strenuously that the Slack panel's decision 'breaks with five-plus decades of previously uniform precedent on the meaning of Section 11' and improperly elevates policy concerns over the plain language of the Securities Act." (quoting Petition for Rehearing and Rehearing En Banc at 15, No. 20-16419 (9th Cir. Nov. 3, 2021))).

349. Pirani v. Slack Techs., Inc., 13 F.4th 940 (9th Cir. 2021), *reh'g denied en banc*, 2022 U.S. App. LEXIS 11846 (9th Cir. May 2, 2022).

350. Alison Frankel, *Slack Will Ask Supreme Court to Review Novel Direct Listing Case*, REUTERS (May 4, 2022, 5:36 PM), https://www.reuters.com/legal/government/slack-will-ask-supreme-court-review-noveldirect-listing-case-2022-05-04/ [https://perma.cc/VB29-QDCS].

351. *Compare Pirani*, 13 F.4th at 946-49 (dispensing with tracing requirement), *with* Barnes v. Osofsky, 373 F.2d 269, 269 (2d Cir. 1967) (following tracing requirement). *Barnes* could arguably be distinguished—and thus no circuit split presented—because while the Second Circuit was dealing with the issue of tracing with regard to an offering of stock, it was not a direct listing. Frankel, *supra* note 350.

352. Petition for Review, *supra* note 174, at 10.

and that approving Primary Direct Listings would exacerbate the problem by "vastly increas[ing] [the] number of direct listings."[353] Remember, Primary Direct Listings would not be limited to unicorns.

The SEC's response to the CII's concern was far from reassuring.[354] The SEC made a two-wrongs-make-a-right argument, pointing out that there are other situations where plaintiffs find the tracing requirement difficult or impossible to meet: where the investor purchases in an IPO after the lock-up ends, or where the investor purchases in a second, third, or fourth offering of the same class of securities (i.e., where that class of securities is already trading prior to the offering).[355]

Next, the SEC points to the Northern District of California's decision in *Pirani v. Slack* (which, as discussed above, was later affirmed by the Ninth Circuit), holding that the tracing requirement can be met in a Direct Listing.[356] It states that, "based on the approaches taken by courts [such as in *Pirani v. Slack*]," it does not "expect any such tracing challenges in [the direct listing] context to be of such magnitude as to render the proposal inconsistent with the Act."[357] This statement ignores the weakness of the Northern District of California's decision (later affirmed by the Ninth Circuit): that it is at odds with other circuits, including the Second Circuit's decision in *Barnes v. Osofsky*,[358] and there is a fair chance the Supreme Court could overturn the decision.[359]

B. Uncertain Underwriter Liability

There is a second issue with the application of Section 11. Assume for purposes of argument that the Ninth Circuit's approach to tracing will be upheld (which, as stated above, is an open question),[360] and that investors in a Direct Listing can bring an action under Section 11 of the Securities Act.[361] The potency of the action will be greatly diminished if there is no underwriter defendant to contribute to any judgment (or settlement).[362]

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353. *Id.*

354. 2020 Final Approval, 85 Fed. Reg. 85815, 85815-16 (Dec. 29, 2020).

355. *Id.*

356. *Id.* at 85816. The Northern District of California had held that "in this unique circumstance—a direct listing in which shares registered under the Securities Act become available on the first day simultaneously with shares exempted from registration—the phrase 'such security' in Section 11 warrants the broader reading[.]" Pirani v. Slack Techs., Inc., 445 F. Supp. 3d 367, 381 (N.D. Cal. 2020).

357. 2020 Final Approval, 85 Fed. Reg. at 85816.

358. Barnes v. Osofsky, 373 F.2d 269, 273 (2d Cir. 1967).

359. Frankel, *supra* note 350.

360. *See supra* Section III.A.3.

361. Securities Act of 1933 § 11, 15 U.S.C. § 77k.

362. *See* 15 U.S.C. § 77k(a)(5) (listing underwriter as a primary defendant); *see also* James J. Park, *Auditor Settlements of Securities Class Actions*, 14 J. EMPIRICAL LEGAL STUD.

Direct Listings are referred to as underwriter-less because the investment bank acts as a financial advisor, not a traditional underwriter.[363] However, regardless of label, a party still may be found to be a statutory underwriter if they fit within the statutory definition. The Securities Act defines an underwriter as follows:

> [A]ny person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking . . . .[364]

Thus, the question becomes, will courts find an investment bank acting as a financial advisor fits the statutory definition of underwriter?

The first part of the definition of underwriter is "any person who has purchased from an issuer with a view to . . . the distribution of any security."[365] In a Direct Listing, the financial advisor does not purchase shares for resale (as would be the case for a firm-commitment underwriting in an IPO), so that part of the definition cannot be met.

The second part of the definition of underwriter is one who "offers or sells for an issuer in connection with[] the distribution of any security."[366] Here, the guiding case is *SEC v. Chinese Consolidated Benevolent Ass'n*.[367] In that case, the court pointed out that "offers or sells" included "solicit[ation] . . . for the issuer."[368] In a Primary Direct Listing, the issuer is selling shares (compare to a Shareholder Direct Listing) and thus this part of the definition could theoretically apply. However, even in a Primary Direct Listing, it is unlikely that a financial advisor would be found a statutory underwriter. The financial advisor will studiously avoid any activity that could be considered soliciting. In fact, if past practice is a guide, the agreement between the

169, 186 n.43 (2017) ("[I]n Section 11 cases, underwriters are often named as defendants and will also contribute significant amounts to the settlement. For example, most of the settlement amount in *Enron* and *WorldCom* came from the underwriters, who contributed an unusually high amount to those settlements."); Laarni T. Bulan, *Securities Class Action Settlements: 2016 Review and Analysis*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 18, 2017), https://corpgov.law.harvard.edu/2017/04/18/securities-class-action-settlements-2016-review-and-analysis/ [https://perma.cc/7AHZ-B2QP] ("Underwriter defendants were named in 79[%] of cases with Section 11 claims in 2016.").

363. Coffee, *supra* note 9.

364. 15 U.S.C. § 77b(a)(11).

365. *Id.*

366. *Id.*

367. Sec. & Exch. Comm'n v. Chinese Consol. Benevolent Ass'n, 120 F.2d 738 (2d Cir. 1941).

368. *Id.* at 740.

issuer and the financial advisor will expressly state that the latter will not engage in any activity that could be considered soliciting, such as participating in investor meetings, or otherwise marketing the securities.[369]

The third part of the definition of underwriter is any person who "participates . . . in any such undertaking."[370] However, as with the previous two parts, this part will likely not confer underwriter status upon the financial advisor because there is no "such undertaking" for the financial advisor to participate in. "Such undertaking" must refer to a previously stated activity, and we have already established that in a Direct Listing, no person "purchase[s] from an issuer with a view to [distribute]" or "offers or sells for an issuer in connection with[] the distribution."[371]

Further, cases generally hold that the mere "taking [of] steps that facilitate the eventual sale of a registered security" does not amount to participating in any such undertaking for purposes of Section 2(a)(11).[372] For example, in *In re Lehman Brothers*, the plaintiffs argued that three financial rating agencies (S&P, Moody's, and Fitch) were statutory underwriters because they exceeded their traditional role as "passive evaluators of credit risk," and instead "actively aid[ed] in the structuring and securitization process."[373] Specifically, the financial rating agencies worked with the issuer to determine the best makeup of the security in question (i.e., choosing which mortgages to include).[374] The plaintiffs argued that the financial rating agencies were underwriters because their actions equated to "participat[ing] in any such undertaking."[375]

The Second Circuit disagreed, holding that the statutory phrase "participates" is limited to participating in the distribution itself, not merely "participat[ing] . . . in non-distributional activities that may facilitate securities' offering by others."[376] The court emphasized that selecting mortgages to include did not involve traditional underwriting

369. *See* Spotify Prospectus, *supra* note 234, at 186; Tao Letter, *supra* note 234.

370. Securities Act of 1933 § 2(a)(11), 15 U.S.C. § 77b(a)(11).

371. *See* Jennifer O'Hare, *Institutional Investors, Registration Rights, and the Specter of Liability Under Section 11 of the Securities Act of 1933*, 1996 WIS. L. REV. 217, 219 n.11, 239 (1996); *see also id.* at 239 ("As a matter of statutory construction, the use of the word 'such' implies a reference to something previously stated."); *In re* Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167, 176-77 (2d Cir. 2011) (" '[S]uch undertaking[]' . . . plainly references the aforesaid purchases, offers, or sales relating to the distribution of securities. . . . Thus, to qualify as an underwriter under the participation prongs of the statutory definition, a person must participate, directly or indirectly, in purchasing securities from an issuer with a view to distribution, in offering or selling securities for an issuer in connection with a distribution, or in the underwriting of such an offering.").

372. *In re Lehman Bros.*, 650 F.3d at 177.

373. *Id.* at 172.

374. *Id.*

375. *Id.* at 176-77.

376. *Id.* at 177-78.

activities (such as book building or actively marketing).[377] Interestingly, the Second Circuit found that even if the rating agencies helped with preparing the registration statement, that would not rise to the level of participating in a distribution.[378] The court held that "drafting offering documents did not constitute participation in purchasing securities for resale."[379] That is important because, in a Direct Listing, one of the few activities the financial advisor engages in is helping to prepare the registration statement.[380]

Finally, there is *Harden v. Raffensperger*.[381] In *Harden*, the Seventh Circuit parted ways with the above precedent in its interpretation of "participate" in any such activity.[382] It found that a firm that recommend the yield at which debt securities would be issued was a statutory underwriter subject to Section 11 liability because it was necessary to the distribution of the securities.[383] However, that is a very unique decision. The main driver of the Seventh Circuit decision (what the court called "additional and substantial reasons") appears to be that the firm called itself a "qualified independent underwriter" and consented to National Association of Securities Dealers (NASD) rules whereby it "agree[d] to undertake the full legal responsibilities and liabilities of an underwriter under the Securities Act of 1933."[384]

While it certainly is an open question,[385] the precedent does not appear to indicate that a financial advisor can be held a statutory underwriter. Like the ratings agencies in *In re Lehman Brothers* (finding no liability), at most, financial advisors "participate only in non-distributional activities that may facilitate securities' offering by others."[386] And, unlike in *Harden* (finding liability), the financial advisor does not call itself an underwriter, nor does it consent to liability as an underwriter.[387]

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377. *In re* Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167, 179 (2d Cir. 2011); *accord* N.J. Carpenters Vacation Fund v. Royal Bank of Scot. Grp., PLC, 720 F. Supp. 2d 254, 262-64 (S.D.N.Y. 2010) ("Plaintiffs have sufficiently alleged that Moody's and S & P played a significant, if not major, role in initial securitization decisions, but this alone is insufficient to create underwriter liability.").

378. *In re Lehman Bros.*, 650 F.3d at 184-85.

379. *Id.* at 184 n.12.

380. Rodgers et al., *supra* note 72.

381. Harden v. Raffensperger, Hughes & Co., Inc., 65 F.3d 1392 (7th Cir. 1995).

382. *Id.* at 1395-96.

383. *Id.* at 1396-99.

384. *Id.* at 1401-02 (emphasis omitted).

385. *See* Coffee, *supra* note 9 ("Arguably, this could reach a financial advisor that participates in pricing.").

386. *In re* Lehman Bros. Mortg.-Backed Sec. Litig., 650 F.3d 167, 177 (2d Cir. 2011). It should be noted that *In re Lehman Bros.* does state that "all of the certificate transactions here at issue involved traditional underwriters other than the Rating Agencies." *Id.* at 179. Query whether that means that if there is not another party that is not a "traditional underwriter," the Second Circuit would be more willing to find that the "participate in" language applies to the rating agency.

387. Tao Letter, *supra* note 234.

To conclude my discussion of whether Financial Advisors can be found to be underwriters for purposes of Section 11, I will note that the plaintiffs in *Pirani v. Slack* did not include the financial advisors—Goldman Sachs, Morgan Stanley, Allen & Co.—as defendants.[388] That is telling.

IV. SOME REFLECTIONS ON THE SEC APPROVAL OF DIRECT LISTINGS AND CONCLUSION

As explained in Section I.D, the NYSE is a self-regulatory organization (SRO).[389] That means its rules (and any changes to its rules) must be approved by the SEC[390]—more specifically, the Division of Trading and Markets. When the SEC Division of Trading and Markets approved Direct Listings, it seemed particularly convinced by the potential advantages, such as facilitating trading, perfecting the mechanism of a free and open market, and removing discrimination between investors.[391]

Consider, by way of example, "perfect[ing] the mechanism of a free and open market."[392] The SEC found that this advantage weighed in favor of approving Direct Listings because they have the potential to be more accurately priced, and thus avoid the "pop" that is associated with so many IPOs.[393] The SEC wrote that "the price of securities issued by the company in a [Direct Listing] will be determined based on market interest and the matching of buy and sell orders, . . . provid[ing] an alternative way to price securities offerings that may better reflect prices in the aftermarket."[394]

Consider also removing "discrimination between customers."[395] The SEC believes Direct Listings will do exactly that.[396] The SEC wrote:

> [Retail investors] may be able to purchase securities in a [Direct Listing] who might not otherwise receive an initial allocation in a firm commitment underwritten offering. The proposed rule change therefore has

388. Nicolas Grabar et al., *Cleary Gottlieb Discusses How Court Allowed Securities Liability for Slack's Direct Listing*, CLS BLUE SKY BLOG (May 4, 2020), https://clsbluesky.law.columbia.edu/2020/05/04/cleary-gottlieb-discusses-how-court-allowed-securities-liability-for-slacks-direct-listing/ [https://perma.cc/RR3E-5HXM].

389. Securities Exchange Act of 1934 § 3(a)(26), 15 U.S.C. § 78c(a)(26).

390. 15 U.S.C. § 78s(b)(2)(C)(i) ("The Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of this title and the rules and regulations issued under this title that are applicable to such organization.").

391. 2020 Final Approval, 85 Fed. Reg. 85815, 85816-17 (Dec. 29, 2020).

392. 15 U.S.C. § 78f(b)(5).

393. 2020 Final Approval, 85 Fed. Reg. at 85816.

394. *Id.*

395. Securities Exchange Act of 1934 § 6(b)(5), 15 U.S.C. § 78f(b)(5).

396. Osipovich, *supra* note 93, at B1.

> the potential to broaden the scope of investors that are able to purchase securities in an initial public offering, at the initial public offering price, rather than in aftermarket trading.[397]

However, when the SEC approves proposed rule changes—as it did here—it must always put investor protection first.[398] Unfortunately, for Direct Listings, it did not. Put bluntly, the SEC's 2020 Final Approval of Direct Listings repeated potential advantages trumpeted by proponents of Direct Listings while dismissing—often without sound reasoning—the threats that Direct Listings pose to investors.[399] By way of example, the SEC dismissed the concern that there is no traditional underwriter to scrutinize the offering, with the assertion that the investment advisor can provide scrutiny.[400] This ignores the fact that the investment advisor faces less reputational pressure to conduct searching due diligence.[401] Likewise, in the event that the investment advisor does not conduct searching due diligence, it likely does not face the same risk of litigation as a traditional underwriter.[402] The SEC alternatively asserts that the issuer's management, and perhaps the accountants, will provide adequate scrutiny. That assertion is questionable at best, as the issuer's management may be under such tremendous pressure to raise capital that it is willing to exaggerate its prospects, and the accountant is only responsible for the registration statement's financials.[403]

Is the SEC willing to provide the scrutiny normally provided by underwriters? While the SEC normally does not do so, it is not prohibited from conducting an "extensive investigation" into a company.[404] It will sometimes do so when deciding whether to exercise its power to issue a stop order under Section 8(d) of the Securities Act.[405]

However, that would be a major role-change for the SEC. The SEC conducting an extensive investigation of every Direct Listing

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397. 2020 Final Approval, 85 Fed. Reg. 85815, 85816 (Dec. 29, 2020); *see also* Osipovich, *supra* note 93, at B1 ("[Direct listings will] giv[e] a broader array of investors the opportunity to get in on a stock's debut at the initial price.").

398. Regarding the SEC's mission and the primacy of investor protection, see *supra* notes 168-69 and accompanying text.

399. *See* Higgins v. Sec. & Exch. Comm'n, 866 F.2d 47, 49 (2d Cir. 1989) (citing 15 U.S.C. §78f(b)(5) when noting how, in approving NYSE rule changes, statute and regulation require the SEC to balance facilitation of trading with investor protection).

400. 2020 Final Approval, 85 Fed. Reg. at 85815, 85815.

401. *See supra* Section II.D.

402. *See supra* Section III.B.

403. Leahy, *supra* note 202, at 476.

404. *In re* Red Bank Oil Co., Securities Act Release No. 3095, 1945 SEC LEXIS 204, at *5 (Oct. 11, 1945). A stop order can be issued by the SEC "[i]f it appears to the Commission at any time that the registration statement includes any untrue statement of a material fact." Securities Act of 1933 § 8(d), 15 U.S.C. § 77h(d). A stop order under Section 8(d) should be distinguished from a refusal order, which may only be issued when "a registration statement is on its face incomplete or inaccurate in any material respect." 15 U.S.C. § 77h(b).

405. 15 U.S.C. § 77h(d).

(especially if Direct Listings overtake IPOs) would strain the limited resources available to the SEC and strain its statutory mandate. Indeed, the Securities Act itself states the following:

> Neither the fact that the registration statement for a security has been filed or is in effect nor the fact that a stop order is not in effect with respect thereto shall be deemed a finding by the Commission that the registration statement is true and accurate on its face or that it does not contain an untrue statement of fact or omit to state a material fact, or be held to mean that the Commission has in any way passed upon the merits of, or given approval to, such security.[406]

Slack's Direct Listing is a timely reminder of what can happen when there is no traditional underwriter to act as a gatekeeper. Consider this counterfactual question: Would Slack's Direct Listing have gone forward if Goldman Sachs, Morgan Stanley, and Allen & Co. were acting as underwriters, rather than financial advisors?[407] We can't know for certain, but it is plausible that, facing reputational risk and potential Section 11 liability, they would have forced withdrawal of the offering. At the very least, they would have insisted that Slack's registration statement disclose the risk posed by Slack's overly generous service agreements.[408]

Exacerbating the problem of inadequate scrutiny for Direct Listings is the fact that if insiders do use it (a Direct Listing) to foist a troubled company on the public at an inflated valuation, investors will be left without a remedy.[409] By approving Direct Listings, the SEC allowed for the gutting of one of the Securities Act's primary enforcement mechanisms, Section 11.[410] Companies can use Direct Listings to game Section 11's tracing requirement.[411] Indeed, they are encouraged to do so. As Latham & Watkins, the law firm that represented Spotify and Slack stated, Direct Listings can be used as a means to "deter private plaintiffs from bringing claims under Section 11" because "few (if any)

406. *Id.* § 77w.

407. See the discussion of Slack's troubled Shareholder Direct Listing and the resulting lawsuit, *supra* Section III.A.3.

408. Compare the case of WeWork, discussed *supra* Section II.C.

409. However, one group of authors argues that even if Section 11 is not available, the investor can still bring a securities fraud action under Rule 10b-5. Anat Alon-Beck et al., *Investment Bankers as Underwriters: Barbarians or Gatekeepers? A Response to Brent Horton on Direct Listings*, 73 SMU L. REV. F. 251, 258 (2000). Alon-Beck, Rapp, and Livingstone write, "Those investors who do not have standing under Section 11 are free to seek recovery under . . . Securities Exchange Act Section 10(b) and SEC Rule 10b-5." *Id.* While technically true, the statement overlooks the fact that Section 11 imposes strict liability for material misstatements or omissions, while Rule 10b-5 is an antifraud provision, requiring proof of intent to defraud on the part of the defendant and reasonable reliance on the part of the plaintiff. Herman & Maclean v. Huddleston, 459 U.S. 375, 382 (1983). Rule 10b-5 is not a substitute for Section 11. The two causes of action are not equivalent.

410. *See supra* Part III.

411. *See supra* Section III.A.

purchasers will be able to trace their stock to the challenged registration statement [since] both registered and unregistered stock are immediately sold into the market in a direct listing."[412] Without a remedy under Section 11, it makes little difference to investors that Section 5 requires the filing of a registration statement with accurate information.[413] Section 5 simply becomes "mere advice."[414]

The SEC dismissed the tracing concern with two assertions.[415] The first is that tracing is not set forth in Section 11 and is a judicially developed doctrine.[416] It follows that the judiciary can undo it.[417] It points to *Pirani v. Slack* to support this position.[418] This position ignores the weak reasoning contained in *Pirani v. Slack*, discussed above, and the strength of the prior tracing precedent.[419]

The SEC then states that even if tracing does prevent Section 11 actions in the context of Direct Listings, that is acceptable because it is just another circumstance where the tracing requirement would prevent recovery (such as where there are SPOs or where private shares were first sold into the public markets pursuant to Rule 144).[420] This sort of two-wrongs-make-a-right reasoning is, at best, baffling coming from an institution tasked with protecting investors.[421] Indeed, that is its primary task.[422]

Two Commissioners of the SEC were forthright about the approval process for Primary Direct Listings: "Unfortunately, the Commission has not candidly assessed the potential benefits and drawbacks of retail investor participation in primary direct listing[s] . . . . We should have engaged in a deeper debate and analysis . . . ."[423] These Commissioners went on to call the decision "rush[ed]."[424]

The SEC is one of the few government agencies to enjoy a favorable assessment from the public, probably because, in the past, it has

412. Clubok et al., *supra* note 177, at 1-2.

413. WEBSTER, *supra* note 38, at 44.

414. *Id.*

415. 2020 Final Approval, 85 Fed. Reg. 85815, 85815-16 (Dec. 29, 2020).

416. *Id.* at 85816.

417. *Id.*

418. *Id.* at 85816 n.107.

419. *See supra* Section III.A.3.

420. 2020 Final Approval, 85 Fed. Reg. at 85816.

421. *See supra* notes 168-69 and accompanying text (discussing the SEC mission and the primacy of investor protection).

422. *Id.*

423. Lee & Crenshaw, *supra* note 150 (footnote omitted).

424. *Id.*

thoughtfully exercised its charge to protect investors.[425] However, in the case of Direct Listings, the SEC's superficial and rushed approval risks that favorable assessment.[426]

POSTSCRIPT

The law governing Direct Listings is quickly developing. This Article entered the editing process before two significant events in December 2022. First, the New York Stock Exchange further amended its rules to require the companies engaging in Primary Direct Listings (but not Shareholder Direct Listings) to retain and identify an underwriter; and second, the Supreme Court agreed to hear *Pirani v. Slack*, the tracing case discussed in Part III. This Postscript will discuss each development in turn.

On November 8, 2002, the NYSE once again amended its rule regarding Primary Direct Listings to require an underwriter.[427] The NYSE reasoned that underwriters play an important role as gatekeepers.[428] It recognized that underwriters are motivated to act as gatekeepers by reputational risk and potential Section 11 liability if they fail to ensure the accuracy of disclosure in the registration statement.[429]

On December 15, 2015, the SEC approved the rule change.[430] The NYSE Listed Company Manual now states that a "Company offering securities for sale in connection with a Primary Direct Floor Listing must (1) register securities by specifying the quantity of shares registered, . . . and (2) retain an underwriter with respect to the primary sales of shares by the Company and identify the underwriter in its effective registration statement."[431]

425. Troy A. Paredes, *On The Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 1028-29 (2006) ("The SEC . . . [has] influence as the dominant regulator of U.S. securities markets and [a] long-standing reputation as a highly respected administrative agency."). There are, of course, some notable exceptions. The SEC was notoriously behind the ball requiring disclosure of issuers for mortgage-backed securities. *See generally* Brent J. Horton, *Toward a More Perfect Substitute: How Pressure on the Issuers of Private-Label Mortgage-Backed Securities Can Improve the Accuracy of Ratings*, 93 B.U. L. REV. 1905 (2013).

426. Lee and Crenshaw, *supra* note 150.

427. *See* Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 2, to Modify Certain Pricing Limitations for Securities Listed on the Exchange Pursuant to a Primary Direct Floor Listing, 87 Fed. Reg. 68558, 68561 (Nov. 15, 2022).

428. *Id.* at 68561.

429. *Id.*

430. *See* Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Modify Certain Pricing Limitations for Securities Listed on the Exchange Pursuant to a Primary Direct Floor Listing, 87 Fed. Reg. 78141 (Dec. 21, 2022).

431. Listed Company Manual, *supra* note 66, § 102.01B n.(E).

I applaud the rule change. It is a good first step in favor of investor protection.[432] However, the rule change only applies to Primary Direct Listings. It does not extend to Shareholder Direct Listings, leaving the lack-of-underwriter problem in place for the type of Direct Listing that, at least so far, has accounted for all direct listings.[433] That is unfortunate because the Shareholder Direct Listing presents many of the same dangers as Primary Direct Listings. In a Shareholder Direct Listing, absent an underwriter, there is a fair risk that early private investors will foist a company on the public at inflated valuations.[434] After all, those private investors will be looking for an opportunity to exit (and the most lucrative way to exit is selling to the public).[435]

The NYSE also took the position that the new amendment requiring an underwriter may solve the tracing issue because the underwriter may impose a lock-up agreement (like in a traditional IPO).[436] However, in reality, it is unlikely that an underwriter will choose to impose lock-up arrangements as part of a Direct Listing. As discussed in the main body of this Article, one of the primary draws of the Direct Listing is that it avoids lock-up periods,[437] and NYSE itself has expressly marketed Direct Listings as a way to go public without a lock-up.[438] In short, the December 15, 2022 amendments—while a good first step—leave in place most of the risks associated with a Direct Listing discussed in the main body of this Article.

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432. Although, it does have a downside. It will increase the cost of a Direct Listing because the underwriters will have to self-insure against liability. *See supra* Section I.B.2.b; *see also* Brian Hirshberg, *NYSE Receives Approval for Rule Change Providing More Flexibility for Direct Listings with Capital Raise*, JD SUPRA (Jan. 5, 2023), https://www.jdsupra.com/legalnews/nyse-receives-approval-for-rule-change-5991873/ [https://perma.cc/3G4L-F6TP] ("While the requirement to include an underwriter mitigated . . . the perceived lack of a 'gatekeeper' that often arise[s], the perception of increased securities liability for the identified underwriter will likely increase the costs associated with conducting a direct listing with a capital raise and potentially diminish the likelihood that this alternative to a traditional IPO will be pursued.").

433. Listed Company Manual, *supra* note 66, § 102.01B n.(E). Nasdaq made a similar rule change in December 2022. Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 3, to Modify Certain Pricing Limitations for Companies Listing in Connection with a Direct Listing with a Capital Raise, 87 Fed. Reg. 75305, 75308 (Dec. 8, 2022). Like NYSE, it limited the underwriter requirement to offerings where the company is raising capital. *Id.*

434. *See supra* Part II.

435. *See supra* Section I.B. (discussing a Shareholder Direct Listing as an exit opportunity). On the other hand, Rule 144 allows for sales on the over-the-counter markets, which are less efficient. *See* 17 C.F.R. § 230.144 (2020); *see also* Steinberg & Kempler, *supra* note 64, at 491 ("The manner of sale requirement set forth in rule 144(f) places a significant limitation on the prospective seller.").

436. Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 2, to Modify Certain Pricing Limitations for Securities Listed on the Exchange Pursuant to a Primary Direct Floor Listing, 87 Fed. Reg. 68558, 68561 (Nov. 15, 2022).

437. *See supra* Section I.B.2.a.

438. NYSE, *Choose Your Path*, *supra* note 116 ("In a Direct Listing, the full liquidity of the market values a company on day one without temporary constraints—no reduced allocations or required lockup periods.").

The second significant event occurring just prior to publication is that the Supreme Court granted Pirani's Petition for a Writ of Certiorari on December 13, 2022.[439] Oral argument is scheduled for April 17, 2023.[440] *Pirani v. Slack* is ripe for reversal for many of the reasons discussed above.[441] Recall that in *Pirani v. Slack*, the Ninth Circuit found that the tracing requirement was met for three (incorrect) reasons. First, the Ninth Circuit reasoned that the plaintiff only need trace their shares back to the offering, not the registration statement.[442] That ignores the plain language of the statute and precedent.[443] Second, the Ninth Circuit held that "[a]ny person who acquired Slack shares through its direct listing could do so only because of the effectiveness of its registration statement."[444] That is incorrect. Even absent the registration statement, many of the shareholders could have sold their shares pursuant to Rule 144.[445] Third, the Ninth Circuit found that Direct Listings are like IPOs (where tracing issues rarely arise), when factually—due to the lack of a lock-up period—they are more like an SPO (where tracing issues are common).[446]

As Judge Miller stated in his dissent in *Pirani*, the majority's decision was not driven by an application of the facts to the law, but instead by the Ninth Circuit's idea of what the law should be.[447] The majority was concerned that if it found the plaintiff did not meet the tracing requirement and dismissed the case, it would "create a loophole large enough to undermine the purpose of Section 11 as it has been understood since its inception."[448] As Justice Gorsuch recently wrote, judges should not allow themselves to be transformed "from expounders of what the law is into policymakers choosing what the law should be."[449]

439. Slack Techs., LLC v. Pirani, 143 S. Ct. 542 (2022).

440. *Slack Technologies v. Pirani*, SCOTUSBLOG, https://www.scotusblog.com/case-files/cases/slack-technologies-v-pirani/ [https://perma.cc/BB6P-SXNS] (last visited Apr. 11, 2023).

441. *See supra* Section III.A.3.

442. Pirani v. Slack Techs., Inc.,13 F.4th 940, 946 (9th Cir. 2021).

443. *See supra* Section III.A.3.

444. *Pirani*, 13 F.4th at 947.

445. *See supra* notes 321-22 and accompanying text.

446. *See supra* Section III.A.3.

447. *See Pirani*, 13 F.4th at 953 (Miller, J., dissenting).

448. Pirani v. Slack Techs., Inc.,13 F.4th 940, 948 (9th Cir. 2021).

449. Epic Sys. Corp. v. Lewis, 138 S. Ct. 1612, 1624 (2018) (emphasis omitted).