

The problem of tracing in Section 11 securities litigation

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Introduction

When securities are offered and sold to the public through a registered offering, Section 11 of the Securities Act allows purchasers of “such securities” to bring a private action if there are material misstatements in the registration statement.

If issues of the same security have been sold pursuant to different registration statements or through unregistered channels, courts have required Section 11 plaintiffs to prove that they have standing by demonstrating that they purchased securities that can be “traced” to the registration statement at issue.¹

This requirement raises the question of whether investors who purchased stock in secondary market transactions (e.g., on a stock exchange) might be able to trace their shares back over time to determine whether they purchased shares that were offered and sold pursuant to a specific registration statement, as opposed to shares in the same class offered and sold through other channels.

Given the realities of how securities are held and traded in modern markets, courts have recognized that securities generally cannot be traced through secondary market transactions.² This has precluded secondary market purchasers from establishing standing in Section 11 cases where additional shares have been offered and sold through channels other than the specific registration statement at issue.

In its 2023 decision in *Slack v. Pirani*, the United States Supreme Court upheld the tracing requirement in the case of a direct listing where all prospective

plaintiffs purchased shares in secondary market transactions, and where “registered” and “unregistered” shares commingled in the market on the first day of trading.³

To address the difficulty for plaintiffs to demonstrate Section 11 standing in a direct listing, some have suggested that using an accounting method such as last-in-first-out (LIFO) or first-in-first-out (FIFO) can help plaintiffs trace a “chain of title” to establish standing.⁴ Courts have not been receptive to this argument, and post *Slack* have continued to deny motions for class certification for secondary market purchases in Section 11 cases where newly-offered shares are commingled with pre-existing shares.

In a recent decision in *Cupat v. Palantir* at the U.S. District of Colorado, the court rejected the LIFO/FIFO approach and dismissed plaintiffs’ Section 11 claims.⁵ The plaintiffs recently appealed some of the Colorado court’s other findings in that matter, but did not challenge the court’s dismissal of the Section 11 claims.⁶

In another recent case, the District Court for the Northern District of California has dismissed a Section 11 claim in *Shnayder v. Allbirds* for lack of statutory standing on the grounds of tracing.⁷

This article explains why tracing securities through secondary market transactions is not feasible and why accounting methods such as LIFO or FIFO cannot solve the problem. While there may be some circumstances where investors might be able to trace back to a registration statement, in most cases, this is not feasible. The reasons relate to the fundamental structure of how securities are held, traded, and settled in modern securities markets.

The vast majority of securities sold to the public are held at the Depository Trust Company (DTC), where all securities are commingled in a fungible mass and beneficial owners’ claims are explicitly not attached to any specific securities.⁸ Investors buy and sell “security entitlement” claims on securities without becoming an owner of record of the securities,⁹ and investors can hold security entitlements against a broker or bank intermediary even if the intermediary does not itself hold the securities.¹⁰

This raises threshold questions of what it means for a secondary market purchaser to trace a “chain of title” of specific securities. When shares are held at the DTC, beneficial owners never have claims on or title to any specific shares, so there is no “true” chain of title to uncover.

Under the narrow circumstances where LIFO or FIFO methods would be possible to implement, at most they can be used to construct an artificial chain of title based on allocation rules that are arbitrary.

Making a LIFO or FIFO assumption is not sufficient to create a tracing path. As explained below, for securities held in a fungible mass at DTC, secondary market trading obligations are settled through a multilateral net settlement process intermediated by a central clearinghouse and broker-dealers.

Under this settlement structure, there is no way to follow securities purchased by a particular buyer backwards through the settlement process to determine which seller the securities came from — nor is there a way to follow securities sold by a particular seller forward to see where those securities went.

This is not a problem that can be resolved by applying a LIFO or FIFO accounting rule. In the remainder of this article, we explain why.

Overview of the clearance and settlement process

When investors decide to trade a particular security (or when investment advisers decide to trade a security on behalf of an investor), they send an “order” to a broker, instructing the broker to buy or sell the security.

The broker receiving the order may handle the execution of the order itself or may route the order to another broker-dealer (known as the “executing broker”) to handle the execution. Executing brokers may or may not know the identity of the investors for whom the trade is executed.

After a trade is executed, a clearing and settlement process takes place in order to carry out the transaction.¹¹ For each equity trade, the buyer and the seller each will clear through a “clearing firm,” which is a broker-dealer that takes on the obligation to settle the trade as a member of the National Securities Clearing Corporation (NSCC), the central clearinghouse.¹²

The buyer’s clearing firm takes on the obligation to pay for the shares, and the seller’s clearing firm takes on the obligation to deliver shares. The clearing firm may or may not be the same as the executing broker and may or may not be the same as the broker that holds the investor’s account. Thus, the clearing firm may not know the identity of the investors whose trades they are clearing.

Institutional investors often hold shares at custodian banks that are not acting as broker-dealers and are not members of the NSCC. For this reason, institutional investors often use clearing brokers that are not the custodians holding the shares on behalf of the investors. As a result, an extra step in the settlement process is needed.

When an institutional investor with a non-clearing member custodian sells shares, the shares must be transferred from the custodian to the clearing broker to make them available for delivery to

the NSCC. Likewise, when an institutional investor purchases shares, after the trade settles through the NSCC, shares must be transferred from the clearing broker to the custodian. These transfers between custodians and clearing brokers happen at the DTC, not at the NSCC.

The settlement of trading obligations between the seller’s clearing broker and the buyer’s clearing broker are intermediated by the NSCC. In a process called “novation,” prior to the settlement of the trade, the NSCC steps in and becomes the buying counterparty to the seller and the selling counterparty to the buyer.

When this happens, the original obligations between the seller and the buyer are eliminated. The seller’s clearing firm no longer has an obligation to deliver shares to the buyer’s clearing firm, but instead has an obligation to deliver shares to the NSCC.

Simultaneously, the NSCC takes on an obligation to deliver shares to the buyer’s clearing firm, and this obligation must be fulfilled irrespective of whether the seller’s clearing firm’s delivery obligation is fulfilled.¹³ Likewise, after novation, the buyer’s clearing firm has an obligation to pay cash to the NSCC, and

the NSCC has a separate obligation to pay the seller’s clearing firm.

The problem of tracing through the settlement process

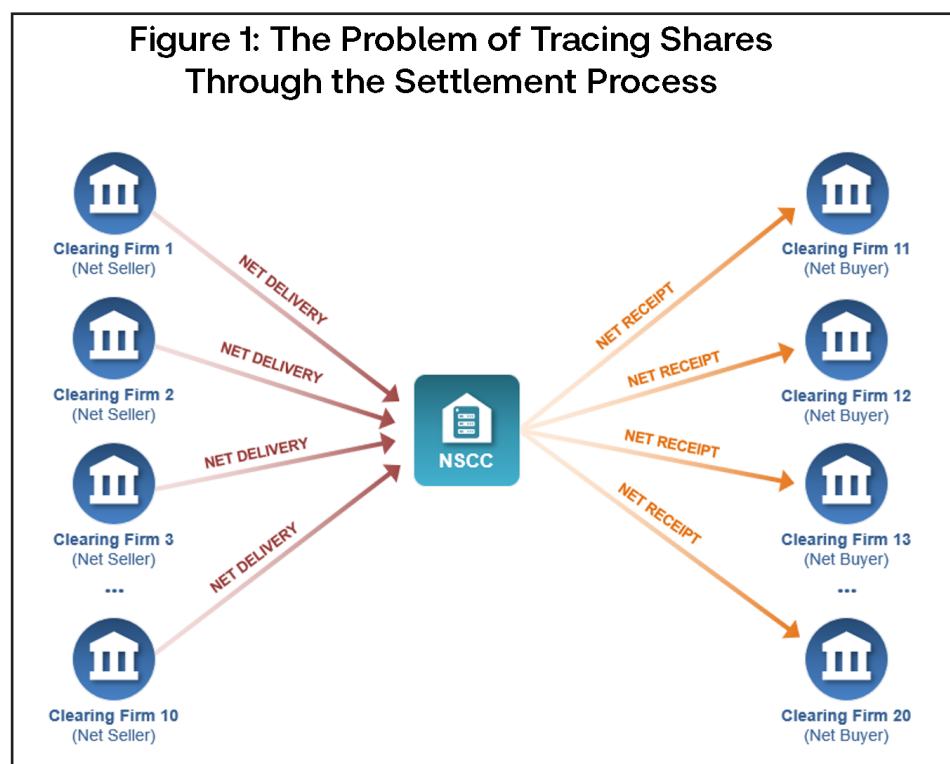
Trades cleared through the NSCC are not settled on a trade-by-trade basis. Rather, for each clearing firm, the NSCC aggregates and nets all trading activity done in each security over the course of the day to a single position, with the NSCC as the counterparty.

These net obligations for security deliveries are usually met through daily transfers of securities between NSCC and clearing firms, whose transactions are aggregated and netted to result in a single net delivery obligation to or from the NSCC each day. Due to this type of netting within the clearing firm, there is no meaningful way to allocate the clearing firm’s net delivery or receipt to individual investor accounts.

To illustrate the problem this creates for tracing, consider a plaintiff who purchased shares on the secondary market and is trying to trace the shares to demonstrate Section 11 standing.

Figure 1 depicts a scenario where 20 different NSCC member firms settled

Figure 1: The Problem of Tracing Shares Through the Settlement Process



trades through NSCC on the date when the plaintiff's trade settled.

Each of these 20 firms settled trades for multiple sellers and multiple buyers, but after netting, 10 of them were net sellers (Clearing Firms 1 through 10), and 10 were net buyers (Clearing Firms 11 through 20).

Courts have recognized that securities generally cannot be traced through secondary market transactions.

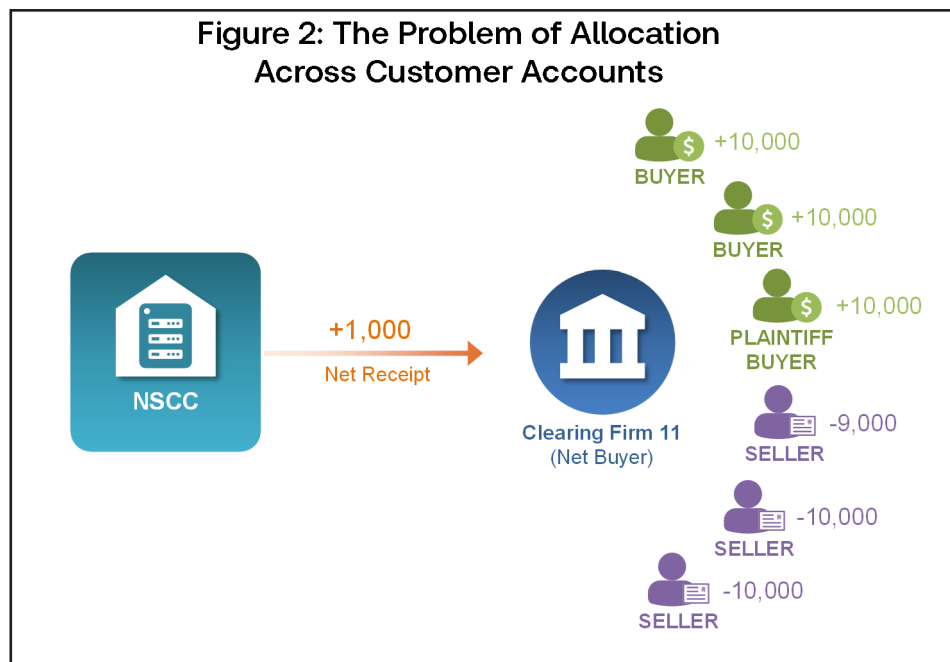
Consider a plaintiff who purchased shares through Clearing Firm 1, one of the NSCC member firms that was a net seller on that date. Even though the plaintiff purchased shares, the plaintiff's clearing firm did not receive any shares from NSCC when the trades were settled (because after netting sales and purchases, that clearing firm had a net delivery obligation).

Even assuming that one could devise an accounting algorithm (such as LIFO or FIFO) to construct an artificial designation of shares held as security entitlements as "registered" or "unregistered" as they flow in and out of DTC accounts, such an algorithm would not help determine which investors have standing.

In this example, there are no shares flowing into Clearing Firm 1's DTC account, so a LIFO or FIFO algorithm would have no shares to classify.

Now assume instead that the plaintiff purchased shares through Clearing Firm 11, one of the NSCC member firms that was a net buyer on that date. Because Clearing Firm 11 is a net buyer, some shares would have been transferred from NSCC to Clearing Firm 11 on the settlement date of the plaintiff's trades, so in this case, there are at least some shares flowing in.

However, it is not clear how a LIFO or FIFO algorithm could be helpful at



classifying the incoming shares as "registered" or "unregistered."

In theory, one could attempt to apply a LIFO or FIFO algorithm to each clearing firm's account and use it to decide what shares would be delivered to the NSCC by Clearing Firm 1, Clearing Firm 2, and so on, and whether they would be "registered" and "unregistered." However, the shares would be delivered to NSCC simultaneously, so they cannot be sequenced to determine which ones arrived "first" or "last" at NSCC.

Moreover, all the shares received from Clearing Firms 1 through 10 are pooled together at the NSCC before they are delivered simultaneously to the receiving clearing firms. Thus, LIFO or FIFO cannot be used to track shares as they go through the settlement process.

There is no way to determine that the shares delivered by NSCC to Clearing Firm 11 were specifically the shares received from Clearing Firm 1, Clearing Firm 2, or any other firm.

Another fundamental problem is that the net delivery obligations between NSCC and clearing firm cannot be disaggregated into components corresponding to individual trades, let alone sequenced for purposes of implementing LIFO or FIFO methods.

This point is illustrated in **Figure 2**, which continues the example where the plaintiff purchased shares through Clearing Firm 11.

Suppose that the plaintiff purchased 10,000 shares through Clearing Firm 11. On the same day, Clearing Firm 11 cleared trades for two other buyers who purchased 10,000 shares each, and three sellers, who sold 10,000, 10,000, and 9,000 shares. In total, Clearing Firm 11 has 30,000 shares purchased and 29,000 shares sold. When these six trades are aggregated and netted at the NSCC, Clearing Firm 11 is a net buyer due to receive 1,000 shares from the NSCC.

There is no meaningful way to allocate the clearing firm's net delivery or receipt to individual investor accounts.

Even if one were somehow able to classify the incoming 1,000 shares as "registered" or "unregistered," one would need some way to allocate the incoming 1,000 shares among the

plaintiff and the other two buyers who purchased 10,000 shares each. Invoking an accounting rule such as LIFO or FIFO does not help resolve this.

Conclusions

In this article, we have focused on the structure of the clearing and settlement process for secondary market trading because plaintiffs have pointed to this as an avenue to trace.¹⁴ For the reasons we have discussed above, this structure is inherently incompatible with the prospect of tracing a chain of title for specific shares through secondary market transactions that are cleared through the NSCC.

Using a LIFO or FIFO rule is not a feasible way to assign Section 11 standing rights.

That secondary market tracing is not feasible has been accepted by courts for decades. The suggestion to use an accounting method such as LIFO or FIFO does not resolve this problem. Due to the structure of multilateral net settlement through a central counterparty, the transfers of shares from/to DTC accounts cannot be sequenced, disaggregated, or mapped to individual trades.

Using a LIFO or FIFO rule is not a feasible way to assign Section 11 standing rights. As a matter of logic, LIFO or FIFO cannot be implemented when settlement obligations are netted and batched.

In summary, given the realities of how securities are held, cleared, and settled — and consistent with what courts have recognized for decades — accounting methods such as LIFO and FIFO are not sufficient to construct a tracing path.

The views expressed herein are those of the authors and do not necessarily represent the views of Cornerstone Research.

Notes:

¹ See, e.g., *Barnes v. Osofsky*, 373 F.2d 269, 271–72 (2d Cir. 1967); *Kirkwood*, 590 F. Supp. at 1378 (D. Minn. 1984); *Abbey v. Computer Memories Inc.*, 634 F. Supp. 870 (N.D. Cal. 1986); *In re College Bound Consol. Litig.*, Fed. Sec. L. Rep. (CCH) 98,310, at 90,134 (S.D.N.Y. May 4, 1994). This situation arises, for example, when a company that already has publicly traded securities sells additional shares through a registered follow-on offering and in cases where securities have been sold to the public under an exemption from registration (e.g., a private placement of securities that were later sold to the public pursuant to Rule 144).

² See, e.g., *Barnes v. Osofsky*, 373 F.2d 269, 271–72 (2d Cir. 1967); *Guenther v. Cooper Life Sciences, Inc.*, 759 F. Supp. 1437 (N.D. Cal. 1990); *In re Puda Coal Securities Inc. et al. Litigation*, S.D.N.Y. 2013; *In re Century Aluminum Co. Securities Litigation*, F.3d (2013).

³ “Syllabus,” *Slack Technologies, LLC (f/k/a Slack Technologies, Inc.) et al. v. Fiyaz Pirani*, Supreme Court of the United States, No. 22–220. Argued April 17, 2023. Decided June 1, 2023.

⁴ Coffee, John C., Jr., and Joshua Mitts, “Can Section 11 Be Saved?: ‘Tracing’ a Path to its Survival,” *Harvard Business Law Review*, Vol 15, No. 1, 2025, pp. 339; “Brief for Amici Curiae Law and Business Professors in Support of Respondent,” *Slack Technologies, LLC (f/k/a Slack Technologies, Inc.) et al. v. Fiyaz Pirani*, Supreme Court of the United States, No. 22–200. See also “Recommendation of the Investor as Owner and Investor as Purchaser Subcommittees of the SEC Investor Advisory Committee regarding Preserving Investors’ Ability to Bring Claims Under Section 11 of the Securities Act of 1933,” February 18, 2025, footnote 34, available at <https://bit.ly/46lBk7C>.

⁵ “Order,” *Minchie Galot Cupat v. Palantir Technologies, Inc. et al.*, United States District Court for the District of Colorado, 1:22-cv-02384, Doc. No. 123, April 4, 2025, footnote 21 (“Ultimately, the Court is not persuaded that actual chain-of-title tracing is feasible under the discovery approach Plaintiffs have proposed. Plaintiffs’ proposed discovery approach involves using ‘[s]tandard accounting methods’ such as first-in first-out (FIFO) or last-in first-out (LIFO) This proposed methodology asks the Court to replace one set of assumptions (probability based inferences) with another (accounting presumptions). ... But Slack implies that strict chain-of-title tracing is required — it emphasizes that liability runs with registered shares alone. Allowing constructive tracing (e.g., by presuming purchases of registered shares under the accounting methodologies proposed) would short circuit that requirement.”).

⁶ “Plaintiffs-Appellants’ Opening Brief,” California Public Employees’ Retirement System, et al., Plaintiffs/Appellants, vs. Palantir Technologies Inc., et al., Defendants/Appellees, United States Court of Appeals for the Tenth Circuit, No. 25–1178, Doc. 20, July 30, 2025, p. 5.

⁷ “Order re Motion to Dismiss,” *Gennady Shnayder, et al. v. Allbirds, Inc., et al.*, United States District Court Northern District of California, 23-cv-01811-AMO, Doc. No. 104, June 23, 2025.

⁸ It is DTC, through its nominee Cede & Co., who is the owner of record for the securities. Beneficial

owners do not have a claim on (or title to) any specific securities. Broker-dealers and banks who hold securities at DTC do not hold claims on specifically identifiable shares, but rather hold *pro rata* claims in the fungible mass of all securities of the same class held at DTC. Under the Uniform Commercial Code (UCC) 8–503(b), “An entitlement holder’s property interest with respect to a particular financial asset under subsection (a) is a *pro rata* property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.”

⁹ See Virginia B. Morris & Stuart Z. Goldstein, *Life Cycle of a Security* (2010).

¹⁰ Under UCC 8.501(b) and (c), if a securities intermediary “indicates by book entry that a financial asset has been credited to the person’s securities account,” then “a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.”

¹¹ See NSCC, “Rules & Procedures,” effective June 5, 2025.

¹² Typically, members of the NSCC are also DTC participants. NSCC and DTC are subsidiaries of the Depository Trust & Clearing Corporation (DTCC). Morris, Virginia B., and Stuart Z. Goldstein, *Life Cycle of a Security*, 2010, Lightbulb Press, Inc., p. 5.

¹³ When a member firm that has a delivery obligation to the NSCC fails to deliver shares on the settlement date, the NSCC does not receive enough shares to meet its delivery obligations to all the clearing members that are due to receive shares. In this situation, the NSCC has a procedure for allocating share deliveries randomly across firms. Thus, if a selling firm fails to deliver shares, it is not the buying firm counterparty to the original trade who fails to receive shares, but a randomly selected buying firm.

¹⁴ See *supra* note 3. While this article has focused on the structure of the clearance and settlement process, this is just one of several concerns we have regarding the claim that LIFO or FIFO accounting methods can provide a path to tracing in Section 11 cases. There are other fundamental issues we have not addressed here. For example, even in scenarios where the LIFO/FIFO approach might be possible to implement, the allocation can result in assignment of Section 11 standing claims in a manner that is highly sensitive to arbitrary assumptions, may create intra-class conflicts, and may be incompatible with common interpretations of the statute. Moreover, the common practices of short selling and securities lending introduce additional complications that represent severe challenges to the prospect of tracing based on LIFO/FIFO. Finally, even if one could somehow follow shares as they move across brokers’ and custodians’ DTC accounts, this would not resolve the question of which individual customers of those brokers own which shares or which have Section 11 standing. Attempting to implement a LIFO or FIFO approach at the individual investor account level would be a monumental undertaking, which would require collecting and aggregating a massive amount of non-public data from numerous broker-dealers and investment advisers.

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