April 2020

Client Alert: The Implications of Cyan – Two Years Removed

In March 2018, the United States Supreme Court issued a unanimous opinion holding that (i) state courts have jurisdiction to hear class actions brought under the federal Securities Act of 1933 ("1933 Act"); and (ii) the Securities Litigation Uniform Standards Act ("SLUSA") does not empower defendants to remove class actions alleging only 1933 Act claims from state to federal court.[1] The Supreme Court's holding in *Cyan* resolved a split in the circuit courts on the question of whether or not SLUSA eliminated concurrent state court jurisdiction for these 1933 Act class action lawsuits.

In the wake of the decision, companies and their directors and officers, faced the possibility of not only litigating Section 11 claims arising under the 1933 Act in state court (those claims alleging liability for misrepresentations in connection with a public offering), but also perhaps concurrently in both state and federal courts. Questions also immediately surfaced about the applicability of the Private Securities Litigation Reform Act of 1995's ("PSLRA") stay of discovery pending a motion to dismiss – to state court actions. Following the two-year anniversary of the *Cyan* decision, we review *Cyan's* impact.

Prior to *Cyan*, the circuit courts were split as to whether claims brought solely under the 1933 Act could be brought in state court. From 2015 – 2017, an average of nineteen 1933 Act cases were filed in state court, with the substantial majority filed in California.[2] However, following *Cyan*, the doors flew open for plaintiffs to forum shop between multiple jurisdictions in both state and federal courts. Companies, insurers, and the defense bar alike expected a wave of state court filings under the 1933 Act. Driving that expectation were perceived advantages to the plaintiffs' bar in terms of more crowded dockets in state court – perhaps leading to motions to dismiss being granted at a lesser rate and fueling increased settlement values. Further, considerable uncertainty remained whether the PSLRA's automatic stay of discovery which applied in federal court, would be allowed in a 1933 Act state court case such that discovery would be stayed pending a motion to dismiss.

The expectations proved correct. In 2018, 1933 Act cases in state court jumped in frequency – totaling 35.[3] Thereafter, in 2019, 1933 Act cases in state court totaled 49 – an almost 2.5 times increase from the 2015 – 2017 average.[4] Further, a procedural headache which was of concern has also been borne out – that is, parallel or related class actions being litigated simultaneously in both state and federal courts. In 2019 for example, the combined number of federal Section 11 filings and state 1933 Act was 65 – 22 parallel filings, 27 state only filings, and 16 federal only filings.

Further clarity, or lack thereof, was also obtained on whether the PSLRA's stay of discovery pending a motion to dismiss applied in state court. In two well-articulated opinions, state court judges in Connecticut and New York held that the PSLRA discovery stay applied in 1933 Act cases in state court. In *City of Livonia Retiree Health and Disability*

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[1] *Cyan, Inc. v. Beaver Cty. Emples. Ret. Fund*, 138 S. Ct. 1061 (2018)
[2] Cornerstone Research, Securities Class Action Filings 2020: Year in Review, 2019, at 19.
[3] Id.
[4] Id.

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Benefits v. Pitney Bowes Inc., 2019 LEXIS 1604 (Conn. Super. 2019), the court held that the stay applies under the plain language of the PSLRA. Notably, the court acknowledged that the PSLRA's discovery stay appears in a section of the statute prefaced with "any private action arising under this subchapter," and it is indisputable that 1933 Act cases arise under the federal statute regardless of whether they are brought in federal or state court. The court noted, by contrast, that a different subchapter—not containing the discovery stay—applied only to cases brought "pursuant to the Federal Rules of Civil Procedure." Similarly, the court in *In re Everquote, Inc. Securities Litigation*, 65 Misc.3d 226 (N.Y. Sup. 2019) reached the same conclusion. The *Everquote* court conducted an in-depth analysis of the text of the PSLRA and SLUSA, and held that "the simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss '[i]n any private action arising under this subchapter,'" and "[n]owhere in [the PSLRA] does the statute indicate that it applies only to actions brought in federal court." The *Everquote* court rejected arguments from plaintiffs that the PSLRA's invocation of the Federal Rules of Civil Procedure in connection with discovery obligations implied that the PSLRA only governed in actions brought in federal court. The court also rejected plaintiffs' contention that if the discovery stay applied, state court procedures—such as preliminary conferences and mediation—could not occur during the stay. The court pointed out that "state court proceedings are often stayed for a host of other reasons" and Rule 11(d) of the New York Supreme Court's Commercial Division "expressly permits the stay of discovery pending the determination of a dispositive motion."

On the other hand, a different state court in New York twice held in 2019 that the PSLRA discovery stay does not apply in state court 1933 Act cases. In *Matter of PPDAI Group Securities Litigation*, 2019 N.Y. Misc. LEXIS 3481 (NY Sup. Ct., 2019) and *In re Dentsply Sirona, Inc. Shareholders Litigation*, 2019 N.Y. Misc. LEXIS 4260 (NY Sup. Ct., 2019), the court held with no elaboration that "[a]pplication of the federal PSLRA automatic discovery stay would undermine *Cyan's* holding that '33 Act cases may be heard in state courts." Whether an appellate level court will have an opportunity to address the applicability of the PSLRA's automatic stay of discovery to state court 1933 Act cases remains to be seen.

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One final interesting development is extremely noteworthy. On March 18, 2020, just two days shy of *Cyan's* two-year anniversary, the Supreme Court of the State of Delaware overturned the Delaware Court of Chancery's decision in *Sciabacucchi v. Salzberg*.[5] In response to the holding of *Cyan*, one strategy that some public companies attempted to employ to ensure a federal forum for Section 11 claims (under the 1933 Act) was to adopt provisions in their charter documents specifying that such claims could only be brought in federal court. However, the Delaware Court of Chancery held in *Sciabacucchi v. Salzberg*[6] that forum selection clauses were invalid for federal causes of action. Nevertheless, the Supreme Court of the State of Delaware disagreed, finding, after an extensive analysis of the Delaware General Corporation Law, that federal forum provisions do not "offend federal law and policy, nor do they offend principles of horizontal sovereignty."

Moreover, in recognizing Delaware corporations' ability to adopt innovative corporate governance provisions, the Court concluded by averring, "that a board's action might involve a new use of plain statutory authority does not make it invalid under our law, and the board of Delaware corporations have the flexibility to respond to changing dynamics in ways that are authorized by our statutory law."

The *Cyan* decision demonstrably resulted in an increase in state court filings under the 1933 Act. Now, following *Cyan's* two-year anniversary — it will be interesting to observe whether the *Sciabacucchi* decision reverses that trend to any extent. Companies, and particularly Delaware companies, will likely incorporate federal forum provisions in their charter documents at a higher rate – perhaps suppressing state court filings under the 1933 Act.

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[5] *Sciabacucchi v. Salzberg*, Del. Supr., No. 346, 2019, Valihura, K. (March 18, 2020) (ORDER).
[6] *Sciabacucchi v. Salzberg*, Del. Ch., C.A. No. 2017-0931, Laster, V.C. (Dec. 19, 2018) (Mem. Op.).

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