Harvard Law School Forum on
Corporate Governance and Financial Regulation

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Post-*Cyan* Ruling on Discovery Stay

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In May 15, 2019, a Connecticut Superior Court found that defendants in a claim under the Securities Act of 1933 (Securities Act) were entitled to the mandatory discovery stay pending a motion to dismiss under the Private Securities Litigation Reform Act of 1995 (PSLRA)—a significant ruling due to its reasoning and the possibility that other state courts may follow the decision.

Background

The Securities Act states that suits brought under the Act may be filed in either state or federal courts and includes an anti-removal provision that prevents defendants from removing a case from state to federal court.

The Securities Act also allows for class-action suits. In 1995, in order "to stem perceived abuses of the class-action vehicle," Congress amended the Securities Act and the Securities Exchange Act of 1934 (the primary mechanism for bringing anti-fraud class action suits) and enacted the PSLRA. In its discovery stay subsection, the PSLRA states: "In any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."

To avoid the PSLRA's procedural reforms, such as the discovery stay, plaintiffs began bringing Securities Act suits in state courts. To make federal court the "exclusive venue for most securities fraud class actions," Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which precludes sizeable class actions based on state law in either state or federal courts, and provides for the removal of those cases to federal court.

Following the passage of SLUSA, district courts issued conflicting decisions on the removability of suits alleging only violations of the Securities Act, and state courts were divided over whether they retain subject matter jurisdiction over such cases.

On March 20, 2018, the Supreme Court unanimously decided *Cyan, Inc. v. Beaver County Employees Retirement Fund, et al.*, holding that SLUSA neither stripped state courts of

jurisdiction over class actions alleging violations of only the Securities Act nor permitted defendants to remove those actions to federal court.

The Court did not address the applicability of the discovery stay provision found in the PSLRA on state courts. At least two other state courts have declined to stay discovery under the PSLRA, but either did not elaborate on their reasoning or found an exception to the rule.

The Connecticut Case

In *Pitney Bowes*, a securities class action under the Securities Act, the Connecticut Superior Court granted defendants' motion for a protective order staying discovery during the pendency of the defendants' motion to strike, which is similar to a 12(b)(6) motion to dismiss.

The opinion is unique because, unlike the other state court decisions, it interprets *Cyan* to apply the PSLRA's discovery stay to Securities Act suits in state courts.

To reach that conclusion, the court first applied the "plain meaning rule" of statutory interpretation to the PSLRA. According to the court: "The meaning of a statute shall, in the first instance, be ascertained from the text of the statute itself and its relationship to other statutes. If, after examining such text and considering such relationship, the meaning of such text is plain and unambiguous and does not yield absurd or unworkable results, extratextual evidence of the meaning of the statute shall not be considered."

The court then examined 15 USC 77z-1(a)(1), the subsection of the PSLRA preceding the discovery stay subsection, which applies to private class actions and states that "[t]he provisions of this subsection shall apply to each private action arising under this subchapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure."

The Court found that "this language makes clear that [the preceding subsection] applies only to actions commenced in federal court."

In contrast, 15 USC 77z-1(b)(1), the discovery stay subsection, states, "[a]ny private action arising under this subchapter."

The court held that, because the discovery stay subsection does not have the same language as the private class actions subsection, it is not limited to actions commenced in federal court. In other words, the discovery stay subsection is applicable to actions commenced in state court.

The court also examined 15 USC 77z-2(c)(1), the provision following the discovery stay subsection, which provides a "safe harbor" for forward-looking statements "in any action arising under this subchapter," and uses identical language as the discovery stay subsection.

The Supreme Court in *Cyan* found that "some of [PSLRA]'s provisions . . . applied even when a [Securities Act] suit was brought in state court," and expressly mentioned the safe harbor subsection as an example. The safe harbor subsection also provides a stay pending a decision on a motion.

The *Pitney Bowes* court found that, because the language in the discovery stay and safe harbor subsections are identical, and because the Supreme Court "held that language identical to that at issue here applies to both state and federal actions commenced under the Securities Act," the discovery stay subsection applies to "actions pending in state court as well as in federal court."

Implications

This decision may be persuasive to other state courts because of its logical approach to statutory interpretation, as well as its application of Supreme Court precedent to the discovery stay subsection of the PSLRA. Following this decision, we expect defendants in other state courts to seek stays of discovery pending a motion to dismiss in Securities Act suits; this could be a useful litigation tactic to potentially reduce defendants' litigation costs and change the perception that state courts are more-friendly to plaintiffs in Securities Act suits.