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Defending Parallel Securities Litigation in Federal and State Court

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A Note providing guidance on defending parallel actions asserting claims under the federal securities laws in state and federal court. It discusses how the US Supreme Court's ruling in *Cyan, Inc. v. Beaver County Employees Retirement Fund* has changed the landscape for securities litigation and also provides guidance on handling lawsuits alleging overlapping federal securities law claims in both state and federal court. It also highlights key measures companies may take to avoid parallel securities litigation.

In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, the Supreme Court held that state and federal courts have concurrent jurisdiction over actions asserting only claims under the Securities Act of 1933 (Securities Act). The Supreme Court held that the Securities Litigation Uniform Standards Act (SLUSA) leaves in place state courts' jurisdiction over Securities Act claims, including when brought as class actions. (*Cyan*, 138 S. Ct. 1061, 1069-71 (2018)). After *Cyan*, defendants generally cannot remove Securities Act claims from state court and therefore face an increased risk of parallel federal and state securities litigation.

Parallel federal and state securities litigation most commonly occurs when plaintiffs bring claims alleging misrepresentations under Sections 11 or 12 of the Securities Act in state court and claims in federal court alleging the same misrepresentations under either or both the Securities Act and the Securities Exchange Act of 1934 (Exchange Act). This Note highlights key issues that parties should consider when defending parallel state and federal litigation under the federal securities laws.

For more information on SLUSA and *Cyan*'s impact on securities litigation, see Practice Note, Navigating the Securities Litigation Uniform Standards Act of 1998 (SLUSA) and Article, Expert Q&A: Securities Act Claims and SLUSA After Cyan.

Preparing for Parallel Litigation

Defendants typically may remove federal claims filed in state court to federal court (see Practice Note, Removal Overview). However, Congress expressly prohibited defendants from removing lawsuits brought exclusively under the Securities Act. Congress took the opposite approach when enacting the Exchange Act, providing that the federal courts have exclusive jurisdiction over Exchange Act claims. Counsel facing parallel litigation must understand:

- The key differences between the Securities Act and the Exchange Act (see Key Differences Between the Securities Act and Exchange Act).
- The requirements applicable to federal securities litigation that may not apply to state courts deciding Securities Act claims (see Federal Securities Litigation Requirements that May Not Apply in State Court).

Key Differences Between the Securities Act and the Exchange Act

The Securities Act is the principal federal statute governing securities offerings. It imposes liability under:

- Section 11, which permits private plaintiffs to bring actions against corporate issuers and their underwriters for investment losses caused by material misstatements or omissions in securities offerings.
- Section 12, which imposes liability for violations of the Securities Act's registration requirements.
- Section 15, which extends liability to "controlling persons," such as directors and officers signing the registration statement associated with a securities offering.

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By contrast, the Exchange Act is the principal federal statute governing securities trading. Courts have interpreted Section 10(b) of the Exchange Act and Securities and Exchange Commission (SEC) Rule 10b-5 to imply a private right of action for plaintiffs to redress investment losses caused by material misrepresentations or omissions made in connection with the purchase or sale of a security (17 C.F.R. § 240.10b-5). Section 10(b) claims typically involve purchases or sales of securities on the secondary market, though such claims can also involve purchases in securities offerings. Section 20(a) of the Exchange Act also allows for control person claims. Unlike private claims brought under the Securities Act, plaintiffs asserting private claims under the Exchange Act must show that the defendant had fraudulent intent and that the plaintiff relied on the misrepresentation.

Given the absence of a mental state requirement, Securities Act claims are sometimes referred to as "strict liability" claims. In other ways, however, Section 11 claims under the Securities Act have a far more restricted scope than Section 10(b) claims under the Exchange Act. Only a purchaser in a securities offering can bring a Section 11 claim based on the statements made in the offering registration statement. Accordingly, all Section 11 plaintiffs must "trace" their shares to the shares that were issued in the offering. In the world of modern trading, physical shares do not change hands in a manner that permits the tracing of specific shares, so, as a practical matter, plaintiffs acquiring their shares after an offering cannot bring Section 11 claims if there are other shares traded in the market that did not come from the offering. Two potential sources of shares entering the market from outside the challenged offering are:

- A prior or follow-on offering.
- Aftermarket sales from corporate insiders owning the shares before an initial public offering (IPO). These sales typically cannot occur until after the expiration of "lock-up" agreements between management and the underwriters (*In re Initial Pub. Offering Sec. Litig*., 227 F.R.D. 65, 117-20 (S.D.N.Y 2004), vacated on other grounds by 471 F.3d 24 (2d Cir. 2006)).

Exchange Act claims remain the primary vehicles to bring putative securities class action claims, in part because they are not subject to the tracing requirement and can be based on alleged material misstatements or omissions made outside the scope of a registration statement. Exchange Act claims also often provide for larger potential damages awards than Securities Act claims.

For a collection of resources focused on defending Securities Act claims, see Securities Act: Federal Private Lawsuit Defense Toolkit. For a collection of resources focused on defending Exchange Act claims, see Exchange Act: Section 10(b) Defense Toolkit.

Federal Securities Litigation Requirements that May Not Apply in State Court

Federal securities actions must comply with the requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA) (109 Stat. 737; 15 U.S.C. § 77z-1). The PSLRA poses several hurdles for plaintiffs to overcome, including:

- A heightened pleading standard for securities fraud claims.
- An automatic stay of discovery pending adjudication of a motion to dismiss.
- A safe harbor for forward-looking statements.
- Sanctions provisions.
- Limits on recoverable damages and attorney's fees.
- Requirements for the selection of lead plaintiffs.

(See *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81-82 (2006).)

The PSLRA's heightened pleading requirement for fraud and its other prerequisites result in relatively high rates of dismissal for federal securities fraud complaints (see Stefan Boettrich & Svetlana Starykh, NERA Economic Consulting (NERA), Recent Trends in Securities Class Action Litigation: 2019 Full-Year Review, at 9-11 (Jan. 2020) (NERA 2019 Full-Year Review)).

SLUSA does not prohibit plaintiffs from filing putative class actions that exclusively assert Securities Act claims in state court, or allow defendants to remove these actions to federal court (*Cyan*, 138 S. Ct. at 1078). Given the certainty *Cyan* provides to plaintiffs against removal, plaintiffs increasingly have brought Securities Act claims in state courts. This trend may be bolstered by plaintiffs' expectation that:

- Certain provisions of the PSLRA, such as the requirements concerning the appointment of a lead plaintiff and some limitations on damages awards, only apply to actions brought "pursuant to the Federal Rules of Civil Procedure" (15 U.S.C. § 77z-1(a)), which plaintiffs interpret to mean only actions brought in federal court.
- Some state courts may not apply certain PSLRA requirements, such as the PSLRA's automatic stay of discovery, even though the PSLRA states

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that these provisions apply to "any private action" (15 U.S.C. § 77z-1(b); see, for example, *Matter of PPDAI Grp. Sec. Litig*., 116 N.Y.S.3d 865, at *7 (N.Y. Sup. Ct. 2019); *Switzer v. Hambrecht & Co*., LLC, 2018 WL 4704776, at *1 (Cal. Super. Ct. Sept. 19, 2018); see also Motions to Stay Discovery).

- Securities Act claims in certain state courts might face different, less stringent pleading standards than those in federal court (see Motions to Dismiss).
- Plaintiffs may be able to obtain more favorable outcomes in state courts, including at the critical motion to dismiss phase (see Michael Klausner, Jason Hegland, Carin LeVine & Jessica Shin, State Section 11 Litigation In The Post-Cyan Environment (Despite Sciabacucchi), 75 BusLaw 1769, 1777 (2020) (finding that federal courts granted 39% of motions to dismiss class action claims brought under Section 11 of the Securities Act, whereas state courts granted only 28% of such motions)).

The collective impact of these trends may cause both plaintiffs and defendants to assess at the outset of litigation the forum most likely to be advantageous for them to proceed and attempt to have the claims adjudicated first in that forum.

Parallel Litigation Challenges and Strategies

Cases in state and federal courts cannot be combined and no procedure exists for consolidating cases filed in the courts of multiple different states. This means that defendants may have no complete procedural solution to avoid parallel litigation involving Securities Act claims.

Parallel Securities Act claims also raise the possibility that federal and state courts, presiding over nearly identical claims, can reach different or inconsistent rulings. This potential hazard is heightened by the fact that federal courts tend to grant a higher percentage of motions to dismiss Securities Act claims.

As a result, defense counsel must stay agile to manage these proceedings and deploy a variety of techniques, including:

- Motions aimed at resolving the litigation pending in the more favorable forum first, or at easing the burden of parallel litigation on defendants, such as:
  - filing a motion to stay one of the proceedings until resolution of the other (see Motions to Stay an Action);
  - moving to stay or dismiss the state court action for *forum non conveniens* (see Forum Non Conveniens); or
  - moving to transfer the federal court action to a venue in the federal district that corresponds to where the state court action is pending (see Motions to Transfer Venue).
- Arguing for the state court to apply the same standards applied by federal courts when deciding motions to dismiss Securities Act claims (see Motions to Dismiss).
- Seeking a stay of discovery in the state court action during the pendency of dismissal motions (see Motions to Stay Discovery).
- Avoiding inconsistent awards in parallel cases by invoking Section 11's damages limitations (see Damages Considerations).
- Seeking a single forum for settlement approval and broad settlement releases encompassing all related pending claims (see Settlement Strategies).

Motions to Stay an Action

Defense counsel should consider seeking a stay of one of the actions, usually the one pending in state court because the federal court action is likely to involve broader claims, until the resolution of the other. State courts are not obligated to grant stays in parallel actions, but some state court judges have stayed parallel state court actions, including before and after the Supreme Court's decision in *Cyan* (see, for example, *Lowinger v. Solid Biosciences, Inc*., 2018 WL 3711305, at *2 (Mass. Super. Ct. June 24, 2018); *Derdiger v. Tallman*, 773 A.2d 1005, 1018 (Del. Ch. 2000); but see *In re Rewalk Robotics Ltd. Stockholder Litig.*, 2017 WL 2427329, at *2 (Mass. Super. Ct. Apr. 4, 2017) (denying motion to stay parallel state court proceedings)).

State courts apply varying standards when deciding whether to stay a state court action in favor of a parallel federal court action so it is important to consult court-specific standards. A motion to stay the state court action is more likely to succeed if:

- The federal court action was filed first.
- The federal action is procedurally more advanced than the state action.
- The claims in both actions are substantially similar.
- Both actions involve the same parties (including because the plaintiff is a putative class member in all actions).
- The federal court can render a prompt and complete resolution of the parties' dispute.
- The federal action offers a more complete disposition of the issues, such as where a federal action asserts Exchange Act and Securities Act claims, but a state action asserts only Securities Act claims.

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- A stay avoids duplication, waste, and the risk of inconsistent rulings.
- A stay does not prejudice the state court plaintiff.
- The defendant is prejudiced if the parallel actions proceed.

(See, for example, *Qudian Sec. Litig.*, 2018 WL 6067209, at *2 (N.Y. Sup. Ct. Nov. 14, 2018); *Derdiger*, 773 A.2d at 1013-17; see also *Labourers' Pension Fund of Cent. & E. Can. v. CVS Health Corp.*, 2020 WL 2857654, at *3 (N.Y. Sup. Ct. June 1, 2020) (listing the factors New York state courts consider when determining whether to stay an action).)

Forum Non Conveniens

Defendants may also be able to dismiss or stay the parallel state court action on *forum non conveniens* grounds or a comparable state law rule. *Forum non conveniens* is an equitable defense "based upon the inconvenience" of the court "as a forum of choice" (*Nat'l Union Fire Ins. Co. of Pittsburgh v. Jordache Enters., Inc.*, 205 A.D.2d 341, 343 (N.Y. 1st Dep't 1994)). If parallel actions are brought in different forums, the state court may find that allowing the parallel state court action to proceed concurrently is burdensome and inconvenient (see *Berg v. MTC Electrs. Techns.*, 71 Cal. Rptr. 2d 523, 532 (Cal. Ct. App. 1998) (staying parallel state securities litigation on *forum non conveniens* grounds); see also *OneBeacon Am. Ins. Co. v. Newmont Mining Corp.*, 82 A.D.3d 554, 555-56 (N.Y. 1st Dep't 2011) (granting motion to dismiss parallel state court action on *forum non conveniens* grounds)).

Although some state courts grant relief on *forum non conveniens* grounds only in exceptional circumstances, they tend to be more likely to dismiss or stay an action if:

- The federal court action was filed first.
- The federal court action is procedurally more advanced than the state action.
- The parallel actions involve the same key issues and parties.
- The state in which the state court action is pending is not the "center of gravity" of the dispute.
- Litigating the claims in state court is burdensome for the parties and the court.

(See, for example, *Berg*, 71 Cal. Rptr. 2d at 531-32 (holding that *forum non conveniens* factors weighed in favor of staying the state court action); *In re Topps Co., Inc. S'holder Litig.*, 2007 WL 5018882, at *2-3 (N.Y. Sup. Ct. June 8, 2007) (describing the factors New York courts consider when determining whether to dismiss or stay an action under NY CPLR 3211(a)(4) or for *forum non conveniens*).)

Motions to Transfer Venue

State courts cannot transfer an action to another state. If a state court believes that an action should proceed in another state, the proper procedure is to dismiss the case without prejudice, which allows the plaintiff to refile the claims in another state's court (see, for example, *Wallace ex rel. Wallace v. Dimon*, 2006 WL 744295, at *2-3 (Tex. Ct. App. Mar. 23, 2006)).

Federal courts, however, may transfer a case to a federal district court located in a different state. Therefore, if a defendant cannot succeed in dismissing or staying a parallel state court action and the federal and state court actions were filed in different states, the defendant may want to transfer the federal court action to a federal court located in the same state as the state court action (assuming it is more convenient to litigate the claims in a single state).

Motions to transfer venue based on convenience are governed by 28 U.S.C. § 1404(a). Under 28 U.S.C. § 1404(a) courts consider various factors in determining whether transfer promotes efficiency and is in the interest of justice. Although different federal courts apply slightly different factors when considering motions to transfer venue under 28 U.S.C. § 1404(a), a motion to transfer is more likely to be granted if:

- Venue is proper in the transferee district.
- The operative facts occurred in the transferee forum.
- The relevant evidence and witnesses are located in the transferee forum.
- It is more convenient for the parties to litigate the claims in the transferee forum (for example, defendants and some class members are located in the transferee forum).
- It is more efficient for the parties to litigate the claims in the transferee forum (for example, the parallel actions are similar and there is overlap between the classes).

(See, for example, *Ahrens v. Cti Biopharma Corp.*, 2016 WL 2932170, at *3-4 (S.D.N.Y. May 19, 2016); *Lord Abbett Mun., Income Fund, Inc., on behalf of Lord Abbett High Yield Mun. Bond Fund v. Stone & Youngberg, LLC*, 2012 WL 13034286, at *3-6 (D.N.J. Nov. 19, 2012); *Wayne Cty. Emps.' Ret. Sys. v. MGIC Inv. Corp.*, 604 F. Supp. 2d 969, 974-78 (E.D. Mich. 2009).)

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For more information on transfer motions, see Practice Note, Motion to Transfer Venue (Federal) and Motion to Transfer Venue Factors by Circuit Chart (Federal).

Motions to Dismiss

Federal and state courts may apply different pleading standards at the motion to dismiss phase. Complaints asserting Securities Act claims in federal court must satisfy FRCP 8(a), which requires a short and plain statement showing that the plaintiff has a plausible claim for relief. The plaintiff fails to state a claim if its complaint is composed of:

- Simple recitals of the elements of a cause of action.
- Conclusory statements (including legal conclusions).
- Alleged facts that only suggest the possibility, and not the plausibility, of misconduct.

(*Ashcroft v. Iqbal*, 556 U.S. 662, 677-78 (2009); *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007).)

In Securities Act cases where the plaintiff alleges fraud rather than negligence, allegations of fraudulent conduct also must satisfy the heightened pleading requirements of FRCP 9(b) and the PSLRA (see Practice Note, Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA)); see also *Rombach v. Chang*, 355 F.3d 164, 171-72 (2d Cir. 2004); *In re AmTrust Fin. Servs., Inc. Sec. Litig.*, 2019 WL 4257110, at *11, *17 (S.D.N.Y. Sept. 9, 2019)).

Most plaintiffs commencing class actions in state courts asserting Securities Act claims post-*Cyan* have done so in California and New York (Cornerstone Research, Securities Class Action Filings: 2019 Year in Review, at 19). These states sometimes have applied more lenient pleading standards than the federal pleading standard (see State Section 11 Litigation In The Post-Cyan Environment (Despite Sciabacucchi), 75 BusLaw 1769, 1772 (comparing New York's and California's general pleading standards to the federal pleading standard)).

For example, the Second Circuit has observed that New York's general pleading standard appears to be more lenient than the plausibility standard that federal courts apply (*Williams v. Citigroup Inc.*, 659 F.3d 208, 215 n.4 (2d Cir. 2011)). And California state courts deem the facts in a pleading as true even if they appear improbable, when considering the merits of a demurrer (which is similar to a motion to dismiss), a standard that is also more lenient than federal courts' plausibility standard (see *Franceschi v. Franchise Tax Bd.*, 205 Cal. Rptr. 3d 75, 82 (Cal. Ct. App. 2016)). For more information on the pleading standards applied in California and New York state courts, see Practice Note, Commencing a Lawsuit: Drafting the Complaint (CA): General Pleading Standards and Practice Note, Commencing an Action in New York State Supreme Court: Summons and Complaint.

Defendants may be able to argue, however, that state-court motions to dismiss Securities Act claims should be decided under the same standards that federal courts use when deciding motions to dismiss Securities Act claims, to ensure consistent and uniform treatment of Securities Act claims. For example, courts in New York and California have found that:

- A heightened state law pleading standard applied to misrepresentation claims under the Securities Act (see *Matter of Sundial Growers Inc.*, 2020 WL 2543817, at *2 (N.Y. Sup. Ct. May 15, 2020); but see *In re Netshoes Sec. Litig.*, 126 N.Y.S.3d 856, 863-65 (N.Y. Sup. Ct. June 2, 2020) (declining to apply New York's heightened pleading standard for misrepresentation claims to the plaintiffs' Securities Act claims)).
- *Cyan* "clearly contemplates uniform treatment of securities class actions in Federal and State courts" (*In re Natera, Inc. Sec. Litig.*, 2018 WL 11028766, at *3 (Cal. Super. Ct. Aug. 7, 2018), aff'd sub. nom. *City of Warren Police & Fire Ret. Sys. v. Natera Inc.*, 259 Cal. Rptr. 3d 890 (Cal. Ct. App. 2020) (applying federal motion procedure to take judicial notice of the defendant's SEC filings and granting the defendant's motion for judgment on the pleadings)).

For a collection of resources on motions to dismiss securities lawsuits in federal court, see Securities Litigation: Motion to Dismiss Toolkit.

Motions to Stay Discovery

In federal courts, the PSLRA provides for an automatic stay of discovery until the court decides a motion to dismiss (15 U.S.C. §§ 77z-1(b), 78u-4(b)(3)(B)). Defendants may argue that the PSLRA's automatic stay provision also applies in state court because the statute states that it applies in "any private action" (15 U.S.C. § 77z-1(b)). In fact, although the Supreme Court in *Cyan* did not expressly address the automatic stay provision, it generally recognized that some of the PSLRA's substantive changes to the Securities Act and to the Exchange Act apply even when plaintiffs bring a Securities Act suit in state court (*Cyan*, 138 S. Ct. at 1066).

State courts, however, have not decided this issue consistently. Some judges have held that the plain language of the automatic stay provision "compels the conclusion" that it "applies to actions commenced in

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state court under the Securities Act" (*City of Livonia Retiree Health & Disability Benefits Plan v. Pitney Bowes Inc*., 2019 WL 2293924, at *3-4 (Conn. Super. Ct. May 15, 2019); see also *In re Everquote, Inc. Sec. Litig*., 106 N.Y.S.3d 828, 837 (N.Y. Sup. Ct. 2019)). Other judges have concluded that state courts are not required to apply the PSLRA's automatic stay provision and have declined to stay discovery pending a motion to dismiss (see *Matter of PPDAI Grp.*, 116 N.Y.S.3d 865, at *7; *Switzer*, 2018 WL 4704776, at *1; *In re Ally Fin. Inc*., 2018 WL 9596950, at *1-2 (Mich. Cir. Ct. Aug. 1, 2018)).

Even if a state court declines to apply the PSLRA's automatic stay provision, parties defending a Securities Act claim in state court may seek a discretionary stay of discovery (see, for example, *Greensky, Inc. Sec. Litig*., 2019 WL 6310525, at *2 (N.Y. Sup. Ct. Nov. 25, 2019)). Parties should consult the applicable state rules of civil procedure and local rules to determine whether they allow for a discretionary stay.

If a court is unwilling to stay discovery, defendants should attempt to coordinate discovery between the federal and state court actions if possible. Discovery coordination can result in various efficiencies, such as avoiding repetitive fact and expert witness depositions and developing a shared document database to reduce duplicative document productions. Federal and state court judges may also be willing to coordinate their rulings on discovery issues, which fosters consistent rulings on the same, or similar, discovery issues (see New York State-Federal Judicial Council, Report on the Coordination of Discovery Between New York Federal and State Courts, at 1, 3-4, 6-13 (2016) (recommending that federal and state court judges consider sharing rulings related to discovery and citing examples of how federal and state courts have coordinated discovery)).

Defendants should also move for protective orders in the actions to ensure:

- The parties in the federal action cannot access confidential documents and other evidence produced during discovery in the state action, absent defendants' consent.
- Consistent confidentiality standards apply in both actions.

For more on coordinating discovery, see Defending Parallel Proceedings: Discovery Tips Checklist. For more on the PSLRA's discovery stay, see Practice Note, Securities Litigation Involving the Private Securities Litigation Reform Act (PSLRA): Automatic Stay of Discovery.

Damages Considerations

Parallel federal and state Securities Act class actions also raise the potential for inconsistent damages awards.

Section 11(e) of the Securities Act limits the damages available to a Section 11 plaintiff to the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and one of:

- The value of the security "as of the time [the] suit was brought."
- The price at which the security was disposed of in the market before suit.
- The price at which the security was disposed of after suit but before judgment if it is less than the difference between the purchase price and the value of the security at the time of suit.

(15 U.S.C. § 77k(e).)

Federal courts have generally understood the phrase "the time such suit was brought" to mean the filing date of the original complaint alleging a Securities Act claim against the defendant (see, for example, *In re Barclays Bank PLC Sec. Litig.*, 2016 WL 3235290, at *5-6 (S.D.N.Y. June 9, 2016); *In re Washington Mut., Inc. Sec., Derivative & ERISA Litig.*, 2010 WL 4272567, at *11 (W.D. Wash. Oct. 12, 2010)). Federal courts may therefore limit damages if a corporation's stock was higher when an earlier action was filed in a different forum (see *In re Washington Mut., Inc*., 2010 WL 4272567, at *11-12).

State courts have generally recognized Section 11's limitations on damages (see, for example, *Conseco, Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2002 WL 31961447, at *8-9 (Ind. Cir. Ct. Dec. 31, 2002); *Bily v. Arthur Young & Co.*, 834 P.2d 745, 760 (Cal. 1992)). However, state courts have generally not ruled on whether to apply all of the limitations on damages that have been recognized under federal securities law, including the PSLRA's limitations on damages.

Parties defending against parallel federal and state court actions should consider seeking the same damages limitations in state court that are available in federal court. For example:

- If an earlier-filed federal court action is based on the same misrepresentations, defense counsel may consider arguing that the state court should determine Section 11 damages based on the stock price on the date that the earlier action was filed in federal court, even if the federal claims were brought under the Exchange Act

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(see, for example, *Alpern v. UtiliCorp United, Inc.*, 84 F.3d 1525, 1542-44 (8th Cir. 1996)).

- If the plaintiff filed a federal court action asserting Exchange Act claims before the stock price dropped below the offering price, a defendant can argue that the plaintiff did not suffer Section 11 damages (see *Pierce v. Morris*, 2006 WL 2370343, at *4 (N.D. Tex. Aug. 16, 2006) (dismissing Section 11 claims because, on the original filing date, the price of securities exceeded the plaintiff's purchase price, and ruling otherwise gives a Securities Act-plaintiff an incentive to file Exchange Act claims and "delay filing Securities Act claims until stock prices fall")).
- Similarly, if a Securities Act action is filed in state court before the filing of an Exchange Act claim in federal court, the federal court may limit the available damages to damages as of no later than the state court action filing date (see *In re Fortune Sys. Sec. Litig.*, 680 F. Supp. 1360, 1362-64, 1370-71 (N.D. Cal. 1987) (holding plaintiffs were unable to recover damages for Exchange Act claims that occurred after commencement of a Securities Act claim because the plaintiffs failed to mitigate their damages by filing their claims after the Securities Act claims were filed)).

Settlement Considerations

Although parties settle federal and state court actions asserting Securities Act claims at approximately similar percentage rates, defendants in state court:

- Are more likely to wait until resolution of a motion to dismiss before settling (see State Section 11 Litigation In The Post-Cyan Environment (Despite Sciabacucchi), 75 BusLaw at 1778 (finding that "35 percent of federal court settlements occur before a final ruling on a motion to dismiss, while only 20 percent of state court settlements do")).
- Settle claims for significantly lower amounts than in federal court, a difference that reflects a greater number of large settlements in federal courts as compared to state courts (State Section 11 Litigation In The Post-Cyan Environment (Despite Sciabacucchi), 75 BusLaw at 1781 (finding that between 2011 through 2019 the mean settlement in state courts was $7,941,875, while the mean settlement in federal courts was $17,900,000)).

For a collection of resources on settlement in securities litigation, see Federal Securities Class Action Settlement Toolkit.

Seeking a Single Forum for Settlement Approval

Defendants contemplating settling parallel federal and state court actions should consider seeking a single forum for settlement approval, in most cases the federal forum where the broader claims were asserted. Procedurally, this may be accomplished by, for example, the state court plaintiff appearing as an intervenor-plaintiff in the federal settlement proceedings. If the federal and state plaintiffs insist on seeking settlement approval in both courts, defendants should consider:

- Ensuring consistent filings in both courts.
- Sending only one settlement notice.
- Conditioning events, such as the obligation to distribute notice, fund the settlement, and the settlements' final effectiveness, on obtaining approval from both courts.

Defendants should also consider attempting to settle both the state and federal actions at a single mediation with the same mediator, in discussions that also include the defendants' liability insurers, if applicable, to ensure that the settlement is acceptable to the insurers. Settling both actions simultaneously avoids the possibility that plaintiffs in one of the actions will object to the fairness of the other settlement or opt-out of the class settlement and demand more generous settlement terms than the other settlement.

For more on mediation and the role of insurers in securities class action settlements, see Practice Note, Settling Securities Class Actions: Early Case Assessment.

Seeking Broad Settlement Releases

Alternatively, defendants may consider settling with only the plaintiff asserting the broader claims, for example, a federal plaintiff asserting Exchange Act and Securities Act claims, and including in the settlement a release that covers the claims in the other action. This approach may carry greater risks for defendants because plaintiffs in the parallel action are likely to argue that the release does not apply to them, seek a fee award, or otherwise challenge the settlement.

For example, a federal court recently granted a motion, filed by the plaintiffs in a parallel state proceeding, to continue the preliminary approval hearing until after the state court decided whether to dismiss the state court plaintiffs' Securities Act claims (see *Gomes v. Eventbrite, Inc.*, 2020 WL 6381343, at *1, *4 (N.D. Cal. Oct. 30, 2020)). Specifically, the federal court was persuaded by the state court plaintiffs' argument that they could not "effectively object or consider whether to opt-out of the settlement" while the state court action is pending, where the proposed release would cover the Securities Act claims asserted in the state court action (*Gomes*, 2020 WL 6381343, at *1, *3-4).

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The state court plaintiffs may also argue that the settlement is a "reverse auction" and therefore the court should not enforce the settlement release. A reverse auction occurs when the defendant in a series of class actions "picks the most ineffectual class lawyers to negotiate a settlement with in the hope that the district court will approve a weak settlement that will preclude other claims against the defendant" (*Reynolds v. Beneficial Nat'l Bank*, 288 F.3d 277, 282 (7th Cir. 2002)).

Courts are generally skeptical of reverse auction challenges as these challenges undermine the settlement of parallel class actions because "none of the competing cases could settle without being accused by another [party] of participating in a collusive reverse auction" (*Negrete v. Allianz Life Ins. Co. of N. Am.*, 523 F.3d 1091, 1099-1100 (9th Cir. 2008) (quoting *Rutter & Wilbanks Corp. v. Shell Oil Co.*, 314 F.3d 1180, 1189 (10th Cir. 2002))).

Even if the court rejects a reverse auction challenge, however, it may require "closer scrutiny" of a release encompassing non-frivolous claims for damages that are substantially higher than the settlement amount (see *Reynolds*, 288 F.3d at 283-86 (holding that the district judge abused his discretion in approving the settlement, in part because the judge should have made a greater effort to "quantify the net expected value of continued litigation to the class" in light of the settlement's release clause)). These types of challenges undercut the benefits of finality that a defendant seeks when settling.

Avoiding Parallel Proceedings

Corporations hoping to limit exposure to Securities Act claims in state court should consider including a federal forum selection provision in their certificates of incorporation and precautionary measures before a public offering of securities.

Federal Forum Selection Provisions

Corporations seeking to avoid Securities Act litigation in state court should consider adopting, in their certificates of incorporation, a forum selection clause specifying that Securities Act claims must be brought in federal court (federal-forum provisions).

In *Salzberg v. Sciabacucchi*, the Delaware Supreme Court upheld federal-forum provisions in the certificates of incorporation of several Delaware corporations (227 A.3d 102 (Del. 2020)). The court determined that Delaware law permits federal-forum provisions for intra-corporate litigation that address the management of the business and the conduct of the affairs of the corporation. It further recognized that federal-forum provisions address "the post-*Cyan* difficulties presented by multi-forum litigation of Securities Act claims" and promote "efficiencies in managing the procedural aspects of securities litigation" (*Salzberg*, 227 A.3d at 113-15, 137).

Some California superior courts have enforced Delaware corporations' federal-forum provisions in the wake of *Salzberg* (see *In re Uber Techs., Inc. Sec. Litig.*, CGC-19-579544 (Cal. Super. Ct. Nov. 16, 2020); *Wong v. Restoration Robotics, Inc.*, 18-CIV-02609 (Cal. Sup. Ct. Sept. 1, 2020)). One decision specifically upheld a company's federal-forum provision, mandating that federal courts "shall be the exclusive forum" for resolving Securities Act claims, as lawful and valid under California law (*In re Uber Techs., Inc.*, Order Granting Defendants' Motion to Dismiss, at 3, 10). That court further held that the company's federal-forum provision did not conflict with concurrent state court jurisdiction over Securities Act claims or with the Supreme Court's decision in *Cyan* (*In re Uber Techs., Inc.*, Order Granting Defendants' Motion to Dismiss, at 10-14).

While other states have not yet indicated whether they intend to uphold federal-forum provisions, many Securities Act claims have been filed in California state courts. If numerous California state courts dismiss claims based on federal-forum provisions, these provisions may become even more prevalent.

Precautionary Measures Before Public Offerings of Securities

Before any offering, corporate counsel should consider:

- Negotiating a lock-up period substantially shorter than the customary 180 days. This reduces risk and exposure to Section 11 claims by limiting the period that shares can be "traced" to the offering.
- Carefully reviewing insurance policies, including directors and officers insurance policies and public offering of securities insurance (POSI) policies, before any offering. This review should include ensuring that the policies:
  - cover claims based on pre- and post-offering activities; and
  - extend to potential state court claims.

Of course, every corporation's situation is different. Taking care with disclosures, retaining skilled advisors, and

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ensuring appropriate due diligence all help to reduce the risk of Securities Act exposure.

For more on issues that corporate counsel should know to best position their client to avoid securities litigation, see Practice Note, Securities Litigation and Enforcement for Transactional Lawyers.

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