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Supreme Court to Decide Whether Discovery Stays Apply to State-Court Securities Lawsuits This Fall

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One of the most significant differences between bringing a securities lawsuit in state versus federal court is the application of the mandatory discovery stay set forth in the Private Securities Litigation Reform Act (the "PSLRA"). Following the enactment of the PSLRA in 1995, federal courts must stay discovery in securities-law cases until after a complaint has survived a pleadings challenge, *i.e.*, a motion to dismiss. State courts have been divided on whether such a stay is mandatory in securities-law cases brought before them as well. Now, a software company facing a challenge under the Securities Act of 1933 in California state court has been granted leave to argue before the United States Supreme Court that the PSLRA's discovery stay equally applies in state courts.

The underlying case involves statements made by Pivotal Software, Inc. in connection with its 2018 initial public offering. The plaintiffs in the ensuing lawsuits alleged that documents related to the IPO contained material misstatements about Pivotal's products and financial health and were not revealed to be false until the company lowered its guidance in 2019. Shortly thereafter, Pivotal and several of its officers, directors, and underwriters were named in parallel state and federal lawsuits in California. Both the federal and state court actions alleged, among other things, violations of the Securities Act in connection with Pivotal's registration statement. The state-court plaintiffs voluntarily stayed their action, pending further litigation of the federal case. After the Northern District of California granted Pivotal's motion to dismiss the consolidated federal complaint in full, the state-court plaintiffs sought discovery from the defendants, even though the defendants' motion to dismiss their complaint was still pending. The defendants sought application of the PSLRA's discovery stay, arguing that because it applies to "any private action" arising under, among other things, the Securities Act, 15 U.S.C. § 77z-2(f), it should stay discovery in the California state-court action as well.

The California Superior Court disagreed. Although it acknowledged that the PSLRA provides the discovery stay applies to "any private action arising under" the Securities Act, the lack of a specific reference to state-court actions precluded its application to such proceedings. The court also noted the separate provision in the Securities Litigation Uniform Standards Act of 1998 ("SLUSA"), which allows a court in certain actions to stay discovery "in any private action *in a State court.*" 15 U.S.C. § 77z-1(b)(4) (emphasis added). In the California court's view, the defendants' reading of the PSLRA's discovery stay provision would render the SLUSA provision redundant. Lastly, the court concluded that limiting the PSLRA's discovery stay to federal actions was in line with the provision's "procedural nature," potentially implicating the Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018). After the California Court of Appeal and California Supreme Court denied relief without a written opinion, the defendants filed a petition for a writ of certiorari and stay application with the United States Supreme Court, which the justices granted last month. *Pivotal Software, Inc. v. Superior Court of California, City & County of San Francisco*, No. 20-1541.

The Supreme Court's decision on this case could significantly alter the landscape for lawsuits brought under the Securities Act. In *Cyan*, the Supreme Court held that under SLUSA, Securities Act cases may be brought in state court and are not removable to federal court. The *Cyan* opinion went onto note that SLUSA's goal of "prevent[ing] plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than Federal, court" would not be undermined by allowing Securities Act lawsuits to be brought in state courts, because SLUSA also incorporates certain "*substantive* sections protecting defendants (like a safe harbor for forward-looking statements) in suits brought under the federal securities laws." 138 S. Ct. at 1072 (emphasis added). Importantly, the *Cyan* opinion did not address the possibility of plaintiffs seeking to avoid *procedural* protections by filing Securities Act complaints in state court.

The California Superior Court's denial of the *Pivotal* defendants' motion to stay discovery appeared to highlight this distinction, as it concluded that limiting the PSLRA's discovery stay to federal cases was consistent with the provision's "procedural nature." In the petitioners' view, *Cyan* does not condition application of a federal protective measure on whether it is substantive or procedural. The petitioners also disagreed with the California court's statutory interpretation of the PSLRA, noting that other provisions of the statute applied to state courts without specifically mentioning them. And although the *Cyan* opinion appeared to dismiss concerns regarding procedural protections not applying to state-law cases by noting that the "bulk" of securities class actions would proceed in federal court because they are brought under the Securities Exchange Act of 1934, rather than the Securities Act, 138 S. Ct. at 1073, the petitioners noted in their brief that the *Pivotal* underwriter defendants "have been cumulatively sued hundreds of times in state-court Securities Act suits in just the three years since *Cyan.*"

The case is scheduled for oral argument on November 9, 2021. Check back here for further updates.

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