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SCOTUS to Decide Whether the PSLRA's Discovery Stay Provision Applies in State Court

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On July 2, 2021, the U.S. Supreme Court granted certiorari to consider whether the discovery stay provision of the Private Securities Litigation Reform Act ("PSLRA") pertaining to the Securities Act of 1933 (the "Securities Act")—which generally pauses all discovery proceedings for Securities Act cases brought in federal court while a motion to dismiss is pending—applies to Securities Act cases brought in state courts as well. The Court's ultimate decision may significantly impact the incentive of plaintiffs to file in state court for the purposes of avoiding the PSLRA's discovery stay and may provide protection to defendants from the use of blunderbuss discovery to attempt to find a claim or coerce a settlement in an otherwise meritless Securities Act case.

By way of background, investors originally filed putative securities class actions in both federal and California state courts against Pivotal Software Inc. ("Pivotal"), a San Francisco–based software company, and the underwriters of its IPO. The complaints alleged that Pivotal made false or misleading statements in its registration statement in violation of Section 11 of the Securities Act. In response, Pivotal and the underwriters challenged the sufficiency of the plaintiffs' pleadings in both the federal and state court actions.

Plaintiffs voluntarily stayed the state court action, which alleged claims under the Securities Act, while the motion to dismiss in the federal court action was decided. Once the federal court dismissed the plaintiffs' allegations, however, the stay in state court was lifted and plaintiffs sought discovery while Pivotal's demurrer (i.e., motion to dismiss) was still pending before the court.

Pivotal requested a discovery stay from the California state court, arguing that the PSLRA's automatic discovery stay applied in both state and federal court proceedings. The state court denied Pivotal's request, reasoning that there is no express reference in the PSLRA to the discovery stay's application in state court proceedings. In addition, the state court reasoned that—because other provisions of the PSLRA expressly reference the federal procedural rules—Congress intended that the discovery stay provision apply only in federal court proceedings.

Pivotal and the underwriters sought relief from both the California Court of Appeal and the California Supreme Court, but both courts summarily denied the appeal without a written opinion. Pivotal and the underwriters thereafter sought review in the United States Supreme Court.

In its petition, Pivotal and the underwriters noted that state courts are sharply divided on the PSLRA's discovery stay application to state court actions. After the U.S. Supreme Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which holds that state courts continue to retain concurrent jurisdiction over Securities Act claims, plaintiffs have increasingly filed actions in state court where, according to Pivotal and the underwriters, "the potential for obtaining discovery on even meritless claims creates the opportunity to coerce a settlement."

Striking a similar note, the US Chamber of Commerce and the Securities Industry and Financial Markets Association (SIFMA) submitted an *amicus curiae* brief in support of Pivotal's petition, arguing that refusing to apply mandatory discovery stay in state securities suits "creates additional risk and uncertainty for issuers and underwriters participating in IPOs" and adversely impacts capital markets and their participants.

On the merits, Pivotal and the underwriters contend that the language of the PSLRA—which states that the discovery stay applies to *"any private action arising under"* the Securities Act—unambiguously governs both state *and* federal court actions. They also point to the statutory purpose of the PSLRA to prevent the use of discovery to coerce settlements in meritless suits.

The investor plaintiffs, on the other hand, maintain that if Congress intended for the PSLRA's discovery stay apply in state courts, the PSLRA would expressly mention its application in state court. Without any express reference, the investor plaintiffs argue that courts should follow the general presumption that federal procedural law does not apply in state court proceedings.

Fortunately, the issuers, corporate officers and directors, and the underwriters that are the defendants in these Securities Act lawsuits will receive some much-needed clarity on the scope of the PSLRA's discovery stay from the Supreme Court. And, if the Supreme Court ultimately holds that the PSLRA's discovery stay does in fact apply in state court actions, it may well offer protection from the use of discovery by plaintiffs to find some claim or coerce a settlement in otherwise meritless lawsuits, and may even deter some securities plaintiffs from filing in state rather than federal courts.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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