



New York Appellate Division, First Department Gives Green Light to First Post-Cyan Case

Posted by Veronica E. Callahan, Aaron F. Miner, and Stephanna F. Szotkowski, Arnold & Porter Kaye Scholer LLP, on Monday, June 14, 2021

Editor's note: Veronica E. Callahan and Aaron F. Miner are partners and Stephanna F. Szotkowski is an associate at Arnold & Porter Kaye Scholer LLP. This post is based on an Arnold & Porter memorandum by Ms. Callahan, Mr. Miner, Ms. Szotkowski, John Hindley, Arthur Luk, Kathleen Reilly, and Michael D. Trager.

On April 29, 2021, a four-judge panel of the New York Appellate Division, First Department, held in *Chester County Employees Retirement Fund v. Alnylam Pharmaceuticals, Inc.*, 2020-04534, 2021 WL 1679511 (1st Dep't 2021), that an investor plaintiff sufficiently alleged violations of the Securities Act of 1933 (Securities Act) to survive a motion to dismiss. This is a significant development after the US Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which held that *state* courts may exercise jurisdiction over class actions alleging violations of only the *federal* Securities Act. Indeed, *Chester County* is the first opinion by a New York appellate court allowing a Securities Act case to proceed to discovery.

Background

As discussed in a previous Advisory, the Securities Act created a private right of action in order for investors to bring suit against issuers, officers, directors, and underwriters involved in the securities offering process. Even though the Securities Act created a federal cause of action, the Securities Act allows for concurrent federal and state jurisdiction for such suits. In addition, the Securities Act specifically prohibits the removal of cases from state to federal court. 15 U.S.C. § 77v(a).

In 1998, in response to increased filings of securities actions in state court, Congress sought to make federal courts the "exclusive venue for most securities fraud class actions" by passing the Securities Litigation Uniform Standards Act of 1998 (SLUSA). Congress's attempt to reform the Securities Act barred "covered class action" state law securities claims and allowed for the removal of those cases to federal court. 15 U.S.C. § 77p(b). Following SLUSA's passage, federal and state courts disagreed regarding the removability of suits alleging only violations of the Securities Act and whether state courts could exercise subject matter jurisdiction over Securities Act claims.

On March 20, 2018, the Supreme Court unanimously held in *Cyan* that SLUSA did not strip state courts of its jurisdiction over class actions alleging only Securities Act violations and that removal

was prohibited. Following *Cyan*, the First Department had repeatedly dismissed Securities Act claims brought in New York state court at the pleading stage.

The First Department's Decision

In *Chester County*, plaintiff purchased common stock in defendant, a biopharmaceutical company, when it went public. Plaintiff alleged that this purchase of stock occurred following defendant's initial public offering in reliance on representations made in the registration statement. Plaintiff sued the company and its officers, directors, and underwriters, alleging the registration statement contained false statements of material fact and omitted material information regarding possible approval by the US Food and Drug Association (FDA) of a drug designed to treat heart and nervous system damage from a rare disease. Plaintiff further alleged that the registration statement contained false information regarding the results of a clinical trial study. Plaintiff brought claims under Sections 11, 12(a)(2) and 15 of the Securities Act. To adequately plead a Section 11 claim, plaintiff had to allege facts showing that the registration statement either omitted to state a material fact required to be stated therein or necessary to make the statement not misleading or contained an untrue statement of a material fact. Section 12(a)(2) has roughly parallel elements to a Section 11 claim and applies to prospectuses and oral communications. Section 12(a)(2) also includes a statutory seller requirement, which means that a plaintiff can only bring a claim against the person who either passed title to the plaintiff or who successfully solicited the purchase of a security, motivated at least in part by a desire to serve his own financial interests or those of the securities' owner. Section 15 claims, in turn, create liability for individuals or entities that control any person liable under Section 11 or 12, and therefore rely on plaintiff's ability to demonstrate primary liability under those provisions.

The trial court denied the defendants' motion to dismiss, concluding that plaintiff had adequately alleged that the registration statement stated that a clinical trial generated "positive complete results" for treating heart disease, when it had not generated any cardiac efficacy data. Defendants appealed, arguing that the registration statement did not contain false information, that the factual statements the plaintiff alleges to have been false were opinions, and that the plaintiff did not adequately allege that defendants' opinion statements were false or misleading.

In a three-paragraph decision, the First Department affirmed the denial of the motion to dismiss of plaintiff's Section 11 and 15 claims and plaintiff's Section 12(a)(2) claims as to defendants other than the individual defendants. The court reasoned that defendants "failed to utterly refute plaintiff's factual allegations and conclusively establish a defense to the asserted claims as a matter of law" and that "there is no basis to find, as a matter of law, that plaintiff has failed to assert valid claims by alleging that in the circumstances here, the registration statements, prospectus or oral communication included either untrue statements of fact . . . or statements of opinion" about the results of the study. Because of this, the court held that defendants failed to establish that plaintiff's claims were "premised on nonactionable statements of opinion." The court, however, did dismiss plaintiff's Section 12(a)(2) claim as to the individual defendants who were alleged to have merely "reviewed and signed the registration statements" because these allegations were "insufficient to establish that they are statutory sellers." *Chester County* did not address the First Department's five previous post-*Cyan* decisions upholding dismissals of Securities Act claims.

Implications

Before *Chester County*, the First Department consistently dismissed Securities Act claims post-*Cyan*, without allowing the cases to proceed to discovery. *Chester County*, however, provides plaintiffs with at least one decision that found an investor adequately alleged violations of the Securities Act. As a result, more companies that go public may find themselves entangled in Securities Act litigation in New York state court. It remains to be seen whether *Chester County* is an outlier or the start of a trend in New York.