ADDRESSING THE SLACK OF *SLACK V. PIRANI*: THE FUTURE OF SECTION 11 WITHIN THE CONFINES OF THE SETTLEMENT WORLD

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This Note examines the implications of the Supreme Court's decision in Slack Technologies, LLC v. Pirani *for Section 11 securities class action settlements. Despite* Slack *reaffirming that plaintiffs must trace their shares to the allegedly misleading registration statement to establish standing under Section 11, the decision's practical consequences have been largely avoided in the settlement context. Claims administrators frequently lack the tools to verify tracing, allowing settlements to include claimants who may not satisfy Section 11's statutory requirements. This Note argues that such practices undermine the fairness, adequacy, and reasonableness requirements of Federal Rule of Civil Procedure 23(e) in its dilution of recoveries owed to legitimate claimants. In consideration of the modernization of securities ownership through electronic book-entry systems, and the structural incentives that color existing settlement practices, this Note proposes a direct-payment settlement model supported by modern tracing technologies, including the Consolidated Audit Trail (CAT). Through automated verification of eligible claimants and direct distribution of settlement proceeds, courts can align Section 11 settlements with statutory intent and preserve the integrity of the Securities Act's strict liability framework.*

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I. INTRODUCTION

To qualify for recovery under Section 11 of the Securities Act of 1933, hereinafter referred to as Section 11, a plaintiff must trace their shares to the allegedly false or misleading registration statement.[1] Tracing is routine in a "benchmark situation," when "all of a company's shares have been issued in a single offering under the same registration requirement" and the individual bringing the case is a primary market purchaser.[2] However, the shift to an electronic book-entry system, where shares exist in a computerized, fungible bulk, and the resulting high-volume trading and complex chains of aftermarket purchasers that has developed, has significantly complicated legal proceedings and

[1] Ken Cunningham et al., *Litigation: Professional Perspective: Litigating Section 11's Tracing Requirement: A Practitioner's View of a Powerful Defense,* BLOOMBERG L. (June 2019), https://www.bloomberglaw.com/external/document/X4M4BSU8000000/litigation-professional-perspective-litigating-section-11-s-trac [https://perma.cc/RDQ8-VXB7].

[2] The Ninth Circuit, one of the premier hotbeds for securities regulation, has affirmed such tracing to be a non-burdensome matter. *In re* Century Aluminum Co. Sec. Litig., 729 F.3d 1104, 1106 (9th Cir. 2013) (citing Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1082 (9th Cir. 1999)).

academic discourse.[3] As innovative public offering methods gain traction, these challenges compound and intensify.[4]

Just a few decades ago, the tracing debate focused on a simple question: whether secondary market purchasers had standing under Section 11.[5] Over time, courts solidified aftermarket purchasers' inclusion, provided that they could trace shares to a registered offering.[6] Nevertheless, the nuances of multiple offerings, mixed registered and unregistered shares[7] have reignited debate over tracing's feasibility for such plaintiff groups.[8] Despite academic skepticism over its feasibility, the strict tracing

[3] *See, e.g.*, Slack Techs., LLC v. Pirani, 598 U.S. 759 (2023) (holding that shareholders must "trace" their shares to a specific, defective registration statement to sue under Section 11. Where shares are commingled in a fungible bulk, proving that an investor purchased shares issued under a specific registration statement—rather than in the general aftermarket—is difficult.).

[4] *See id.* at 764.

[5] Some literature argues that restricting standing to primary market purchasers preserves the statutory framework's integrity, ensuring the regime's deterrent and compensatory purposes remain focused on issuers and their direct affiliates. *See* Paul C. Curnin & Christine M. Ford, *The Critical Issue of Standing Under Section 11 of the Securities Act of 1933*, 6 FORDHAM J. CORP. & FIN. L. 155, 206 (2001). Other literature takes an opposite position, arguing that tracing is altogether a judicial invention and therefore probabilistic tracing should be allowed. Hillary A. Sale, *Disappearing Without a Trace: Sections 11 and 12(a)(2) of the 1933 Securities Act*, 75 WASH. L. REV. 429, 433 (2000).

[6] *See* Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076 (9th Cir. 1999) (citing Barnes v. Osofsky, 373 F.2d 269, 272 (2d Cir. 1967)) (confirming the expansion of Section 11 to aftermarket purchasers, ending debate within the circuit about the appropriateness). *See also* Joseph v. Wiles, 223 F.3d 1155, 1160 (10th Cir. 2000) (holding that aftermarket purchasers can maintain an action under section 11 if "they can demonstrate they bought their securities pursuant to the registration statement"). "[T]he civil remedies . . ., are given to all purchasers . . . regardless of whether they bought their securities at the time of the original offer or at some later date." *Id.* (quoting H.R. REP. NO. 73–85, at 22 (1933)).

[7] As the economic landscape evolves, even minor complexities—like multiple offerings or mixed share types—have revived debate over tracing feasibility for plaintiffs with unclear ownership chains. "When a company has issued shares under more than one registration statement, the plaintiff must prove that her shares were issued under the allegedly false or misleading registration statement, rather than some other registration statement." *In re Century Aluminum Co.*, 729 F.3d at 1106. *See also Slack*, 598 U.S. at 764.

[8] *See* Brief for Amici Curiae Law and Business Professors in Support of the Respondent at 3, Slack Techs., LLC v. Pirani, 598 U.S. 759 (2023) (No. 22-200).

requirement was reaffirmed by the Court in *Slack*, which rejected statistical, speculative methods that some courts had previously used to bypass the requirement, thereby ending a period of doctrinal divergence.[9] It would seem that this heightened standard should extend to settlements. In practice, however, its impact remains unrealized.

The Court's decision is *Slack* has been poised to create significant challenges for pure Section 11 settlements, [10] yet its practical impact has yet to be faced as practitioners have circumvented tracing requirements by relying on the more lenient "fair, reasonable, and adequate" standard in settlement approval.[11] During the settlement stage, the standing question shifts from courts to claims administrators, who lack judicial oversight and access to necessary data to validate standing of plaintiffs. Unable to verify claims, administrators and counsel may rely on settlement's laxer standards, utilizing the reduced evidentiary rigor of the settlement standard as a pathway to secure approval. This structural deficiency, compounded by the inherently cooperative nature of settlement negotiations, deprioritizes the rights of legitimate claimants.[12] Lead plaintiffs, counsel, and defendants who are motivated by efficiency and expedience are disincentivized to ensure that recoveries are reserved for verifiable Section 11 claimants. This standard allows for more speculative

[9] "[W]e think the better reading of the particular provision before us requires a plaintiff to plead and prove that he purchased shares traceable to the allegedly defective registration statement." *Slack*, 598 U.S. at 770.

[10] In this Note, a "pure Section 11 settlement" refers to a securities class action settlement that involves exclusively Section 11 claims, without the inclusion of any other claims—such as those under Section 10(b) of the Securities Exchange Act—that do not require plaintiffs to trace their shares to a specific registration statement. In these cases, recovery is strictly limited to shareholders who can establish that they purchased registered shares directly linked to the allegedly misleading registration statement, as reaffirmed by *Slack*. 598 U.S. at 761. Because Section 11 imposes strict liability without requiring proof of scienter, its tracing requirement serves as the primary gatekeeping mechanism for determining eligible claimants.

[11] FED. R. CIV. P. 23(e)(2) ("If the proposal would bind class members, the court may approve it only after a hearing and only on finding that it is fair, reasonable, and adequate . . .).

[12] Shai Berman, *Claimless Claimants and the Preclusion Premium: Troubling Trends in Class Action Settlements*, 120 COLUM. L. REV. 389, 389 (arguing that, in class action settlements generally, class counsel may shortchange individuals with viable claims by agreeing to include claimless claimants).

inclusion of claimants than the preponderance of evidence standard of litigation would allow. Furthermore, the rarity of standalone Section 11 claims has further alleviated the need to confront tracing in the settlement process, because the registration requirement is not a real hurdle in other causes of action.[13] This Note contends that the rarity of pure Section 11 settlements does not justify disregarding the true implications of the tracing requirement. The failure to enforce strict tracing required by *Slack* undermines settlement integrity, leading to distorted outcomes that compromise the statutory framework intended under Section 11.

The failure to distinguish between registered and unregistered shares defies *Slack's* core statutory interpretation, which reaffirmed that Section 11's strict liability framework applies only to those who can prove access to the statutory regime through tracing. By disregarding this requirement, settlements may suffer from twofold systematic dilution: (1) regular, issuer-initiated dilution, where settlements are artificially deflated to account for litigation risk and avoid trial, and (2) compounded claims-administrator dilution, where the inclusion of speculative, untraceable claims distorts recovery allocations. This Note argues that, under current conditions, pure Section 11 settlements cannot even meet the "fair, reasonable, and adequate" standard required for approval. Consequently, the securities litigation system needs a mandatory direct-payment model, where class members are paid automatically from a common settlement fund, ensuring that counsel, lead plaintiffs, and claims administrators may adopt the necessary tools to align settlements with legislative intent in a modernizing securities market. By establishing direct payment as the sole viable approach, this framework not only preserves statutory integrity but also supports legal innovation, integrating private-market actors with the computational capabilities to resolve the tracing challenge.

Part II of this Note will provide all foundational information in understanding the current post-*Slack* situation, including a recapitulation of the legislative history and historical origins of Section 11 as well as the genesis and development of the

[13] For example, in Section 10(b)-5 cases, a non-strict liability claim, one of the "hurdles" is the scienter requirement. In settlements that involve such claims, the registration requirement is arguably not necessary to keep out invalid claims. *See* Sale, *supra* note 5, at 469.

tracing problem. Part III will discuss the issue as it is transposed within the settlement sphere. Part IV will discuss this note's solution to the structural deficiencies in Section 11 settlements by advocating for a direct payment model combined with the current common fund system that aligns settlement outcomes with statutory intent. This model will ensure the equitable distribution among verifiable claimants and mitigates the dilution effects stemming from the current settlement framework.

II. UNDERSTANDING THE TRACING PROBLEM

A. *Section 11's "Golden Ticket" to Strict Liability Recovery: Tracing*

1. *Section 11 Scope*

At a high level, Section 11 states: if there are any portions of a registration statement which contain an untrue statement of material fact or omit a material fact, "any person acquiring such security" may sue a designated list of individuals or entities associated with the issuer.[14] Importantly, "such security" refers to a security offered under a registration statement; standing under Section 11 requires securities purchased to be part of the registered offering.[15] Furthermore, damages under Section 11 are capped at the offering price[16] and are structured to align liability with the economic benefit gained by the issuer, preventing excessive penalties beyond the amount issued.[17]

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[14] 15 U.S.C.A. § 77k.

[15] *Slack*, 598 U.S. at 767.

[16] Section 11 grants a plaintiff to recover damages equal to: "the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought." 15 U.S.C.A. § 77k(e).

[17] Douglas Baumstein et al., *How the U.S. Supreme Court's Upcoming Decision in* Slack v. Pirani *May Tilt the Legal Playing Field Between Investors and Issuers*, 140 BANKING L.J. 263, 271–73 (2023) (Section 11's strict liability and

Section 11 imposes strict liability on issuers for material misstatements in a registration statement, requiring no proof of scienter.[18] This makes Section 11 particularly attractive to plaintiffs, as it waives intent requirements and limits causation defenses, serving as the primary cause of action for investors purchasing in an issuer's first market entry, such as an IPO.[19] However, Section 11's protections are limited to those who can prove they acquired either (1) registered shares directly from the offering or (2) aftermarket shares that can be traced to the registered offering; these distinctions are at the core of its framework.[20] Consequently, if shares are purchased directly, tracing is unnecessary, but for aftermarket buyers, it is the essential threshold requirement.[21]

2. *Section 11 History and Legislative Purpose*

Since Section 11's inception, the distinction between registered and unregistered shares has been central to its strict liability framework.[22] By tying liability to directly acquiring registered shares, only those within the intended protective sphere of the Securities Act could invoke its powerful remedies.

Congress enacted Section 11 as part of a broader regime of the Securities Act of 1933 in response to the episodic economic failures of the Great Depression.[23] This particular section was designed as an *in terrorem* remedy,[24] effectively operating as a threat

tracing requirement prevent issuers from unjustly profiting from misleading registration statements. Since IPO share prices are directly tied to disclosures, issuers receive an unwarranted windfall if capital is raised through misstatements, justifying strict liability when only traceable securities are in the market.).

[18] *Id.* at 267.

[19] John C. Coffee Jr. & Joshua Mitts, *Can Section 11 Be Saved?: "Tracing" a Path to Its Survival*, 15 HARV. BUS. L. REV. 1, 4 (2025).

[20] *Id.* at 7–9.

[21] *Id.*

[22] *See id.* at 3 (without distinguishing between registered and unregistered shares, "issuers would face disproportionate liability out of scale to the amount of stock that they were selling").

[23] Elisabeth A. Keller, *Introductory Comment: A Historical Introduction to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 49 OHIO ST. L.J. 329, 345 (1988).

[24] Harry Shulman, *Civil Liability and the Securities Act*, 43 YALE L.J. 227, 227 (1933) ("Both in the extent of liability imposed—the variety of persons to whom the liability is attached, the bases of the liability, and the persons in whose

meant to urge potential violators into compliance—a form of legal deterrence.[25] Following the economic crash of 1929 and the ensuing Great Depression, Congress recognized that simple tweaks to common-law jurisprudence would not suffice to restore devastated investor confidence.[26] Instead, lawmakers imposed near-absolute liability on issuers for any material misstatements or omissions.[27] By making those who actually sold the security—underwriters and every person who signs the registration statement—jointly and severally liable, and shifting proof burdens to them, regardless of scienter, Section 11 departed sharply from traditional deceit doctrines.[28] This departure was intentional: the looming specter of liability was meant to ensure scrupulous diligence in securities offerings, seeking to deter wrongdoing at its inception.[29] At the time, such a forceful provision was viewed as central for correcting market abuses that had helped spur the economic collapse.[30] Such threat was operative through the potential of absolute liability enforceable by any afflicted parties acquiring a security against those who directly partake in the registered offering.[31] As supported by the House Report accompanying the version of the bill that ultimately became the Securities Act of 1933, *any person* who acquires the security can bring suit if they can prove standing

favor it runs–and in the limitation of the amounts recoverable, the *in terrorem* function of the Act is evidenced.").

[25] *See* Keller, *supra* note 23, at 345.

[26] *See id.* ("At common law, a remedy for an action in deceit was severely limited because the buyer had to prove that the seller knowingly made the false statement. Additional problems of obtaining jurisdiction over the seller and varying common law elements in deceit further supported the need for a single standard to provide those defrauded in securities transactions an appropriate remedy.").

[27] *See id.*

[28] *See id.* Outside of the purview of Section 11 and consistent with common law, a purchaser alleging fraud must meet a high burden, alleging the following: "(1) false representation of a material fact; (2) knowledge of falsity; (3) intent to deceive; (4) action in reliance based on the false representation; and (5) damages. PROSSER & KEETON ON TORTS § 108 (W. Keeton ed. 1984 & Supp. 1988). *See also* Securities Act § 11(a), 15 U.S.C. § 77k(a) (1982).

[29] *See* Keller, *supra* note 23, at 345.

[30] *Id.* at 329.

[31] Herman & MacLean v. Huddleston, 459 U.S. 375, 381–82 (1983) (Section 11 "was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering[.]").

through directly tracing their purchase, providing that ". . . the civil remedies accorded by this subsection against those responsible for a false or misleading statement . . . are given to *all purchasers* . . . *regardless of whether they bought their securities at the time of the original offer or at some later date* . . ."[32]

The requirement of tracing provides as a foundational funneling mechanism for the securities regulation regime, with those who did not buy registered shares pushed into other regulatory sections with heightened pleading requirements.[33]

B. *The Genesis Of "Tracing" and the Development of Section 11 Jurisprudence*

Given the centrality of the distinction between registered and unregistered shareholders in the Section 11 statutory framework, any settlement purporting to meet the goals of Section 11 without accounting for tracing ultimately fails to uphold the statute's intent of limiting recovery to registered shareholders. Yet, such settlements persist for the same reason courts have long struggled with the tracing question: a fundamental mismatch between a stagnant legal framework and the evolving complexities of modern securities markets.

Despite clear legislative intent, strict tracing under Section 11 has not always been uniformly enforced, with courts misconstruing the statute or diverging at times from its intentionally rigid application.[34] This inconsistency arises from the growing complexity of modern securities markets, which has outpaced corresponding legal innovations.[35] On one hand, courts faced with this mismatch have systematically excluded aftermarket purchasers' inclusion within the Section 11 framework.[36] On the other hand,

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32 H.R. REP. No. 73-85, pt. 2, at 5 (1933) (emphasis added).

33 Section 11 is largely understood in contrast to Section 10b-5, as the prevailing notion is that the two sections were created to balance one another. *See* Curnin & Ford, *supra* note 5, at 191.

34 *See* Cunningham et al., *supra* note 1.

35 *See generally* Slack Techs., LLC v. Pirani, 598 U.S. 759, 770 (2023) (reinforcing the idea that judicial interpretations, such as strict tracing, are bound by existing statutes unless Congress chooses to revise them).

36 Coffee & Mitts, *supra* note 19, at 8. As securities markets evolved and the synthetic chain of aftermarket purchasers expanded, making tracing more

courts have loosened tracing standards, permitting aftermarket claims based on speculative or probabilistic reasoning rather than concrete proof.[37]

The questioning of legislative intent surrounding aftermarket purchasers, and the standard by which they should be included, only emerged as financial markets evolved beyond the framework envisioned at the time the original statute was enacted, signaling the need for paired legal and market innovation within this space.[38]

1. *Origination of Tracing: Solidified Place for Aftermarket Purchasers*

The concept of tracing is often traced back to *Barnes v. Osofsky*, where the Second Circuit established that Section 11 plaintiffs must demonstrate that their shares were acquired directly from the public offering linked to the registration statement, thereby limiting the class of eligible claimants.[39] In *Barnes*, the District Court approved a settlement class limited to purchasers of 200,000 newly issued shares, excluding those who purchased in the open market prior to the new issuance.[40] In excluding such shareholders,[41] the District Court funneled their claims into other

difficult, courts questioned whether aftermarket purchasers were ever truly intended to fall within Section 11's scope, cutting off this plaintiff group's standing. *Id.*

[37] *Id.* at 8–9.

[38] Similarly, the erosion of strict tracing in favor of speculative and probabilistic reasoning has carried over into the settlement sphere, making the understanding of the judicial struggles over tracing in litigation essential to recognizing the fundamental flaws of settlements that disregard tracing, distort recoveries, and dilute legitimate claims. *See infra* Part III.

[39] *See* Barnes v. Osofsky, 373 F.2d 269, 271 (2d Cir. 1967) (rejecting the more expansive interpretation that a Section 11 suit can be maintained by anyone "acquiring a security *of the same nature* as that issued pursuant to the registration statement") (emphasis added).

[40] Barnes v. Osofsky, 254 F. Supp. 721, 722 (S.D.N.Y. 1966), *aff'd*, 373 F.2d 269 (2d Cir. 1967).

[41] The District Court determined that any technical challenges to implementing its decision were without merit as the defendants had the ability to identify the shares issued through the public offering. Some scholars have conveyed alternative suggestions, arguing that the District Court's explanation implies that only initial purchasers were intended to have standing because it is

sections of the securities regulation regime, withholding strict liability treatment.[42] The plaintiffs appealed, arguing that tracing was effectively impractical and should thus be broadly interpreted to include all shareholders.[43] Despite complaints by the plaintiffs of the technical impracticability of tracing in their case,[44] the Second Circuit affirmed this limitation, citing two key reasons: (1) since the financial system is structured around the registration of individual shares rather than entire classes of shares, it was unlikely that Congress intended to extend remedies to holders of non-registered shares; and (2) the central purpose of Section 11 was to protect purchasers who relied on the registration statement, a foundational principle reinforced by Section 11(g)'s damages cap, which ties recoverable losses to the registered offering.[45] The limitation of Section 11 standing to all registered shareholders was consistent with the consensus amongst leading legal scholars of the time.[46]

While affirming that the shares must be traced, *Barnes* did not limit Section 11 actions to primary market purchasers or only those who acquired the shares during the IPO. In fact, the Court affirmed legislative intent that "the remedies of [Section 11] were accorded to purchasers regardless of whether they bought their securities at the time of the original offer *or at some later date*."[47]

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impossible for defendant to identify shares once they are subject to secondary market. *See* Curnin & Ford, *supra* note 5, at 159 n.26.

[42] *Barnes*, 373 F.2d at 272–73.

[43] *See Barnes*, 373 F.2d 269.

[44] *Barnes*, 373 F.2d at 272–73. The *Barnes* plaintiffs offered three arguments against the limitation provided by "tracing:" (1) The distinction between old and new shares is irrational as an overly optimistic registration statement can influence the entire marketplace; (2) "to read that section as applying only to purchasers who can trace the lineage of their shares to the new offering makes the result turn on mere accident since most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares;" and (3) "it is often impossible to determine whether previously traded shares are old or new, and that tracing is further complicated when stock is held in margin accounts in street names." *Id.* at 271–72.

[45] *Id.* at 272.

[46] *See e.g.,* Fischman v. Raytheon Mfg. Co., 188 F.2d 783, 786 (2d Cir. 1951) (holding that "[a] suit under Sec. 11 of the 1933 Act requires no proof of fraud or deceit, and such a suit may be maintained only by one who comes within a narrow class of persons i.e., those who purchase securities that are the direct subject of the prospectus and registration statement.").

[47] *Barnes*, 373 F.2d at 273 (quoting H.R. REP. No. 85) (emphasis added).

Moreover, *Barnes* affirmed a settlement plan, demonstrating that considerations of tracing in settlements had precedent and were not an uncommon practice.

In response to *Barnes,* courts grappled with the tracing standard in a gradually evolving market, formulating varying methodologies to evaluate standing. Four main theories evolved, summarized below.

2. *The Contra Broker Theory*

This theory utilizes transactional records maintained by brokers to trace securities back to their original source. The notion under this methodology was that plaintiffs could show, through trade confirmations and account records, that they purchased shares from a broker who had purchased shares directly from the underwriter.[48] However, the *Kirkwood* court rejected this approach, noting that this was a speculative method which assumed that *all shares* purchased from the broker were new shares issued under the same registration statement.[49] Since the broker was a "market-maker" there was no guarantee that the entirety of house account inventory was new stock through the date of the plaintiff's purchase. Ultimately, the contra broker methodology only shows whether the plaintiff "'might' have purchased offering shares."[50]

3. *The Heritage Theory*

This method focused on the historical lineage of securities through the establishment of a connection between the securities.[51] Under this theory, plaintiffs argued they could trace their purchased shares by linking their stock certificates back through successive issuances to the original registered offering.[52] In *Kirkwood,* the plaintiffs were able to trace their shares to the offering through the express date of which the certificates were issued. Nevertheless, it could not be proven whether these shares delivered by brokers on

48 *See* Kirkwood v. Taylor, 590 F. Supp. 1375, 1381–82 (D. Minn. 1984).
49 *Id.* at 1381.
50 *Id.*
51 *Id.* at 1382.
52 *Id.*

issuance date were new shares or old shares.[53] Therefore, the court reasoned that plaintiffs had merely shown that they *might* have purchased offering stock.

4. *The Fungible Mass Theory*

This theory assumes that all shares of a given class are interchangeable, treating them as a single, undifferentiated mass of shares. Under the fungible mass method, plaintiffs argued that they were able to trace their shares by imputing the proportion of new shares held by the Depository Trust Commission (DTC)[54] to the number of shares held by the plaintiff. Utilizing this methodology, the plaintiffs argued that if a certain percentage of the fungible mass was issued under the faulty registration statement, then a proportionate number of damages could be allocated.[55] This theory was rejected on the basis that it did not comport with the standards of Section 11 liability, effectively eliminating the tracing requirement, and signaling a departure from conventional tracing principles.[56]

5. *The Direct Trace Theory*

Ultimately, the direct trace theory was the one accepted in *Kirkwood,* providing a narrow method for plaintiffs to prove tracing. The direct trace theory requires plaintiffs to explicitly link their purchased securities to the registration statement at issue. Simply

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[53] The District Court cited the age-old problem present within the tracing context: "[I]t is often impossible to determine whether previously traded shares are old or new." The court conceded that the same problem as that present in *Osofsky* persists, that a statutory construction of section 11 that includes only purchasers who can trace their lineage back to the offering "makes the result turn on mere accident since most trading is done through brokers who neither know nor care whether they are getting newly registered or old shares." *Id.* at 1383.

[54] The DTC, explained more thoroughly in the next section, is the organization founded in the 1970s to solve Wall Street's paperwork crisis. As preliminary background, the DTC holds all an issuing company's share in a fungible bulk or mass, allocating proportionate interests in the shares to brokers accounts which are all of a company's shares in one pool, or fungible mass. *DTCC History: 1970s*, DEPOSITORY TR. & CLEARING CORP., https://www.dtcc.com/annuals/history/1970s (on file with Columbia Business Law Review) (last visited Feb. 11, 2025).

[55] *See Kirkwood*, 590 F. Supp. at 1378–79.

[56] *Id.*

put, stock must be "directly purchased in the underwritten public offering."[57] This method is the most stringent and straightforward, requiring a clear chain of custody from purchaser to seller. Under this method, tracing relies on specific transactional indicators, such as broker records, prospectus receipts, purchase order notations, and special coding by brokerage firms.[58] While the direct trace model provides the most certainty, it is also the hardest to satisfy for many aftermarket purchasers.[59]

Ultimately, each tracing theory reflects an attempt to balance the practical realities of modern securities markets with the statutory framework of Section 11, yet each fall short. No court has adopted the contra broker, heritage, or fungible mass theories of tracing due to the common flaw present in all three methods: it reduces standing to a possibility rather than a certainty. Ultimately, "[Section] 11 . . . requir[es] more than a showing that a plaintiff's stock 'might' have come from the relevant offering."[60] Following the *Kirkwood* case, courts required plaintiffs to use the "direct trace" method, proving they purchased shares through the underwriter in the offering.[61] Without modern computational tools, aftermarket

[57] *See* Curnin & Ford, *supra* note 5, at 163.

[58] "…an indication of interest by the broker on behalf of the customer, the customer's receipt of a preliminary prospectus with a legend in red ink (called a 'red herring'), a notation on the purchase order ticket showing purchase in the offering, purchase at the offering price, lack of commission, language regarding the prospectus on the customer's confirmation slip, and special coding of the transaction by the brokerage firm." *Kirkwood*, 590 F. Supp. at 1378.

[59] Note that in *Kirkwood*, the court states that "[t]he direct trace method is the easiest method to understand and prove"; however, the court was not considering the potential impact on aftermarket purchasers. *Id.*

[60] *See, e.g.*, *In re* Quarterdeck Office Sys., Inc. Sec. Litig., No. CV. 92-3970, 1993 WL 623310, at *3 (C.D. Cal. Sep. 30, 1993) (emphasis added) (recognizing that courts have rejected a showing of "more probable than not" as sufficient to establish standing).

[61] Guenther v. Cooper Life Sciences, Inc., 759 F. Supp. 1437, 1439 (N.D. Cal. 1990) (determining that only plaintiffs who purchased "stock actually issued in the offering for which the plaintiff claims there was a false or misleading registration statement" can maintain a Section 11 claim); *see also* Abbey v. Comput. Memories, Inc., 634 F. Supp. 870, 874 (N.D. Cal. 1986) (dismissing plaintiff's claim due to failure to directly trace their shares to IPO).

purchasers were effectively excluded in the 1970s and 80s, as courts focused on those buying directly from underwriters.[62]

In 1995, *Gustafson v. Alloyd Co.* further restricted aftermarket purchasers' access to Section 11 protections, as the Supreme Court had limited Section 12(2) liability[63] to public offerings while classifying the two statutes as "neighbors."[64] Courts following *Gustafson* extended the reasoning to Section 11, reinforcing strict tracing requirements and excluding aftermarket purchasers.[65] This period was short-lived as the PSLRA's enactment and a surge in IPO activity in the 1990s led courts to reconsider direct tracing as overly restrictive.[66] Thus, a shift in jurisprudence emerged, recognizing that aftermarket purchasers had historically been granted standing and rejecting their categorical exclusion under Section 11.[67] In this trend of cases, courts held that tracing is

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[62] *See* Franklin Life Ins. Co. v. Commonwealth Edison Co., 451 F.Supp. 602, 607 n.1 (S.D. Ill. 1978) (stating that Section 11 "has been interpreted generally as being limited to damages for purchasers at the original offering, thus excluding those members of the plaintiff class who purchased in a secondary market") *aff'd*, 598 F.2d 1109 (7th Cir. 1979); *see also* Lorber v. Beebe, 407 F. Supp. 279, 287 (S.D.N.Y. 1975) (determining that shares acquired through open-market transactions cannot be traced directly to a specific registration statement, and consequently, aftermarket purchasers are not entitled to assert claims under Section 11.); Wolfson v. Solomon, 54 F.R.D. 584, 588 (S.D.N.Y. 1972) (stating that "only persons who purchased securities that are the direct subject of the prospectus and registration statement may sue under Section 11"); Langert v. Q-1 Corp., 1974 WL 377, at *6 (S.D.N.Y. 1974).

[63] Gustafson v. Alloyd Co., 513 U.S. 561, 578 (1995) (stating that it was not "plausible to infer that Congress created this extensive liability for every casual communication between buyer and seller in the secondary market" . . . it is often "altogether impractical, for those engaged in casual communications not to omit some fact that would, if included, qualify the accuracy of a statement.").

[64] *Id.* ("The intent of Congress and the design of the statute require that Section 12(2) liability be limited to public offerings.").

[65] *See, e.g.*, *In re* Summit Med. Sys., Inc., 10 F. Supp. 2d 1068, 1070 (D. Minn. 1998) ("Section 11 is applicable only to shareholders who acquired their stock in the IPO"); Gould v. Harris, 929 F. Supp. 353, 358–59 (C.D. Cal. 1996) (applying the *Gustafson* standard); Stack v. Lobo, 903 F. Supp. 1361, 1376 (N.D. Cal. 1995) (concluding "that § 11 is not applicable to aftermarket transactions").

[66] Sean Belcher, *Tracing the Invisible: Section 11's Tracing Requirement and Blockchain*, 16 COLO. TECH. L.J. 145, 153 (2017); s*ee also* Curnin & Ford, *supra* note 5, at 177.

[67] For example, District Courts viewed "tracing" as a crucial method for aftermarket participants to maintain Section 11 standing, disregarding the period

fundamentally a merits issue and should not bar claims from Section 11 liability at the outset, a view supported by both the Ninth[68] and Tenth Circuits, that allow aftermarket purchasers to bring suit if they can trace their securities to the registration statement.[69] Despite this recognition, courts have not developed a coherent method to address tracing challenges in today's complex markets, underscoring the need for legal modernization.

While the fundamental intent of the legislation has remained unchanged, and there is evidence that it was well-understood amongst early cases, the confusion and misinterpretation in jurisprudence introduced by modern market dynamics reinforces the need for a corresponding modernization of the mechanisms used to determine standing. Addressing these tracing issues requires innovative solutions that align with the realities of contemporary markets, representing a critical step toward achieving the statute's original purpose in today's financial environment. This is critical in a post-*Slack* world, where any divergence from the strict tracing model was deemed incompatible with legislative intent.

C. *The Pivotal Case of* Slack Technologies, LLC et al. v. Pirani

On June 1, 2023, the Supreme Court decided a case concerning the applicability of the tracing requirement under Section 11 to direct stock listings—a niche ruling with significant implications for securities regulation. The case originated from Slack Technologies' decision to go public; on June 20, 2019, Slack listed its shares and opted for a direct listing, ditching the IPO and

of divergence which preceded the case. Belcher, *supra* note 66, at 153–54 (2017); *see also* Curnin & Ford, *supra* note 5, at 177.

68 *See* Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076, 1080 (9th Cir. 1999). The United States Court of Appeals for the Ninth Circuit stated that the *Gustafson* Court "gave no indication that it intended [restrictions on standing] to apply to Section 11." *Id.* The Ninth Circuit zoned in on the phrasing "any person acquiring such security," citing to *Barnes* and endorsing a broad application for the tracing doctrine. *Id.* at 1080 n.4.

69 *See* Joseph v. Wiles, 223 F.3d 1155, 1161 (10th Cir. 2000) (rejecting the argument that *Gustafson* has limited Section 11 standing and reaffirming that allowing secondary market purchasers standing is consistent with explicit statutory language and legislative spirit).

sidestepping the traditional underwriting process.[70] In its direct listing, 290 million shares became available for public trading, yet less than half of the total shares, about 118 million, were registered shares under Slack's filing.[71] This mix of registered and unregistered shares was made possible by an SEC-approved exemption under Rule 144A, which allowed certain shares to remain unregistered yet still be sold lawfully.[72]

Following the direct listing, an investor and aftermarket purchaser, Pirani, brought his claims to the U.S. District Court for the Northern District of California, arguing that the registration statement made by Slack prior to its direct listing was inherently misleading and that it had omitted material information.[73] Slack sought to dismiss the claims of the class action, arguing that lead plaintiff Pirani lacked standing as he bought shares in a direct listing that included both registered and unregistered shares.[74] Ultimately, Slack contended that this mere fact made it impossible to confirm whether those shares stemmed from the allegedly misleading registration statement.[75] The District Court denied Slack's motion,

70 The methodology of a direct listing is inherently different from an IPO, including the fact that the issuer does not receive the benefit of all the capital proceeds from the transaction, making it more like an open-market exchange where unknown buyers and sellers engage in transactions at a market-clearing price. Baumstein et al., *supra* note 17, at 272.

71 Slack Techs., LLC v. Pirani, 598 U.S. 759, 764 (2023).

72 Direct listings permit previously private company shareholders to sell their shares publicly. Among these shareholders are issuer affiliates, defined by SEC Rule 144 as those who control, are controlled by, or share control with the issuer. While affiliates must register their shares before selling, non-affiliates may sell shares in a private or newly public company without registration if they have held them for one year. Facilitating the lengthy registration process, private companies register *only the shares* of the affiliates and those that do not meet the one year holding period requirement, allowing both registered and unregistered shares entering the market. 17 C.F.R. § 230.144. Control is typically defined as the "the power to direct the management and policies of the company in question, whether through the ownership of voting securities, by contract, or otherwise." 17 C.F.R § 230.405.

73 Mainly, Pirani alleged that Slack omitted that it was obligated to pay all customers' service credits whenever Slack's service was disrupted and the frequency of such disruptions. Furthermore, it was alleged that Slack had downplayed the competition it faced from Microsoft Teams. Pirani v. Slack Techs., Inc., 13 F. 4th 940, 944 (9th Cir. 2021).

74 *Slack,* 598 U.S. at 765.

75 *Id.*

finding that in a direct listing, all shares are of the same nature and thus can be purchased "pursuant to" or traceable to the registration statement.[76] Slack then obtained interlocutory appeal.[77]

In an expansive reading of Section 11's tracing requirement, the Ninth Circuit (over a dissent) upheld the denial on different grounds. The Ninth Circuit reasoned that since no shares could have traded before the effective date of the registration statement, even unregistered shares were deemed to be purchased pursuant to the faulty registration statement.[78] Influenced by policy, the court reasoned that a strict tracing requirement in direct listings could eliminate Section 11 liability, incentivizing companies to avoid traditional IPOs.[79] Slack petitioned the Supreme Court.

In its review, a unanimous Supreme Court struck down any future divergence from the strict tracing requirement for new developments such as direct listings, reaffirming that standing under Section 11 requires the securities held by the plaintiff to be traceable to the faulty registration statement alleged to be false or misleading.[80] In a simple statutory construction exercise, the Court vacated the Ninth Circuit's broad understanding of "such security," reasoning that the statute includes a "definite article to reference the registration statement alleged to be misleading, and in this way seems to suggest the plaintiff must "acquire such security" under that document's terms."[81]

As seen by decades of jurisprudence and affirmed in *Slack*, Section 11 relief is reserved for those who acquired securities under the faulty registration statement, reflecting legislative intent and necessitating strict tracing. However, modern market conditions force many groups—particularly aftermarket purchasers like investor Pirani—to risk forfeiting their Section 11 rights without extensive discovery, leaving their standing subject to judicial discretion on lifting discovery stays.[82] Even when settlements are

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[76] *Id.*

[77] *Id.*

[78] "All of Slack's shares sold in this direct listing, whether labeled as registered or unregistered, can be traced to that one registration." Pirani v. Slack Techs., Inc., 13 F.4th 940, 947 (9th Cir. 2021) *vacated and remanded sub nom.*, 598 U.S. 759 (2023).

[79] *Id.* at 948.

[80] *Slack*, 598 U.S. at 760–61.

[81] *Id.* at 766–67.

[82] Coffee & Mitts, *supra* note 19, at 31–32.

reached, claim dilution remains a major concern; administrators often struggle to distinguish valid, traceable claims from those that are untraceable or illegitimate. In doing so, they frequently resort to the statistical, speculative reasoning that was rejected in *Slack*, thereby straying from the strict tracing standards mandated by legislative intent.

D. *Structural Hurdles Posed to Aftermarket Purchasers*

The primary issue in today's tracing cases, one that should play a more prominent role in the settlement world, is whether aftermarket purchasers can successfully trace their shares to the registration statement.[83] To fully grasp the challenges the strict tracing framework presents for certain plaintiff groups, one must first appreciate the mechanics of the modern securities market.

1. *The Evolution of Securities Holding and the Challenges of Tracing*

Since aftermarket purchasers do not acquire their shares directly through the offering, they face greater challenges in meeting the tracing requirement due to practical challenges of recordkeeping practices. The securities regulatory framework of 1933 was designed around the assumption that possession and delivery of physical certificates were the primary mechanisms for securities holding and trading.[84] Thus, while the intent of Section 11 is mostly clear, translating that intent into the modern era has proved challenging, particularly given that its framers crafted the law against the backdrop of an entirely different system. The evolution to an electronic, commingled securities system has introduced complexities that the drafters could not have foreseen, rendering the application of their original vision increasingly fraught with uncertainty.[85]

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[83] Cunningham et al., *supra* note 1.

[84] *Id.*

[85] For example, while some have concluded that the current system makes tracing impossible, others have pushed back, arguing that while these notions may have been true in the 1970s, modern computational abilities have transformed the landscape and have made tracing possible. *See infra* Part IV (discussing tracing in the direct-payment model).

The Depository Trust Company (DTC) was created in 1973, modernizing the way in which securities are transferred and held in accounts.[86] Prior to 1973, ownership of securities was evidenced by possession of certificates, and transfers of ownership required the physical delivery of these certificates.[87] For registered securities, transfers involved surrendering the certificates to the issuer or its transfer agent for registration.[88] This certificate-based system was labor-intensive and cumbersome: companies used a manual record-keeping system consisting of three books: the transfer book, where share transfers were recorded; the stock certificate book, containing details of issued certificates; and the stock ledger, tracking each shareholder's credits and debits for transferred shares.[89] Each transaction required the movement of physical certificates, creating inefficiencies that were unsustainable during the economic boom following World War II, leading to the "paperwork crisis" of the late 1960s.[90] With that system in place, ten million shares of daily activity constrained the settlement system.[91]

In response to the crisis, Congress eliminated the need for a physical system of clearance and settlement with an amendment to the Securities and Exchange Act, thus beginning "dematerialization."[92] The Depository Trust and Clearing Corporation (DTCC) and its subsidiaries, the DTC and the National Securities Clearing Corporation (NSCC) replaced manual

[86] *See* Belcher, *supra* note 66, at 155–56.

[87] *Id.*

[88] *See* U.C.C. ART. 8, Prefatory Note pt. I.A. (A.L.I. & UNIF. L. COMM'N 1994).

[89] Kevin V. Tu, *Blockchain Stock Ledgers*, 96 IND. L.J. 223, 232–33 (2020).

[90] *See* Belcher, *supra* note 66, at 155–56.

[91] U.C.C. ART. 8, Prefatory Note, *supra* note 88; *see also* Belcher, *supra* note 66, at 155 ("The volume of shares traded on the NYSE increased from approximately one to two million shares per day in December 1949 to ten to twenty million per day in July 1968.").

[92] Securities Acts Amendments of 1975, sec. 15, § 17A(a)(2), 89 Stat. 97, 141 (codified at 15 U.S.C. § 78q-1(a)(2)(A)(i)); *see also* VIRGINIA B. MORRIS, GUIDE TO CLEARANCE AND SETTLEMENT: AN INTRODUCTION TO DTCC 1, 14 (2021), https://static1.squarespace.com/static/5afc7c9d12b13fd2d1e912bb/t/632090504d38ae2ecc5709f2/1663078486818/DTCC-ClearanceSettlement_2021.pdf [https://perma.cc/5ZHR-SRA9] (". . . the industry has made substantial progress eliminating paper certificates, a process known as dematerialization.").

handling of physical certificates with an electronic book-entry system, centralizing the process nationally and significantly enhancing trade settlement efficiency.[93] In this streamlined system, the NSCC serves as the sole clearinghouse by matching orders, facilitating settlements, and guaranteeing payments, while the DTC functions as the central depository, holding securities in a fungible bulk pool for brokers and banks.[94]

At a high-level overview, when a purchaser acquires a share from a seller in the United States, these shares are "immobilized" at the DTC, meaning that physical certificates are no longer transferred in transactions, and ownership is transferred electronically.[95] First, certificates are deposited with the DTC, which designates legal title to the securities to Cede & Co. (C&C), a nominee entity.[96] While legal title is held by C&C, the DTC maintains electronic records of beneficial ownership for market participants, who hold the immobilized security in a "street name."[97] When a transaction occurs, the NSCC settles it by debiting and crediting the transacting parties' DTC accounts.[98] Consequently, an indirect holding system is created; brokers who are DTC members (broker-dealers and banks) do not hold legal title but have a proportional interest of the fungible bulk of shares held by the DTC and owned by C&C.[99] The fungible bulk ownership form ensures that securities are interchangeable and can be replaced by "another security from the pool of securities deposited with

[93] Morris, *supra* note 92, at 6 ("NSCC offers as a central counterparty (CCP). NSCC receives trades in near-real-time and, after validation, guarantees them. As the CCP, NSCC becomes the buyer for every seller and the seller for every buyer. At that point, regardless of what happens to either of the trading parties, NSCC guarantees trade completion.").

[94] *Id.*

[95] *Glossary of Terms*, DEPOSITORY TR. & CLEARING CORP. https://dtcclearing.com/helpfiles/cross_bus/glossary/Content/Topics/gloss.htm [https://perma.cc/49LF-2WEL] (last visited Jan. 15, 2024) ("Immobilization occurs when securities certificates are placed in the custody of a central securities depository to reduce the movement of physical securities. Ownership records for immobilized securities are updated electronically using a book-entry system, first at the CSD and then at the participant firms whose clients are the beneficial owners.").

[96] Morris, *supra* note 92, at 14.

[97] *Id.*

[98] *Id.*

[99] Coffee & Mitts, *supra* note 19, at 12–13.

DTC and owned by Cede & Co., and therefore shareholders have only a fractional interest in that larger pool."[100] Accordingly, the electronic book-entries update ownership, improving efficiency within the marketplace. With this system in place, the market can support a daily volume of upwards of hundreds of millions of shares.[101]

Building on this high-level overview, the transactional process unfolds as follows: when investors or investment advisers (third-party asset managers) decide to trade a stock, they place an order with a broker to buy or sell.[102] The broker receiving the order may execute the trade directly or pass the order to another broker-dealer for execution; the broker which executes the trade is deemed the "executing broker."[103] The executing broker matches the trade on the "trade date."[104] After the transaction is matched between the buyers and the sellers, the trade information is automatically sent to the NSCC, which validates the transaction.[105] The NSCC legally binds the parties to complete the transaction. Upon trade execution, NSCC steps in as a "central counterparty" (CCP) to the transaction, backing up the trade if either party cannot deliver their corresponding obligation. At this point, the obligation has not yet been fulfilled. On settlement date,[106] the DTC transfers securities electronically "from the selling firm's account to NSCC's account

[100] *Id.* at 13.

[101] U.C.C. ART. 8, Prefatory Note, *supra* note 88.

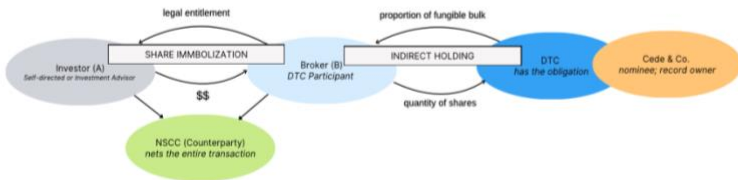
[102] Will Kenton, *Understanding Executing Brokers: Roles, Process, and Key FAQs*, INVESTOPEDIA (Dec. 24, 2025), https://www.investopedia.com/terms/e/executingbroker.asp [https://perma.cc/62J8-26FK].

[103] *Id.*

[104] *Understanding Settlement Cycles*, FINRA, https://www.finra.org/investors/insights/understanding-settlement-cycles [https://perma.cc/HNA4-L7KT] (last visited Feb. 11, 2025) ("Trade date is the day your order to buy or sell a security is executed . . .").

[105] Morris, *supra* note 92, at 13 ("these locked in trades mean that the marketplace compared them at the time of execution, confirming all details, including share quantity, price, and security.")

[106] FINRA, *supra* note 104 ("Settlement date is the day your order is finalized and on which funds and the securities must be delivered. As of May 28, 2024, the standard for settlement is next business day after a trade, or T+1.").



at DTC, and then from NSCC's account to the buying firm's account."[107] Once funds and securities are exchanged between the DTC and the participating broker, the transaction is completed.

2. *Scholarly Debate Regarding Possibility of Tracing for Certain Plaintiff Groups*

The consensus in some legal academic circles is that this methodology of proportional interest destroys an aftermarket purchaser's ability to trace their shares to the registration statement.[108] Academics have argued that when a share enters the fungible bulk, it loses its identity and therefore cannot be traced as most brokerage firms lack the necessary records to enable shareholders to link their shares to a specific securities offering.[109] If true, this would eliminate Section 11 standing for all aftermarket purchasers. However, this line of thought is largely outdated and consistent with unhelpful, cemented legal myths of the 1970s prior to modern computational abilities.

Legal scholars, Joshua Mitts and John C. Coffee, professors at Columbia Law School, amongst the minority, have maintained that there is a way to make tracing possible, arguing that: (1) there are "continuous time-stamped transactional records" that are

[107] Morris, *supra* note 92, at 12.

[108] *In re* Initial Pub. Offering Sec. Litig., 227 F.R.D. 65, 118 (S.D.N.Y. 2004) ("The modem practice of electronic delivery and clearing of securities trades, in which all deposited shares of the same issue are held together in fungible bulk, makes it virtually impossible to trace shares to a registration statement once additional unregistered shares have entered the market."); *see also* Abbey v. Comput. Memories, Inc., 634 F. Supp. 870, 873–76 (N.D. Cal. 1986) (granting summary judgment in situation where commingling of shares had occurred, and Section 11 tracing was deemed impossible).

[109] George S. Geis, *Traceable Shares and Corporate Law*, 113 NW. U. L. REV. 227, 229 (2018).

mandated by law to be maintained[110] and thereby (2) there is a tracing methodology involving standard accounting procedures that can track the settlement of trades that is possible with a particularized subpoenaing of broker records.[111] Notably, this approach has yet to be accepted in courts, yet could provide a first step in the right direction of pushing innovation within this sphere and in reclaiming Section 11 rights for aftermarket purchasers.[112]

III. MOVING BEYOND THE MOTION TO DISMISS: TRACING ISSUES IN SETTLEMENT

From 1997 to 2022, *forty-six percent of core federal securities lawsuits settled*, forty-three percent were dismissed, 0.5 percent were remanded, and 0.4 percent went to trial.[113] However, much of the existing literature on the tracing issue has primarily examined its implications for litigation, particularly at the motion to dismiss stage. An equally concerning issue is the tracing obstacle within the settlement landscape, where challenges that arise in the courtroom regarding tracing have the potential to compound existing securities class action inefficiencies.

The preceding section of this Note provided the foundational material to demonstrate a misalignment between the modern securities regime and the tracing requirement by examining how courts have increasingly struggled to reconcile clear legislative intent with the realities of evolving financial markets. When courts have deviated from the strict proof of registration envisioned by the statute's framers, the Supreme Court clarified these misconceptions in *Slack*, reaffirming the necessity of the tracing requirement, despite known hurdles for aftermarket purchasers presented by the

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110 *See, e.g.*, 17 CFR § 240.17a-3(a)(6) (2026) (delineating that broker-dealers must maintain records of "the time the order was received, the time of entry, the price at which executed, the identity of each associated person, if any, responsible for the account . . . and, to the extent feasible, the time of execution or cancellation").

111 Coffee & Mitts, *supra* note 19, at 21–22.

112 Addressed *infra* Part IV.

113 James K. Goldfarb et al., *Securities Class Actions: Data, Trends, and Insights*, DAVIS WRIGHT TREMAINE LLP (Mar. 13, 2023), https://www.dwt.com/blogs/financial-services-law-advisor/2023/03/securities-class-actions-data-trends-2022 [https://perma.cc/B3YV-Z4PS].

modernizing financial economy. The challenges plaintiffs encounter in proving their claims during litigation evolve into distinct hurdles in the settlement phase, where the realities of administering compensation take over.

The *Slack* decision underscores the critical importance of the strict tracing requirement for ensuring that those eligible for recovery, those which hold registered shares and have the "golden ticket," receive their due compensation. It is thereby crucial that Section 11 settlement proceedings, operating under a flexible standard of fairness, adequacy, and reasonableness, do not allow probabilistic methods to shape allocation decisions.

This section of the note will foreshadow the practical difficulties of tracing within the confines of settlement, showing that eligible plaintiffs in the aftermarket are caught in a no-win situation. If eligible claimants are disenchanted in collection of their settlement funds by the heavy burden of compiling records of their standing and do not submit their claims, they forfeit their rightful share. Yet, even if eligible claimants navigate the arduous process of gathering and submitting documentation, claims administrators lack the means to validate shares, ultimately blurring the distinction between registered and unregistered securities, meeting only the lenient "fair, adequate, and reasonable" standard, and diluting recoveries by admitting ineligible claimants.

A. *The Settlement Process*

Securities settlements follow a typical route within securities class actions involving a four-step process: (1) negotiating a settlement; (2) seeking preliminary court approval; (3) obtaining court approval; and (4) the claims administration process.[114] Put simply, the settlement process can be understood in two parts: (1) the negotiation and approval of the settlement terms and agreement, and (2) the allocation and distribution of settlement funds to eligible class members.[115]

[114] *The Multiple Stages of Securities Litigation*, FEDERMAN L. FIRM, https://www.federmanlaw.com/wp-content/uploads/2018/03/TheMultipleStagesofSecuritiesLitigation.pdf [https://perma.cc/9BXV-KKJL] (last visited Feb. 11, 2025).

[115] *Id.*

Firstly, negotiations will begin regarding the gross settlement amount, at which point the defendant and class counsel will negotiate the value of the case.[116] Common fund settlements are typical of securities actions, meaning that the defendant negotiates the total cost of the settlement they will pay, known as the common fund, which becomes the pool from which all settlement expenses become deducted.[117] This ultimate settlement figure is representative of an aggregate discount due to risk of plaintiffs losing at trial and other factors, including those specific to the case itself.[118]

Once the parties come close to finalizing a settlement agreement, the claims administrator and economic experts work on drafting a *proposed plan of allocation*, calculating the damages by measuring the exact impact of the company's fraud on the price of the securities at numerous points during the class period.[119] The damage impact is eventually split up into a *pro rata* allocation, dependent on the number of eligible class members.[120] Upon completion of the settlement agreement and the plan of allocation, plaintiffs' counsel bring these documents to court for preliminary approval.[121] After preliminary approval, the claims administrator must now make efforts to notify individuals that are eligible for fund collection—both known and unknown class members.[122] If the Court preliminarily approves the proposed settlement, the second step is a "fairness hearing to determine whether the

[116] Litigation Practice at Pierce Atwood LLP, *Settlement Structures, Residual Funds, Attorneys' Fees, and Reverters: Part I*, NAT'L L. REV. (Dec. 15, 2021), https://natlawreview.com/article/settlement-structures-residual-funds-attorneys-fees-and-reverters-part-i [https://perma.cc/8JGQ-7WAZ] (last visited Feb. 11, 2025).

[117] *Id.*

[118] "Besides the possibility of success, the parties should weigh the possibility of an adverse verdict and the cost of settlement against the cost of getting to verdict, which includes attorneys' fees and, if relevant, applicable prejudgment interest." Gregory A. Markel et al., *Settling Securities Class Actions*, WESTLAW W-024-4806 (last visited Feb. 11, 2025).

[119] Jessica Erickson, *Automating Securities Class Action Settlements*, 72 VAND. L. REV. 1817, 1825–27 (2019).

[120] *Id.*

[121] *Id.*

[122] *Id.*

settlement is 'fair, reasonable, and adequate' for all class members and thus should receive final approval."[123]

1. *Rule 23(e)(2): "Fair, Reasonable, and Adequate"*

While Rule 23 of the Federal Rules of Civil Procedure mandates that class action settlements be "fair, reasonable, and adequate," the current approach to Section 11 settlements fails to meet this standard due to fundamental tracing deficiencies.

Rule 23 states as follows: "If the [settlement] proposal would bind class members, the court may approve it only after a hearing and only on finding that it is fair, reasonable, and adequate."[124] Courts approving settlements must confirm that the relief under the settlement, among other factors, is "adequate," taking into account:

> (i) the costs, risks, and delay of trial and appeal; (ii) the effectiveness of any proposed method of distributing relief to the class, including the method of processing class-member claims; (iii) the terms of any proposed award of attorney's fees, including timing of payment; and (iv) any agreement required to be identified under Rule 23(e)(3).[125]

Furthermore, settlements must fulfill Rule 23(e)(2)(D), affirming that there is equitable treatment of all class members in relation to one another.[126]

Importantly, the "relative degree of importance to be attached to any particular factor will depend upon and be dictated by the nature of the claim(s) advanced, the type(s) of relief sought, and the unique facts and circumstances presented by each individual case."[127] Yet, in Section 11 cases, the current

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[123] Starr v. Credible Behav. Health, Inc., No. CV 20-2986 (PJM), 2021 WL 2141542, at *5 (D. Md. May 26, 2021) (quoting Manual for Complex Litigation § 21.634); *see* Grice v. PNC Mortg. Corp. of Am., No. CIV. A. PJM-97-3084, 1998 WL 350581, at *2 (D. Md. May 21, 1998).

[124] FED. R. CIV. P. 23(e)(2)(A)–(D).

[125] *Id.*

[126] FED. R. CIV. P. 23(e)(2)(D).

[127] Offrs. For Just. v. Civ. Serv. Comm'n of City & Cnty. of S. F., 688 F.2d 615, 625 (9th Cir. 1982), *cert. denied*, 459 U.S. 1217 (1983).

methodology for assessing class-member claims and distributing settlement funds does not align with this standard, as the high likelihood of misidentifying eligible claimants undermines the adequacy of relief. Ultimately, the same tracing obstacles that complicate litigation resurface in the settlement process of negotiation and approval, leading to distorted recoveries that fail to satisfy the statutory objectives of Section 11 and deprive investors of meaningful compensation.

a. Barriers for Claim Administrators and Issuers in Making Equitable Judgements

Unlike with Section 10b-5, Section 11 claims administrators face increased hurdles in identifying the class members. This is because class members in Section 11 suits are required: (1) to be beneficial owners of the stock purchased within the relevant period and (2) to have bought shares directly traceable to the registration statement.[128] However, claims administrators do not have a list for the members eligible for collection of the settlement funds, nor do they have access to any centralized database of information that can track down the class members, especially not to the level of registration.[129] Instead, an indirect and diffuse process ensues: firms will send notices of settlement and accompanying claim forms that individual investors must complete and return to claim administrators to receive their share of the proceeds.[130]

This inefficient process is a consequence of the disconnect between the financial system and the legal regime, resulting in an informational barrier between the holders of this information and stakeholders. Claims administrators cannot directly obtain data from DTCC or other securities intermediaries because DTCC's role is limited to clearing and settling trades at the broker level while the information central to this process is the beneficial ownership of the shares.[131] While DTCC ensures the transfer of funds and shares between brokers, as well as keeping records of the banks and

[128] *See, e.g.*, Slack Techs., LLC v. Pirani, 598 U.S. 759, 767–68 (2023).

[129] Erickson, *supra* note 119, at 1833.

[130] *Id.* at 1826.

[131] As explained in section II.D, shares at the DTCC are technically owned by Cede & Co. Brokers and banks have records of the beneficial owners of these shares that have *legal entitlements* rather than true ownership of the shares. Erickson, *supra* note 119, at 1836.

brokers, it does not maintain records of the individual customers (beneficial owners) on whose behalf trades are executed.[132] This information resides solely with individual banks and brokers, creating a dispersed system of record holding within hundreds of proprietary databases across the country.[133] Not only is this recordkeeping incredibly dispersed and subject to various obstacles in its collection, but these institutions are also under no obligation to provide claims administrators with this data.[134] This current situation leaves claims administrators in an increasingly difficult position to identify which beneficial owners purchased shares at inflated prices during the relevant class period. As a result, the dispersed and inaccessible nature of this critical information complicates the tracing of ownership and injuries, which is essential for determining eligibility for settlement distributions under Section 11.

While the logical solution to this might be to compel defendants to provide such information about their registered shareholders, they are also subject to severe informational barriers.[135] Rather than the names of the beneficial owners, corporations only have registered owners on their books, Cede & Co., maintaining access to only a limited set of shareholder information from DTCC.[136] While corporations can get limited lists of their non-objecting beneficial owners, known as "NOBO lists," this data is only for moments in time, and they are severely limited in utilizing this information.[137] Moreover, these lists still do not provide a record of the owners' purchases and sales of the corporation's stock, which is particularly the information of interest in calculating *pro rata* share distribution in the plan of allocation. [138]

[132] Joseph A. Grundfest, Morrison, *the Restricted Scope of Securities Act Section 11 Liability, and Prospects for Regulatory Reform,* 41 J. CORP. L. 1, 14–15 (2015) ("The participants in the process only know the name of the broker, bank, or other 'street' entity at which the account is being held.").

[133] Erickson, *supra* note 119, at 1835.

[134] *Id.* at 1835–36.

[135] "Corporations have far less information about their shareholders than one might guess . . . typically a trust company called Cede and Company ('CEDE') is listed as the registered owner of nearly all of the corporation's shares." Erickson, *supra* note 119, at 1833.

[136] Specifically, they can request the "CEDE list," which discloses the banks and brokers for whom CEDE holds shares. *Id.*

[137] *Id.* at 1834.

[138] *Id.*

b. Lack of Methods of Claims' Verification Leads to Compounded Dilution

The issue in Section 11 claims extends beyond plaintiffs' difficulty in obtaining detailed broker records to substantiate losses on the front end. It also lies in claims administrators' inability to independently validate submissions on the back end, leading to lower verification standards and diluted recoveries. Ultimately, the tracing requirement has not been considered in these plans of allocations,[139] allowing potentially ineligible claimants into the pool through the more lenient standard of "fair, adequate, and reasonable," rather than the preponderance of evidence standard required at trial. Lowering the evidentiary standard eliminates the need for tracing, removing a key barrier that reserves the right of recovery to registered shareholders. As a result, the settlement fund is capped by statute, discounted by projected litigation costs and probability of success at trial, and further undergoes structural dilution as the loosening of tracing requirements allows ineligible claimants into the pool. The difficult question of tracing is thereby side-stepped at the claims administration level, undermining the statutory protections intended for registered shareholders and reducing their rightful recovery.

In understanding the process of structural dilution, the focus of the inquiry will be the common fund settlement structure, as it is the most prevalent in securities settlement class actions. In this structure, class members submit their claim forms and validated forms receive *pro rata* shares of the common fund.[140] Thus, the amount each claimant receives can be mathematically reduced to "a function of the number of claims," ensuring that the entire fund is equally distributed.[141] As discussed prior, the total amount available for recovery is negotiated prior to the plan of allocation. Consequently, it follows that if claims administrators were to allow more claims to be eligible for recovery, exceeding the number of

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[139] *Id.* at 1825–26, 1836.

[140] Elizabeth Cabraser & Andrew Pincus, *Claims-Made Class-Action Settlements*, 99.3 JUDICATURE 81, 81 (2015), https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1002&context=judicature [https://perma.cc/TWG8-HY2E].

[141] *Id.*

registered shares issued under the faulty registration statement, then there would be a dilution of the per-share recovery.

2. *Section 11 Settlements as they Stand – Not "Fair, Adequate, Reasonable"*

It is difficult to see how a Section 11 settlement, post-*Slack*, could be deemed fair, reasonable, and adequate if it fails to account for the most critical distinction between claimants: their registration status.[142]

Firstly, it is unfair. The procedural fairness prong requires that the settlement "be the result of arm's-length negotiations and that plaintiffs' counsel have possessed the experience and ability, and have engaged in the discovery, necessary to [effective representation] of the class's interests."[143] Negotiation processes are presumed fair when these elements are present. However, in Section 11 settlements, post-*Slack*, the necessity of discovery extends beyond traditional fact-finding; it is essential for accurately assessing claimant eligibility and preventing dilution of legitimate recoveries. A settlement process that lacks sufficient discovery into claimant eligibility fails to ensure an equitable allocation of funds in the settlement process and cannot be deemed fair under Rule 23(e).

Secondly, it is inequitable and inadequate, directly contravening Rule 23(e)(2)'s requirement that courts ensure equitable treatment of class members and provide adequate relief. The failure to account for tracing in allocation plans suggests that dilution is not merely a byproduct of the settlement but is a structural flaw. If Section 11 settlements treat all claimants as equally entitled, regardless of their ability to meet the statutory tracing requirement, there is an overinclusion which results in legitimate shareholders receiving significantly reduced recoveries.

Thirdly, it is unreasonable. Plans of allocation for a class settlement fund involving *pro rata* distribution of the settlement proceeds based on investment loss have been held to be

[142] *See In re* BankAmerica Corp. Sec. Litig., 210 F.R.D. 694 (D.C. Mo. 2002) (refusing to approve the settlement due to an unfair, unreasonable, and inadequate plan of allocation for the October 1998 Delaware bank stock purchasers who held shares through December 31, 1998. The court found that only the October purchasers were entitled to rescissory damages, yet the allocation plan failed to properly reflect this distinction.).

[143] Weinberger v. Kendrick, 698 F.2d 61, 74 (2d Cir. 1982).

presumptively reasonable.[144] However, such reasonability can be questioned when it disregards the fundamental distinction necessary to that distribution: the distinction between registered and unregistered shares. A *pro rata* distribution that fails to differentiate between registered and unregistered shareholders effectively nullifies the statutory tracing requirement, allowing ineligible claimants to dilute the recovery of those with legitimate claims. This not only undermines the statutory framework of Section 11, but also fails the Rule 23(e) reasonableness standard, which requires that the settlement appropriately reflects the strengths and weaknesses of individual claims rather than applying a mechanically uniform allocation that disregards statutory eligibility criteria.

3. *Placing Burden on Passive Claimants is Ineffective and Inefficient*

The logical solution for some may be to require that passive claimants submitting forms ensure their documentation is sufficiently robust to meet the direct-tracing requirement. However, this approach is plagued with challenges. Not only does it impose additional burdens on claimants who may lack the resources to secure comprehensive records, but it also introduces another obstacle to an already faulty settlement process. While this is not the focus of this Note, it is worth briefly mentioning that across all securities class action settlements, there are low claims filing rates amongst institutional investors due to reasons including: rational apathy, a lack of awareness of the requirement[145] and absence of designated oversight.[146] Instead of shifting this burden onto those who have already struggled to meet the standard, it is necessary to have a better incentive-aligned solution that fulfills the settlement standard of fairness, adequacy, and reasonableness.

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144 *In re* Merrill Lynch Tyco Research Sec. Litig., 249 F.R.D. 124, 135 (S.D.N.Y. 2008).

145 Institutional investors often assume that this process will be completed for them by their brokers, unaware that the burden is on them to complete the claims return forms. *See, e.g.*, *id.* (plaintiff objected to a settlement on the basis that, "in order to submit a valid proof of claim form, he is required to find certain financial records he claims that he does not possess and does not know how to find.").

146 Erickson, *supra* note 119, at 1828.

IV. PROVIDING SOLUTIONS WITHIN THE CONFINES OF "FAIR, ADEQUATE, AND REASONABLE"

An injured shareholder unable to meet Section 11's stringent tracing requirement may consider pursuing a Section 10(b) claim. While specific data quantifying the frequency of standalone Section 11 claims is limited,[147] it is widely recognized in securities litigation that Section 11 claims are often filed amongst numerous other claims such as Section 10b-5 claims because of the complementary nature of the claims, as well as plaintiffs seeking to maximize their chances at recovery with multiple claims.[148] Recent statistics underscore the relative rarity of standalone Section 11 claims through showing a decrease in Section 11 claims on their own.[149] This decline suggests that Section 11 claims are frequently accompanied by other allegations, perhaps as part of a broader litigation strategy.

While most securities settlements involve a common fund that distributes recovery across both Section 10(b) and Section 11 claims, there are rare instances where Section 11 cases proceed independently. In these rare instances, the distinction between registered and unregistered shares becomes a critical factor in settlement distribution and allocation, as the tracing requirement directly impacts claim eligibility.

A. *Potential Solution to Dilution in Section 11 Settlement Cases*

Despite their rarity, a more precise and structured approach is necessary to ensure that standalone Section 11 settlements align with the standards of fairness, adequacy, and reasonableness under Rule 23(e). By addressing the issue of verifying claim eligibility and

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147 *Securities Class Action Filings 2023 Year in Review*, CORNERSTONE RSCH. 1, 15 (2024), https://www.cornerstone.com/wp-content/uploads/2024/01/Securities-Class-Action-Filings-2023-Year-in-Review.pdf [https://perma.cc/W6MA-GK92] (the share of core federal filings with Section 11 claims decreased from 21% in 2022 to 8% in 2023).

148 *See* 15 U.S.C.A. §§ 77k, 78j (Section 10(b) addresses broader fraudulent activities, while Section 11 focuses specifically on material misstatements or omissions in registration statements).

149 CORNERSTONE RSCH., *supra* note 147 (the share of core federal filings with Section 11 claims decreased from 21% in 2022 to 8% in 2023. Ninety-four percent of core federal filings in 2023 contained a Rule 10b-5 claim, highlighting the predominance of these claims in securities litigation.).

the risks of dilution posed by the strict tracing requirement of *Slack* and legislative intent, an improved methodology can help refine settlement allocation, ensuring that investors with legitimate Section 11 claims receive appropriate and equitable treatment within the settlement process.

Necessary to accomplish these goals is a realignment of incentives among parties involved in the settlement process. Decades of litigation have failed to resolve the challenges posed by the tracing requirement, and neither Congress nor the SEC has taken action to amend or modernize the nearly century-old securities framework to better reflect the realities of today's markets.[150] The modernization of financial technology seems to be the core of the struggle to implement the tracing requirement envisioned by courts. Given the absence of regulatory intervention, the most immediate and viable path to relief in standalone Section 11 cases lies with the judiciary, making judicial oversight and reform in settlement practices critical. Just as the judiciary introduced the tracing requirement to address the structural gap between modern economic reality and the goals of Section 11, it can address the modern technology issue by adapting the legal framework to better align with economic realities.

1. *Direct Payment as the "Fair, Reasonable, and Equitable" Settlement Distribution Structure*

Within the consumer class action landscape, there has been ongoing debate over the appropriateness of direct-payment versus the traditional claims-made settlement structures,[151] a discussion that may initially seem unrelated to the issues arising in Section 11 securities settlements. However, at their core, both debates revolve around the efficiency, fairness, and adequacy of settlement distributions. These debates involve whether claimants are properly identified, whether funds are equitably distributed, and whether structural inefficiencies lead to dilution or under-compensation. Understanding these broader settlement allocation principles can provide valuable insights into how Section 11 settlements processes, particularly ones involving standalone cases, might be restructured to ensure more equitable outcomes.

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150 *See supra* Part III.

151 *See, e.g.*, Cabraser & Pincus, *supra* note 140, at 82–83, 86.

a. Direct-Payment vs. Claims-Made Structure vs. Common Fund

To contextualize this solution, it is essential to first examine the distinctions between various settlement structures and identify those most utilized in securities litigation. Claims-made settlements are commonly used in retail consumer class actions, where defendants lack sufficient records to identify purchasers or determine the volume of their transactions.[152] As a result, class members take affirmative steps, such as submitting claims, to secure their portion of the settlement. In claims-made settlements, each submitted claim effectively increases the total payout required from the settlement fund, like adding individual charges to a receipt.[153] Unlike common-fund settlements, where the total amount is fixed and divided among all claimants, claims-made settlements do not have a predetermined total payout; instead, the final amount depends on the number of validated claims submitted.[154] In contrast, common-fund settlements are more prevalent in antitrust, securities, and mass-tort cases, where claimants typically receive *pro rata* shares of a fixed settlement fund.[155] In these cases, the total recovery per claimant is directly impacted by the number of claims submitted, ensuring that the entire fund is distributed among those who participate in the settlement.

By contrast, a direct-payment structure of settlement refers to a structure in which settlement funds are distributed directly to class members without requiring them to submit claims or go through an additional process to receive their compensation.[156] Instead of relying on class members to take affirmative steps, defendants make direct efforts to identify and compensate eligible individuals, often through checks, credits, or other direct transfers.

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[152] *Id.* at 83.

[153] Ross Weiner, *Claims-Made Settlements Are More Common Than You Think*, CERTUM GRP. (Mar. 13, 2023), https://certumgroup.com/blog/casi/claims-made-settlements-are-more-common-than-you-think [https://perma.cc/2KKF-Q6AY].

[154] Cabraser & Pincus, *supra* note 140, at 81.

[155] *Id.*

[156] *Id.* at 85–86.

b. Consolidated Audit Trail (CAT) Allows for Direct Payment Structure in Section 11 Cases

Until now, tracing for aftermarket purchasers has been widely dismissed by courts and scholars as impossible due to the fragmented and diffuse record-keeping systems maintained by brokers. This challenge is compounded where shares are commingled with others and exchanged across countless transactions. However, this perspective is increasingly outdated. The longstanding narrative—now misaligned with modern computational capabilities—asserts that securities are held in a "fungible bulk," managed by intermediaries such as DTCC, without individual identifiers or transaction records linking shares back to their original issuance. With contemporary electronic record-keeping systems, centralized audit trails, and modern computing power, the assumption that tracing is inherently impossible no longer holds weight.

On May 26, 2010, the Securities and Exchange Commission (SEC) proposed Rule 613 requiring the creation of the CAT.[157] The CAT represents a groundbreaking development in the securities market, capturing detailed, comprehensive information on every transaction within the U.S. financial system. The CAT tracks approximately fifty-eight billion records daily, including data on orders, executions, and quote lifecycles.[158] For each transaction, it records the buy/sell price, the number of shares traded, and the exact time of the trade, down to the millisecond. Furthermore, CAT assigns a unique customer identifier for every investor, linked to personal information such as names, addresses, dates of birth, and Social Security numbers for individuals, or employer identification numbers for institutions.[159] This centralized repository provides a complete and auditable record of securities activity, enabling precise tracking of ownership across different brokers and banks—information that was previously fragmented and inaccessible. In

[157] U.S. Sec. & Exch. Comm'n, Rule 613: Consolidated Audit Trail, https://www.sec.gov/about/divisions-offices/division-trading-markets/rule-613-consolidated-audit-trail [https://perma.cc/2E2P-ZS9U] (last visited Feb. 11, 2025).

[158] CAT NMS Plan, Appendix D-4 n.262 (sizing requirement for receipt, processing, and loading of more than 58 billion records per day).

[159] 17 C.F.R. § 242.613(c)(7)(i), (c)(8); CAT NMS Plan § 1.1 (defining "Customer Identifying Information" and "Customer Account Information").

June 2020, the SEC began collecting mandated broker-dealer reports.[160]

Scholars, utilizing information made available by the CAT and FINRA Blue Sheets, have been able to utilize modern computational abilities and standard accounting methods to patent proprietary tracing mechanisms.[161] These scholars maintain that no record-keeping nor computational limitation exists to prevent tracing. Importantly, while arguments regarding the impracticality and inefficiency of tracing for aftermarket purchasers may have held merit in an era where proving tracing required a massive and burdensome subpoenaing of broker records, the implementation of the CAT has fundamentally transformed this landscape, offering the technological means to automate tracing and produce accurate, centralized data on securities ownership.[162]

2. *Lack of Incentive to Change Existing Situation*

With the existence of modern computational solutions in the market and no record-keeping barriers, why has no action been taken? Notably, any improvement in the settlement process for Section 11 claimants will not come from the existing stakeholders in the settlement process. Change in this arena is unlikely, not due to a lack of technological capability, but because the settlement procedure is not an adversarial process.[163] The absence of adversarial tension, where lead counsel, plaintiffs, and defendants share converging incentives to maintain the status quo, serves as a conservative force against any potential private-market innovation.

Despite their fiduciary title, lead counsel lacks financial incentive to improve settlement fund distribution when their contingency fees are tied to the entire settlement value rather than to the preciseness or equity of fund distribution.[164] Lead counsel and their leading plaintiffs are, at a minimum, indifferent to a

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[160] Press Release, U.S. Sec. & Exch. Comm'n, SEC Provides for Phased CAT Broker-Dealer Reporting Timelines with Conditional Exemption for Impacts of COVID-19 (Apr. 20, 2020), https://www.sec.gov/newsroom/press-releases/2020-92 (on file with Columbia Business Law Review).

[161] *See* Coffee & Mitts, *supra* note 19, at 21–22.

[162] *Id.*

[163] *See* Erickson, *supra* note 119, 1847–49.

[164] Cabraser & Pincus, *supra* note 140, at 82.

bettering of the situation in some cases could even be opposed.[165] As Judge Posner observed:

> The judge who presides over a class action and must approve any settlement is charged with responsibility for preventing the class lawyers from selling out the class, but it is a responsibility difficult to discharge when the judge confronts a phalanx of colluding counsel. The defendant wants to minimize outflow of expenditures, and the class counsel wants to increase inflow of attorney's fees. Both can achieve their goals if they collude to sacrifice the interests of the class.[166]

Claims administrators may also resist improvements to this system out of concern that such advancements could mark the initial stage of their roles becoming obsolete, particularly in scenarios where the next step could be an automated class identification mechanism that could effectively replace the need for their involvement. This is not a valid concern as there will remain, even with an automated system, edge cases due to the CAT not reflecting economic reality in certain situations or maintaining incomplete broker records. This would require involvement of the claims administrators only in difficult scenarios rather than validating class members in every instance. Without a robust mechanism or dedicated party to champion the interests of bona fide shareholders, the integrity of the allocation scheme is compromised, further disadvantaging those with legitimate, substantiated claims.

3. *How the Direct Payment Settlement Structure Can Realign Incentives*

If judges acknowledge that Section 11 settlements failing to distinguish between registered and unregistered shares do not meet the legal standards of fairness, adequacy, and reasonableness, a simple shift to a direct-payment structure in these settlements

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165 *See* Erickson, *supra* note 119, 1847–49.

166 Thorogood v. Sears, Roebuck & Co., 624 F.3d 842, 848–49 (7th Cir. 2010) (cleaned up), *vacated on other grounds*, 131 S.Ct. 3060 (2011).

could fundamentally reorient incentives. This approach would mitigate distributional inequities by eliminating the probabilistic inclusion of ineligible claimants, ensuring that settlement funds are allocated only to those who can meet the tracing requirement. Requiring a direct-payment structure in such cases would compel counsel, defendants, and claims administrators to develop a viable solution—likely by leveraging private market innovations in tracing—to ensure accurate claimant verification and facilitate direct distribution of settlement funds from the total settlement pool. There are already proprietary tracing solutions which exist in the market, waiting to be leveraged within the settlement arena.[167]

While the idea of incorporating private market actors into the legal process may seem unconventional, it is not without precedent. Companies like Broadridge, which transformed proxy voting, demonstrate how private-sector solutions can effectively address regulatory and procedural challenges. In the proxy space, Broadridge utilized technology to streamline communication and enhance transparency, ultimately improving alignment among stakeholders.[168] A similar model could be applied in the tracing context, leveraging proprietary algorithms and CAT data to automate ownership verification and ensure a more accurate and efficient settlement process.

Courts have generally rejected the notion that the court must identify the payment structure that would provide optimal relief to the class.[169] However, when the core issue is the very fairness, reasonableness, and adequacy of the settlement itself, and when the absence of a proper structure distorts incentives and undermines equitable distribution, this hands-off approach must be

[167] *See* Coffee, Jr. & Mitts*, supra* note 19 at 21–22.

[168] Erickson, *supra* note 119, at 1844–45; *see also Proxy Management*, BROADRIDGE FIN. SERVS., https://www.broadridge.com/capability/governance-and-regulatory-compliance/proxy-services/ [https://perma.cc/W3NZ-SJ82] (last visited May 11, 2026).

[169] Casey v. Citibank, N.A., No. 13–cv–820, 2014 WL 4120599, at *3 (N.D.N.Y. Aug. 21, 2014) ("The Court does not have the authority to impose a preferred payment structure upon the settling parties"); Lee v. Ocwen Loan Servicing, LLC, No. 14-CV-60649, 2015 WL 5449813, at *16 (S.D. Fla. Sept. 14, 2015).

reconsidered. If the structure of the settlement is what enables unfair outcomes, then judicial intervention is not just warranted—it is necessary.

V. CONCLUSION

While pure Section 11 settlements are relatively rare, the distinction between registered and unregistered shares is still a pertinent consideration in ensuring settlements align with statutory intent in such cases. This Note highlights a key tension: without clear tracing mechanisms, Section 11 recoveries risk deviating from the principles reaffirmed in *Slack*, potentially leading to unintended dilution of legitimate claims. Refining settlement structures to incorporate modern tracing tools would better preserve the integrity of Section 11's strict liability framework and enhance the precision of recoveries. In these cases, if courts continue to approve settlements that fail to distinguish between registered and unregistered shares, Section 11's strict liability framework will erode into a system that prioritizes expediency over statutory intent. Modern market technological developments such as the Consolidated Audit Trail (CAT) and proprietary tracing algorithms make precise claimant verification feasible, yet settlements persist in treating all shares as fungible, diluting recoveries and undermining fairness.

This failure is not a technological inevitability, but a product of inertia exacerbated by lenient settlement approval standards (fair, adequate, and reasonable) not accounting for the specific dynamics of the Section 11 statute. The passive acceptance of outdated tracing assumptions under the blanket approval of a fair, adequate, and reasonable settlement allows lead counsel, defendants, and claims administrators to maintain a settlement process that values convenience over accuracy. If this trajectory continues, courts will institutionalize inefficiency, sanctioning payments to ineligible claimants while depriving legitimate investors of their rightful compensation.

A direct-payment model which is grounded in automated tracing and verification of registered shares is both theoretically appealing and possible with current technological advantages. Without it, the integrity of pure Section 11 settlements will further deteriorate, transforming a strict liability regime into a flawed compensation mechanism riddled with unverified claims. Judges must act to prevent a future where procedural shortcuts override statutory protections, ensuring that settlements meet the fair, adequate, and reasonable standard required by Rule 23(e).