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To Be Discussed at the March 6, 2025 meeting of the SEC Investor Advisory Committee

Recommendation of the Investor as Owner and Investor as Purchaser Subcommittees of the SEC Investor Advisory Committee regarding Preserving Investors' Ability to Bring Claims Under Section 11 of the Securities Act of 1933

I. Executive Summary

The Supreme Court's decision in *Slack Techs., LLC v. Pirani,* 143 S. Ct. 1684 (2023) addressed plaintiffs' ability to bring claims under Section 11 of the Securities Act of 1933, emphasizing the importance of the tracing requirement for asserting such claims. The Court's decision underscored that investors must be able to conclusively trace their shares back to the pertinent registration statement to establish standing; for instance, if a plaintiff purchased one share from a pool of one billion shares—where all but one of those shares were registered—that plaintiff would lack standing under Section 11 because they could only demonstrate an extremely high probability (over 99.99%) of having purchased a registered share, rather than the requisite certainty of 100%.

The stringent tracing requirements have restricted investors' ability to file claims under Section 11. This challenge has become more acute as a growing number of public offerings forego lockup periods, allowing non-registered shares to be traded shortly after the offering. Once these non-registered shares enter the pool of registered shares, investors who buy in the secondary market cannot conclusively trace their shares back to the pertinent registration statement and thus lose the protections of Section 11, regardless of the merits of their claims.

A broad array of former U.S. Securities and Exchange Commission ("SEC" or "Commission") officials, industry stakeholders, and academics has highlighted the vital necessity of preserving Section 11 liability, urging the SEC to safeguard investors' ability to bring claims under this provision and/or noting administrative remedies that are available to the Commission. For instance, former SEC senior officials submitted two amicus briefs in the case of *Slack Techs. v. Pirani*. In the first brief, former Chairman Jay Clayton and former Commissioner Joseph Grundfest asserted that administrative action could effectively preserve Section 11 standing.[1] In the second such amicus brief, four former SEC Commissioners, including former Acting Chair Allison Lee, and several former senior SEC staff members noted that it is critical to ensure that the "crucial" protections of Section 11 remain available to investors.[2]

The comments in these amicus briefs have been echoed by investors and securities law experts. For example, in response to *Slack Techs. v. Pirani*, the Council of Institutional Investors

[1] Brief for Hon. Jay Clayton & Hon. Joseph Grundfest as Amici Curiae Supporting Petitioners at 31, *Slack Techs. v. Pirani*, 598 U.S. 759 (2023).

[2] Brief of Former SEC Officials as Amici Curiae Supporting Respondents at 10, *Slack Techs. v. Pirani*, 598 U.S. 759 (2023). The amici also included former Commissioners Luis Aguilar, Roberta Karmel, and Bevis Longstreth; and former senior officials John Coates (General Counsel and Acting Director for the Division of Corporate Finance), Jane Adams (Acting Chief Accountant), Tyler Gellasch (Counsel to Commissioner Kara Stein), and Matthew Cain (Advisor to Commissioner Robert Jackson).

petitioned the SEC to address Section 11's "acute" standing problem.[3] The Working Group on Investor Protection in Public Offerings ("Working Group"), comprised of several securities law experts and academics,[4] similarly called for SEC rulemaking to protect traceability.[5] These sentiments were reflected by participants during the Investor Advisory Committee's September 19, 2024 panel discussion "Key Topics from Securities Litigation: Shareholder Proposals & 'Tracing' in Section 11 Litigation." In their testimony, former SEC Commissioner Robert Jackson argued for the SEC to take action,[6] and former SEC General Counsel Robert Stebbins agreed that the SEC "should consider" a remedy.[7]

In alignment with the recommendations from former SEC officials, commissioners, investors, and the panelists at our meeting on September 19, 2024,[8] the Investor Advisory Committee recommends that the Commission consider administrative remedies to protect the viability of Section 11. We propose the SEC implement a short lockup period following an initial public offering, during which only registered shares would be permitted to trade. This temporary lockup would allow investors who acquire securities during this period to preserve their ability to demonstrate tracing, thereby ensuring their standing under Section 11. The Committee suggests that this lockup could be instituted by amending Rule 461, by the Commission exercising its authority under Section 8(a), or by amending Rule 144.

Our recommendation is structured as follows. We start with a background on Section 11, outlining how it complements other liability provisions, including claims under Section 10(b) and Rule 10b-5 promulgated thereunder. Next, we discuss the current challenges faced by plaintiffs seeking to establish standing under Section 11. We then present our suggestions for potential

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[3] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to Vanessa A. Countryman, Sec'y, SEC, at 2 (Feb. 29, 2024), https://www.sec.gov/files/rules/petitions/2024/petn4-824.pdf.

[4] The Working Group is composed of Edwin Hu (Postdoctoral Fellow at New York University School of Law), Bradford Lynch-Levy (Researcher at The Wharton School), Daniel J. Taylor (Arthur Anderson Professor at The Wharton School), Jonathon Zytnick (Associate Professor of Law at Georgetown University Law Center), Benjamin Alter (Researcher at New York University School of Law), Matthew Kalinowsky (Researcher at New York University School of Law), Charlotte LeBarron (Researcher at New York University School of Law), and Victor Simonte (Researcher at New York University School of Law). Letter from Working Group on Investor Protection in Public Offerings to Vanessa A. Countryman, Sec'y, SEC, at 2 (Mar. 9, 2023), https://www.sec.gov/files/rules/petitions/2023/petn4-801.pdf. Hereinafter *Working Group*.

[5] *Id.* at 1 (The Working Group "ask[s] that the SEC amend Rule 144 in light of changes in securities-offering practices and the Supreme Court's consideration of *Slack* v. *Pirani*, addressing Section 11 liability in direct listings").

[6] SEC Investor Advisory Committee, *Investor Advisory Committee Meeting Part Two*, YouTube at 23:00 (Sept. 19, 2024), https://www.youtube.com/watch?v=dCGGF-kDtL0 ("This [Section 11 standing issue] is the kind of meat and potatoes problem that [the Investor Advisory Committee] should get [the SEC] leadership to focus on.").

[7] *Id.* at 18:30.

[8] SEC Investor Advisory Committee, *Meeting Agenda* (Sept. 19, 2024), https://www.sec.gov/about/iac091924-agenda. The panel was moderated by Colleen Honigsberg (Professor of Law at Stanford Law School and Secretary of the Investor Advisory Committee). The panelists included Robert Bartlett (W.A. Franke Professor of Law and Business, Stanford Law School); Trevor Fay (Founder and Chief Executive Officer, KOPA Market); Marie Oh Huber (Former Chief Legal Officer, eBay and Agilent Technologies and Board Member, Portland General Electric); Robert J. Jackson Jr. (Nathalie P. Urry Professor of Law, NYU Law School and Former SEC Commissioner); and Robert B. Stebbins (Partner, Willkie Farr & Gallagher LLP and former SEC General Counsel).

administrative remedies to address these challenges. Finally, we conclude with our specific recommendations.

II. Background on Section 11

The Securities Act of 1933 ("1933 Act") "was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud, and . . . to promote ethical standards of honesty and fair dealing."[9] The authors of the Act acknowledged that, in the absence of liability, company executives might be inclined to withhold essential information, as investors may lack the necessary motivation or capacity to obtain such information from portfolio companies or to oversee whether those firms are misrepresenting their performance.[10]

Most pertinently, Sections 5 and 11 of the 1933 Act collectively address issues related to information asymmetry when a company undertakes a public offering. Section 5 mandates that any company engaging in a public offering must submit a registration statement.[11] In turn, Section 11 establishes a strong incentive for the accuracy and completeness of that registration statement by imposing a rigorous standard of liability on those individuals and entities directly involved in a registered offering, in the event of material misstatements or omissions within the registration statement.[12]

Section 11's Pleading Requirements and Goals

In comparison to claims brought under Section 10(b) and Rule 10b-5 established thereunder, Section 11 has historically been thought to impose lenient pleading requirements on plaintiffs.[13] Section 11 imposes strict liability on defendants, meaning plaintiffs do not need to show scienter.[14] Additionally, Section 11 does not necessitate that plaintiffs demonstrate reliance

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[9] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976).
[10] Stephen Choi & Adam Pritchard, *Securities Regulation: Cases and Analysis* 569-70 (5th ed. 2019).
[11] Prohibitions Relating to Interstate Commerce and the Mails, 15 U.S.C. §77e.
[12] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381 (1983). *See also* Civil Liabilities on Account of False Registration Statement, 15 U.S.C. §77k.
[13] As a comparison, Rule 10b-5 claims require plaintiffs to plead scienter, reliance, and loss causation. *Tellabs, Inc. v. Makor Issues & Rts, Ltd.*, 551 U.S. 308, 319 (2007) ("To establish liability under . . . Rule 10b-5, a private plaintiff must prove that the defendant acted with scienter . . ."); *Basic v. Levinson*, 485 U.S. 224, 243 (1988) ("[R]eliance is an element of a Rule 10b-5 cause of action."); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005) (explaining that loss causation is an element of a 10b-5 claim).
[14] Choi & Pritchard, *supra* note 10, at 579-80. *See Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 575 U.S. 175, 193 (2015) (noting that, in creating Section 11, Congress intended "to establish a strict liability offense promoting 'full and fair disclosure' of material information" (quoting *Pinter v. Dahl*, 486 U.S. 622, 646 (1988))). Possible defendants include: every person who signed the registration statement; directors or partners in the issuer and those named in the registration statement as about to become directors or partners; accountant, engineers, appraisers, and others whose profession gives authority to statements prepared by them in the registration statement; and underwriters. *See* 15 U.S.C. §77k(a). Anyone who "controls" the possible defendants above may also be liable. *See also* Liability of Controlling Persons, 15 U.S.C. §77o.

or loss causation.[15] Rather, plaintiffs need only to convincingly illustrate that the registration statement included a material misstatement or omission, and that they bought shares registered on the faulty registration statement (i.e., they can "trace" their shares).[16]

The minimal pleading requirements of Section 11 are designed to ensure compliance with the disclosure provisions of the 1933 Act and to provide "special protection" to purchasers involved in public offerings of registered securities.[17] This additional protection is justified as there exists a significant information gap between issuers and investors, particularly prior to a firm's initial public offering.[18]

Heightened Liability Risk, But a Small Pool of Plaintiffs

Although Section 11 subjects eligible defendants to a substantial risk of liability concerning materially misleading statements and omissions, both the scope of the misstatements and omissions covered and the class of plaintiffs entitled to bring a claim are relatively limited.[19]

- First, claims under Section 11 pertain exclusively to material misstatements and omissions contained within the registration statement.[20]

- Second, plaintiffs under Section 11 must "trace" their shares to the pertinent registration statement.[21] Tracing necessitates direct evidence of purchase; a mere high probability that the plaintiff acquired registered shares is insufficient.[22] As

[15] *Rombach v. Chang*, 355 F.3d 164, 169 n.4 (explaining that Section 11 does not require that plaintiffs allege reliance). However, plaintiffs must show reliance if the issuer releases an earnings statement covering at least twelve months after the effective date. Choi & Pritchard, *supra* note 10, at 580. Although plaintiffs need not show loss causation, defendants may use loss causation as a defense. *See Amorosa v. AOL Time Warner, Inc.*, 409 Fed. Appx. 412, 417 ("The absence of loss causation is an affirmative defense to a section 11 claim . . .").
[16] *Herman & MacLean v. Huddleston*, 459 U.S. at 382 ("If a plaintiff purchased a security issued pursuant to a registration statement, he need only show a material misstatement or omission to establish his *prima facie* case."). However, defendants other than the issuer may demonstrate their due diligence as a defense. *Id.*
[17] *Id.* at 381-83.
[18] Working Group, *supra* note 4, at 2 ("[T]he informational gap between issuers and investors is largest [] the day a firm goes public.").
[19] Plaintiffs filed 205 Federal Section 11 and/or State 1933 Act filings from 2019 to 2023. Cornerstone Research, *Securities Class Action Filings: 2023 Year in Review*, at 4 (2023), https://www.cornerstone.com/wp-content/uploads/2024/01/Securities-Class-Action-Filings-2023-Year-in-Review.pdf.
[20] 17 U.S.C. §77k(a). For comparison, Rule 10b-5 extends to any material misstatements or omissions made "in connection with the purchase or sale of any security" thereby significantly broadening the range of materials that could potentially result in liability. *See* Employment of Manipulative and Deceptive Devices, 17 CFR §240.10b-5. *See also Herman & Maclean v. Hudleston*, 459 U.S. at 382 (explaining that the actions for which one may be liable under Section 11 are limited compared to those for which one may be liable under Section 10(b)).
[21] Section 11 allows only "those who purchase securities that are the direct subject of the prospectus and registration statement" to bring a claim. *See Krim v. pcOrder.com, Inc.* 402 F.3d 489, 495 (5th Cir. 2005) (quoting *Barnes v. Osofsky*, 373 F.2d 269, 273 (2d Cir. 1967)).
[22] *Id.* at 500-01 ("Congress conferred standing on those who *actually* purchased the tainted stock, not on the whole class of those who *possibly* purchased the tainted shares . . . [G]eneral statistics say nothing about the shares a specific person *actually* owns . . .").

described below, this procedural requirement imposes an increasingly significant burden on plaintiffs who purchase their shares in the open market.

- Finally, the damages provision of Section 11 constrains both the scope and the number of potential plaintiffs. Unlike Section 10(b), Section 11 establishes a specific formula for calculating damages.[23] In essence, damages are restricted to the initial offering price, indicating that recovery is only possible if the stock's value falls below its initial offering price—and, in such cases, damages are limited to the difference between the initial offering price and the value received for the share.[24] This damages calculation implies that an investor would have little incentive to pursue a claim under Section 11 if the value of the share exceeds the initial offering price (e.g., if the share price has appreciated from the initial offering price).

III. Current Challenges Regarding Section 11 Tracing

Section 11 offers plaintiffs a more straightforward avenue for litigating material misstatements or omissions in registration statements than Rule 10b-5. However, this pathway is restricted to a narrower pool of plaintiffs, and the damages are more limited than those available under Rule 10b-5. This tradeoff was designed to introduce an additional layer of liability in a high-risk environment characterized by increased managerial incentives for misconduct and heightened information asymmetry. Nevertheless, recent changes to the IPO process have modified this historical arrangement, consequently diminishing plaintiffs' ability to pursue claims under Section 11.

Historically, the lockup periods following initial public offerings (IPOs) allowed many plaintiffs to demonstrate tracing without substantial difficulty.[25] IPO lockups are contractual arrangements between an issuer and its stockholders that prevent holders of unregistered securities from selling those securities for a certain period of time (usually six months) following the IPO.[26] Consequently, unregistered shares are not in the initial pool of securities offered to the public, and

[23] *See* 15 U.S.C. §77k(e). In contrast, Section 10b-5 calculates damages as the difference between the price paid and the value received. *See Randall v. Loftsgaarden*, 478 U.S. 647, 661-62 (explaining that damages under §10(b) are generally calculated as the difference between the value the plaintiff received and what the plaintiff would have received in the absence of fraud).

[24] The "value received" depends on the time when the plaintiff sold her shares. If the plaintiff sold her shares prior to filing the suit, "value received" is calculated based on the price when the plaintiff sold her shares. If the plaintiff owns her shares at the end of the suit, "value received" is calculated based on the value of the shares at the time of filing. If the plaintiff sold her shares after filing the suit but before judgment, the "value received" is based on the greater of the sale price or the value at the time of filing the suit. 15 U.S.C. §77k(e).

[25] Working Group, *supra* note 4, at 2 ("For most of the last century, Section 11 tracing has been straightforward" due to IPO lockups.).

[26] *Id.;* SEC, Office of Investor Education and Advocacy, *Updated Investor Bulletin: Investing in an IPO* (Oct. 14, 2022), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-17 (in lockup agreements, shareholders "agree not to sell their shares for a certain period of time, typically 180 days.").

plaintiffs who purchased during the lockup period could easily trace their shares to the public offering.[27]

However, recent work shows that innovations in public offerings have increased the number of shares sold to the public with shortened lockup periods or without any lockup periods, making it more difficult—and in some cases, impossible—for plaintiffs to trace their shares to the applicable registration statement.[28] A key innovation is that underwriters may waive lockups, allowing holders of unregistered shares to sell before the lockup period has ended. Research demonstrates that underwriter discretion to waive lockups was practically nonexistent before 2010, but that underwriters have enjoyed this discretion in hundreds of IPOs over the past decade.[29] Moreover, underwriters "frequently" exercise this waiver to permit early sales.[30] Direct listings, which have also risen in popularity, similarly taint the pool of registered shares. If a company goes public through a direct listing, owners of unregistered shares are typically allowed to sell those shares immediately, meaning that any investor buying shares on the open market will find it impossible to trace their shares.[31]

As the number of offerings with limited or nonexistent lockup periods has risen in recent years, plaintiffs' ability to preserve standing under Section 11 has become increasingly uncertain. The Supreme Court's recent decision in *Slack Techs. v. Pirani* clarified that there is no wiggle room; even if the offering lacks a lockup period, Section 11 will not extend to shares purchased from a pool of registered and unregistered shares.[32] As a result, if there are any unregistered shares in the pool available to the public following the offering, it may be impossible for plaintiffs to trace.

Because the existence of unregistered shares in the pool eliminates Section 11 standing for all purchasers who purchased from that pool, issuers may be incentivized to purposely introduce unregistered shares following an offering. Law firms have already advised issuers and underwriters

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[27] Working Group, *supra* note 4, at 2.
[28] *Id.* ("[W]aivers of IPO lockups and direct listings that involve no lockup . . . today make tracing harder by producing post-offering pools of both registered and unregistered shares, leaving some plaintiffs unable to trace shares they purchased to a registration statement.").
[29] To measure underwriter discretion to waive lockups, the Working Group examined the language in S-1 filings. *Id.* at 3-4.
[30] To capture early sales, the Working Group merged Form 144 filings data and data on actual sales, both collected by The Washington Service, with public offerings data over the same period. *Id.* at 4. The Washington Service provides data and analytics based on insider trading forms filed with the SEC. *See* The Washington Service, https://washingtonservice.com [https://perma.cc/PF74-7SUL], (last visited Feb. 3, 2025).
[31] Direct listings are offerings to the public, but unlike IPOs, the company registers stock already held by major existing shareholders. Because direct listings rarely include a lockup period, preexisting holders of unregistered shares can sell their shares immediately following the offering. *Id.* at 4; SEC, *Types of Registered Offerings* (Dec. 17, 2024), https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/types-registered-offerings.
[32] *Slack Techs. v. Pirani*, 598 U.S. at 761, 769 ("While direct listings . . . are new, the Court's conclusion is not": plaintiffs bringing Section 11 claims in direct listings must "plead and prove that [they] purchased shares traceable to the allegedly defective registration statement."). While *Slack Techs. v. Pirani* involves direct listings, the holding appears to apply to IPOs broadly.

to structure offerings to achieve this result. For example, a Wilson Sonsini lawyer noted in one article that "underwriters would be well-advised to think about easing lockup requirements in order to enhance the potency of the standing defense to Section 11 claims."[33]

Issuers and underwriters' ability to extinguish plaintiffs' standing threatens to minimize compensation available to investors—and to undermine the deterrent effect of Section 11. Without the prospect of strict liability lawsuits, issuers may feel less pressure to accurately disclose information in their registration statements, potentially leaving all investors less informed.

IV. Possible Remedies & Method of Implementation

A number of bipartisan commentators have suggested various remedies for the Commission to preserve investors' ability to assert standing under Section 11 and to protect the historical balance of liability contemplated by the 1933 Act. These proposed remedies range from technological innovations, such as the use of a distributed ledger system, to more conventional administrative solutions.[34] While there is disagreement regarding the specific approach the Commission should adopt to address this concern, there is a general consensus that the Commission possesses the authority to tackle this issue and should take action to do so.

One approach to preserve investors' ability to trace their shares to the registration statement and bring claims under Section 11 is to mandate some sort of lockup following an IPO. In their amicus brief, former Chairman Clayton and Commissioner Grundfest suggested that the SEC had authority to impose brief lockups following direct listings.[35] The Working Group likewise suggested that the SEC had authority to impose a lockup.[36] Below we discuss possible avenues through which the Commission could impose a lockup.

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[33] Boris Feldman, *A Modest Strategy for Combatting Frivolous IPO Lawsuits*, HARV. L. SCH. F. ON CORP. GOV. (March 13, 2015), https://corpgov.law.harvard.edu/2015/03/13/a-modest-strategy-for-combatting-frivolous-ipo-lawsuits.

[34] Potential technological innovations include migrating the clearance and settlement system to a distributed ledger system. The Council of Institutional Investors suggested migrating the clearance and settlement system in its petition for rulemaking. *See* Petition for Rulemaking Regarding Traceability of Shares, *supra* note 3, at 4. When the Investor Advisory Committee discussed this suggestion at its September 19, 2024 meeting, panelist Trevor Fay expressed that blockchain technology is capable of tracing and differentiating shares as the suggestion envisions. See *SEC Investor Advisor Committee Meeting Part Two*, *supra* note 6, at 39:15. Another suggestion involves applying an accounting method (first-in-first-out or last-in-first-out) to existing trading data to trace individual shares. *See* John Coffee & Joshua Mitts, *Slack v. Pirani and the Future of Section 11 Claims*, SSRN (Dec. 1, 2023), https://dx.doi.org/10.2139/ssrn.4644888. A third proposal, discussed by Chairman Clayton and Commissioner Grundfest in their *amicus brief*, entails requiring different tickers for registered and exempt shares, at least until the Section 11 statute of limitations expires. *See* Brief for Hon. Jay Clayton & Hon. Joseph Grundfest, *supra* note 1, at 31-32.

[35] Brief for Hon. Jay Clayton & Hon. Joseph Grundfest, *supra* note 1, at 32-33 (The SEC could "requir[e] that exempt shares not trade until the day after an initial auction that is limited to registered shares. This would, in effect, impose a regulatory one-day lock-up as a method of preserving issuer Section 11 liability.").

[36] Working Group, *supra* note 4, at 6 (recommending that the SEC amend Rule 144 to require lockups for the later of ninety days or the next 10-Q or 10-K).

1) Condition of Acceleration

One way for the SEC to tackle the tracing issue associated with Section 11 is to mandate that issuers maintain Section 11 liability as a precondition for the SEC to accelerate a registration statement. As outlined in Commissioner Grundfest's letter to the Investor Advisory Committee,[37] this requirement could be implemented either by amending Rule 461[38] or by the SEC exercising its Section 8(a) authority.[39] This approach would effectively link the acceleration of the registration process to the safeguarding of investor rights.

- Rule 461 defines prerequisites for accelerating effectiveness. Commissioner Grundfest suggests amending Rule 461 to state the general principle that, as a condition of acceleration, the offering must be structured to allow initial purchasers to retain their ability to sue under Section 11.

- Section 8(a) of the 1933 Act provides the Commission with the authority to impose conditions on the acceleration of the registration process based on, among other factors, "the public interest and the protection of investors."[40] Utilizing this flexibility, the Commission could mandate that any company seeking acceleration under Section 8(a) must guarantee that initial purchasers fulfill the tracing requirements outlined in Section 11.

2) Rule 144

Another avenue for the SEC to address Section 11's tracing problem and impose a lockup is to amend Rule 144. Rule 144 provides an exemption that allows holders to sell unregistered shares to the public without those sales constituting "distributions."[41] Currently, to fit the exemption, the holders must keep their shares for at least one year, or six months for issuers subject to reporting requirements under Section 13 or 15(d) of the Securities Exchange Act of 1934.[42]

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[37] Letter from Joseph Grundfest, Stanford Law School, to Brian L. Schorr and Colleen Honigsberg, Chair and Secretary respectively of the SEC Investor Advisory Committee(Jan. 30, 2025), available at https://www.sec.gov/comments/265-28/26528-565015-1620302.pdf. Commissioner Grundfest suggests that imposing a lockup through the acceleration process is superior to amending Rule 144 because the Rule 144 approach "fails to consider the fact that holders can sell into the public aftermarket in reliance on 'Section 4 (1 ½).'" *Id*. In other words, Rule 144 is not an exclusive safe harbor, so sales of unregistered shares could still occur outside of Rule 144. If so, those unregistered shares would enter the market and impede tracing.
[38] Acceleration of Effective Date, 17 C.F.R. §230.461 (2024).
[39] Cease-and-Desist Proceedings, 15 U.S.C. §77h-1 (2024).
[40] Grundfest, *supra* note 40, (quoting 15 U.S.C. §77h-1).
[41] When sales are considered distributions, any intermediary facilitating the transaction (such as a broker-dealer) will be deemed an underwriter under Section 2(a)(11) of the Securities Act of 1933. *See* Persons Deemed not to be Engaged in a Distribution and Therefore not Underwriters, 17 C.F.R §230.144.
[42] Working Group, *supra* note 4, at 5. The holding period applies when the holder acquired the shares from the issuer or from an affiliate. *See* 17 C.F.R §230.144(d).

Transactions conducted under this safe harbor are the main barrier preventing investors from tracing their securities, as sales of unregistered shares post-IPO occur principally under Rule 144.

To address the challenge that direct listings pose to Section 11 standing, the SEC could amend Rule 144 to require holders of unregistered shares to hold their shares for a certain period of time following the effectiveness of a registration statement, even where they have held the shares for longer than the requisite holding periods (six months or one year) described above.[43] Such an amendment to Rule 144 would help to address Section 11's tracing problem by minimizing—or even eliminating—unregistered shares in the pool for a period following an IPO, allowing at least some purchasers in the open market to trace their shares.

Length of Lockup

While a lockup under either of these approaches could theoretically allow standing for certain plaintiffs and thus uphold some of Section 11's deterrent effect, the optimal duration of the lockup period remains uncertain. The Working Group recommends a lockup period extending to the later of ninety days or the issuer's subsequent 10-Q or 10-K filing.[44] The Working Group contends that ninety days provides adequate time for registered shares to trade without unregistered shares in the market, thereby preserving Section 11's deterrent impact.[45] The Working Group also emphasizes that the option to release financial statements enables issuers to reduce the holding period.[46]

Conversely, in noting the administrative actions available to the Commission, former Chairman Clayton and Commissioner Grundfest suggest a lockup period of only one day.[47] Arguably, even such a brief period can provide sufficient deterrence by preserving Section 11 standing for initial purchasers.

V. Investor Advisory Committee Recommendation

Consistent with the recommendations of our panel of investor representatives, of former commissioners, and of the Council of Institutional Investors, we recommend that the SEC address the questions highlighted by the Supreme Court's decision in *Slack Techs. v. Pirani*. In particular, we recommend that the Commission move to ensure that investors retain their ability to bring claims under Section 11 following an initial offering by establishing a required lockup period.[48]

[43] *Id.* at 6.
[44] Working Group, *supra* note 4, at 5.
[45] *Id.*
[46] *Id.*
[47] Brief for Hon. Jay Clayton & Hon. Joseph Grundfest, *supra* note 1, at 32-33.
[48] A required lockup period may also be pertinent to demonstrating Section 12(a)(2) standing. Section 12(a)(2) claims involve materially misleading misstatements and omissions in a prospectus or oral communication. *See* Civil Liabilities Arising in Connection with Prospectuses and Communications, 15 U.S.C. §77l. The elements of Sections 11 and 12 are not necessarily the same: the Court in *Slack Techs. v. Pirani* noted that Sections 11 and 12 do not "necessarily travel together" and "contain distinct language." However, as a practical matter, courts could limit

The Investor Advisory Committee does not hold a view on whether the lockup should be promulgated by amending Rule 461, through the Commission exercising its authority under Section 8(a) of the 1933 Act, or by amending Rule 144. We note that different securities law experts have different views on the relative costs and benefits of each approach, and we are neutral regarding the approach as long as Section 11 standing is preserved.

We further note that different securities law experts have different views on the appropriate duration for the lockup period.[49] On the one hand, a shorter lockup period (e.g., a one-day lockup) may be sufficient to deter misconduct, as these early purchasers would have the ability to trace and assert claims under Section 11. However, any investors who acquire shares after the one-day period may struggle to trace their holdings and may be undercompensated.

On the other hand, a longer lockup period (for instance, a ninety-day lockup) similarly serves to deter misconduct but also enables open-market purchasers within that timeframe to assert claims under Section 11. This could enhance investor confidence in the market, but it may also constrain investors who wish to sell during this period and/or expose issuers to a greater risk of frivolous claims made under Section 11. Of course, however, the nature of damage calculations under Section 11 means that these secondary market purchasers would only have an incentive to bring claims if the stock price falls below the initial offering price (not the price at which those investors bought the stock, but the initial offering price), thus placing an upper bound on the frequency of excessive or frivolous litigation.[50]

In light of the ongoing discussion, the Investor Advisory Committee does not take a position on the appropriate length of the lockup period. We recognize that there are compelling arguments for both extending and shortening the lockup, and we recommend that the Commission seek public comment regarding the appropriate length of the lockup period.

As part of the notice and comment process, we further recommend that the Commission seek input regarding the role of technological improvements. As noted above, public commentators and our panelists, notably Trevor Fay, highlighted the role that technology can play in tracking and

statutory standing to shareholders who can trace their shares to the allegedly defective prospectus or oral statement. *Slack Techs. v. Pirani*, 598 U.S. at 769 n.3 (2023).

[49] As noted above, *supra* note 36, the Working Group recommends a lockup period of ninety days, where that period can be shortened if the firm releases financial statements during that ninety-day period. In contrast, Commissioners Clayton and Grundfest recommend a lockup period of a single day. Brief for Hon. Jay Clayton & Hon. Joseph Grundfest, *supra* note 35.

[50] Most IPOs yield positive returns in the initial three months. Rocky White, *What to Expect After Landing a Huge IPO Return*, Schaeffer's Investment Research (Dec. 16, 2020), https://www.schaeffersresearch.com/content/analysis/2020/12/16/what-to-expect-after-landing-a-huge-ipo-return. Nonetheless, the risk of Section 11 claims may be trending upwards. Although issuers historically did not see a stock price decline below the initial offering price in the initial 3-month period, recent years have seen an uptick in this figure. *Initial Public Offerings and Section 11 Claims*, Charles River Associates (Jan. 2024), https://media.crai.com/wp-content/uploads/2024/01/02155929/Insight-Initial-public-offerings-and-Section-11-claims-Jan-2024.pdf ("The percentage of companies with stock price declines three months following the IPO fluctuated at about 33% on average in 2014 to 2020. The percentage of such companies increased to 52% in 2021 and to 79% in 2022 and decreased to 69% in 2023.").

differentiating shares.[51] Former Commissioner Jackson further noted that the Commission could incentivize adoption of technology through, for example, reducing the length of any lockup. A notice and comment period would allow the Commission to explore these possibilities.

[51] *See supra* note 34.