Defending PARALLEL SECURITIES LITIGATION in Federal and State Court

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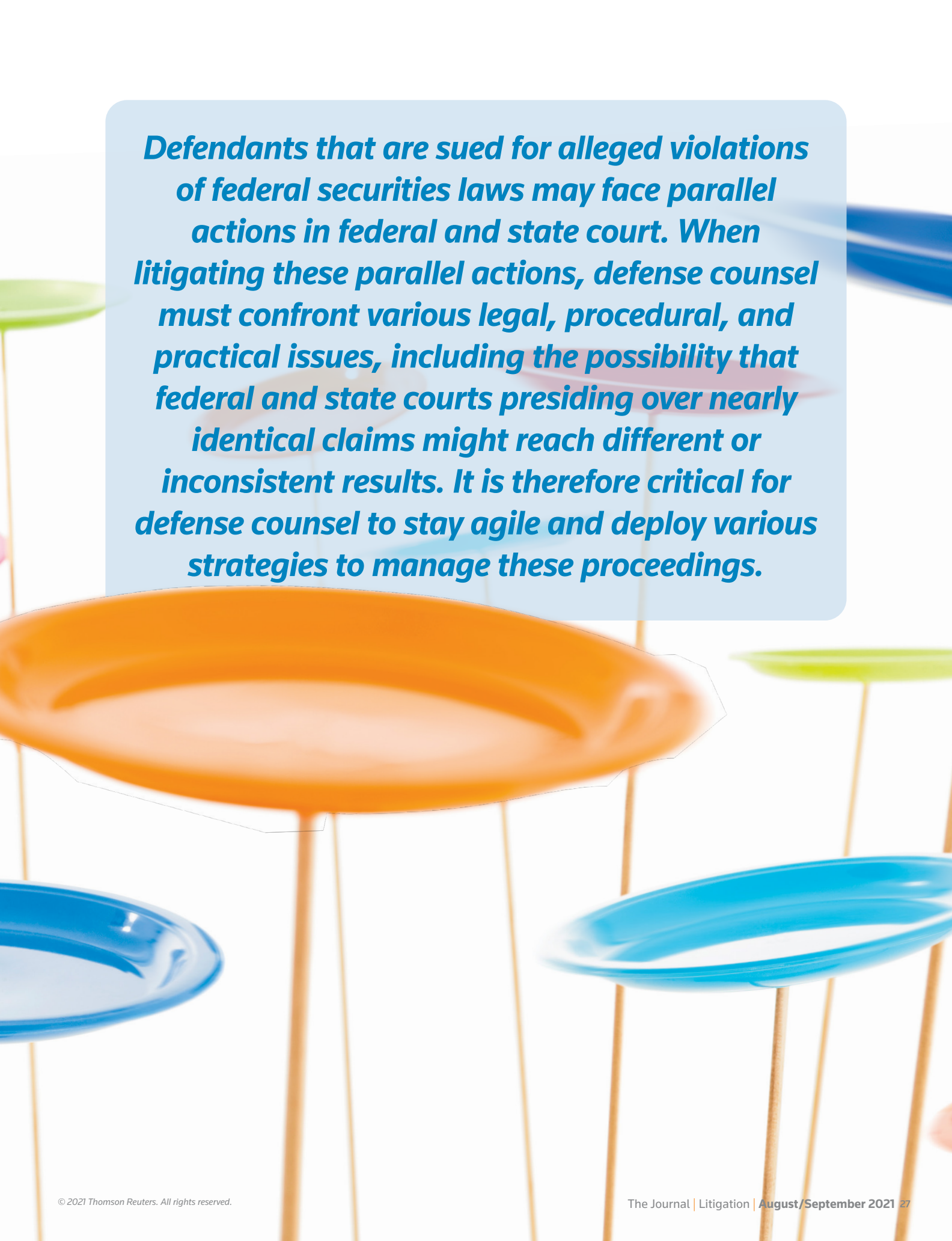
Defendants that are sued for alleged violations of federal securities laws may face parallel actions in federal and state court. When litigating these parallel actions, defense counsel must confront various legal, procedural, and practical issues, including the possibility that federal and state courts presiding over nearly identical claims might reach different or inconsistent results. It is therefore critical for defense counsel to stay agile and deploy various strategies to manage these proceedings.



The US Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund* changed the landscape for securities litigation. In *Cyan*, the Supreme Court held that federal and state courts have concurrent jurisdiction over actions asserting only claims under the Securities Act of 1933 (Securities Act). In so holding, the Supreme Court addressed the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which, among other things, enables defendants to remove securities class action lawsuits that meet certain criteria from state court to federal court. The Court clarified that SLUSA leaves in place state courts' jurisdiction over Securities Act claims, including when the claims are brought as a proposed class action. (*Cyan*, 138 S. Ct. 1061, 1069-71, 1078 (2018).)

In light of *Cyan*, defendants generally cannot remove Securities Act claims from state court and therefore face an increased risk of parallel federal and state securities litigation. This type of parallel litigation most commonly occurs when plaintiffs bring claims in state court alleging misrepresentations under Section 11 or 12 of the Securities Act 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).

Given that cases in federal and state courts cannot be combined, and no procedure exists for consolidating cases filed in the courts of multiple different states, defendants may have no complete procedural solution to avoid parallel litigation involving Securities Act claims. It is therefore important for counsel representing securities litigation defendants to understand the challenges and strategies involved in litigating parallel actions.

This article provides guidance to defense counsel involved in parallel federal and state securities litigation, including:

- Understanding the applicable legal framework.
- Engaging in strategic motion practice.
- Avoiding inconsistent damages awards.
- Achieving an optimal settlement.

Additionally, it highlights precautionary measures companies can take to avoid parallel securities litigation.

Search Navigating the Securities Litigation Uniform Standards Act of 1998 and Expert Q&A: Securities Act Claims and SLUSA After Cyan for more on SLUSA and *Cyan*'s impact on securities litigation.

LEGAL FRAMEWORK

Defendants typically may remove federal claims filed in state court to federal court. However, when enacting the Securities Act, Congress expressly prohibited defendants from removing lawsuits brought exclusively under the Securities Act. By contrast, when enacting the Exchange Act, Congress provided that federal courts have exclusive jurisdiction over Exchange Act claims. Counsel facing parallel securities litigation must understand:

- The key differences between the Securities Act and the Exchange Act.
- The requirements applicable to federal securities litigation that may not apply to state courts deciding Securities Act claims.

Search Removal: Overview for more on the removal process generally.

DIFFERENCES BETWEEN THE SECURITIES ACT AND EXCHANGE ACT

The Securities Act is the principal federal statute governing securities offerings. Key liability provisions include:

- **Section 11.** This provision 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.** This provision imposes liability for violations of the Securities Act's registration requirements.
- **Section 15.** This provision extends liability to "controlling persons," such as directors and officers who sign the registration statement associated with a securities offering.

The Exchange Act is the principal federal statute governing securities trading. Key provisions include:

- **Section 10(b) and Securities and Exchange Commission (SEC) Rule 10b-5.** Courts have interpreted these provisions as implying 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 also can involve purchases in securities offerings.
- **Section 20(a).** This provision 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 for Securities Act claims, these claims are sometimes referred to as strict liability claims.

However, Securities Act Section 11 claims have a more restricted scope than Exchange Act Section 10(b) claims in that 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. Therefore, as a practical matter, plaintiffs who acquired 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 who owned 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 vehicle 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.

Search Securities Act: Section 11 Elements and Defenses and Exchange Act: Section 10(b) Elements and Defenses for more on defending lawsuits brought by private plaintiffs based on Securities Act Section 11 and Exchange Act Section 10(b).

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 attorneys' fees.
- Requirements for the selection of lead plaintiffs.

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

As discussed above, the Supreme Court in *Cyan* made clear that 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) apply only 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 automatic stay of discovery, even though the PSLRA states 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.*, 2018 WL 4704776, at *1 (Cal. Super. Ct. Sept. 19, 2018). This issue — whether the language of the PSLRA requires state courts to impose the automatic discovery stay — is the subject of an appeal on which the Supreme Court has granted *certiorari* (*Pivotal Software, Inc. v. Superior Court of CA*, 2021 WL 2742794 (U.S. July 2, 2021); see below *Motions to Stay Discovery*).
- Securities Act claims in certain state courts may face different, less stringent pleading standards than those in federal court (see below *Motions to Dismiss Securities Act Claims*).
- Plaintiffs may be able to obtain more favorable outcomes in state courts, including at the critical motion to dismiss phase, because 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 Cornerstone Research, Securities Class Action Filings: 2020 Year in Review, at 18 (2021) (Cornerstone 2020 Year in Review); Michael Klausner et al., 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 in which it would most likely be advantageous for them to proceed and attempt to have the claims adjudicated first in that forum.

Search Securities Litigation Involving the Private Securities Litigation Reform Act for more on the PSLRA.

MOTION PRACTICE

Defense counsel should consider how motion practice can be employed as part of the strategy for defending parallel federal and state court actions. For example, counsel may consider bringing a motion to:

- Stay one of the actions until resolution of the other action.
- Stay or dismiss the state court action for *forum non conveniens*.
- Transfer the federal court action to a venue in the federal district that corresponds to where the state court action is pending.
- Dismiss the Securities Act claims in state court and argue that the state court should apply the same pleading standards applied by federal courts.
- Stay discovery in the state court action during the pendency of dismissal motions.

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 include broader claims, that is, both Securities Act and Exchange Act claims) until the resolution of the other action. Although state courts are not obligated to do so, some judges have granted stays of 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 a motion to stay parallel state court proceedings)).

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

- The federal court action was filed first.
- The federal court action is procedurally more advanced than the state court action.
- The claims in both the federal and state court actions are substantially similar.
- Both the federal and state court actions involve the same parties (including where 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 court action offers a more complete disposition of the issues, such as where a federal court action asserts Exchange Act and Securities Act claims but the state court action asserts only Securities Act claims.
- 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 *Convery v. Jumia Techs. AG*, 2020 WL 4586301, at *2 (N.Y. Sup. Ct. Aug. 7, 2020) (listing the factors that New York state courts consider when determining whether to stay an action).)

MOTIONS TO STAY OR DISMISS AN ACTION FOR *FORUM NON CONVENIENS*

Defendants also may be able to dismiss or stay a parallel state court action based on *forum non conveniens* or a comparable state law rule (again, the focus is on the state court action because the federal court action will likely involve broader claims). *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 Elecs. Techns.*, 61 Cal. App. 4th 349, 363 (1998) (staying a parallel state court action 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 a motion to dismiss a 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 court 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*, 61 Cal. App. 4th at 362-63 (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 Rule 3211(a)(4) of the New York Civil Practice Law and Rules, which involves an analysis similar to considering a *forum non conveniens* motion).)

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 would be 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 this provision, 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), the motion 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. ex rel. 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).)

Search Motion to Transfer Venue (Federal) and Motion to Transfer Venue Factors by Circuit Chart (Federal) for more on motions to transfer venue under 28 U.S.C. § 1404(a).

MOTIONS TO DISMISS SECURITIES ACT CLAIMS

As noted above, federal courts tend to grant a higher percentage of motions to dismiss Securities Act claims than state courts, which may in part be attributed to the fact that 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 suggest only 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).)

Federal courts tend to grant a higher percentage of motions to dismiss Securities Act claims than state courts, which may in part be attributed to the fact that federal and state courts may apply different pleading standards at the motion to dismiss phase.

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 *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)).

After *Cyan*, most plaintiffs commencing class actions asserting Securities Act claims in state courts have done so in California and New York (see Cornerstone Research, Securities Class Action Filings: 2019 Year in Review, at 19, available at *cornerstone.com*). These states sometimes have applied less stringent pleading standards than the federal pleading standard (see, for example, *Williams v. Citigroup Inc.*, 659 F.3d 208, 215 n.4 (2d Cir. 2011) (observing that New York's general pleading standard appears to be more lenient than the federal plausibility standard); *Franceschi v. Franchise Tax Bd.*, 1 Cal. App. 5th 247, 256 (2016) (explaining that

California courts considering the merits of a demurrer (which is similar to a motion to dismiss) deem the facts in the pleading as true, even if they appear improbable); State Section 11 Litigation in the Post-*Cyan* Environment (Despite *Sciabacucchi*), 75 BusLaw at 1772 (comparing New York's and California's general pleading standards to the federal pleading standard)).

Search Commencing a Lawsuit: Drafting the Complaint (CA) and Commencing an Action in New York State Supreme Court: Summons and Complaint for more on the pleading standards applied in California and New York state courts.

However, defendants may be able to argue that state courts should decide motions to dismiss Securities Act claims under the same standards (or similar standards) that federal courts apply to ensure consistent and uniform treatment of Securities Act claims. For example, certain state courts have found that:

- A heightened state law pleading standard applied to misrepresentation claims under the Securities Act (see *Hoffman v. AT&T Inc.*, 126 N.Y.S.3d 854 at *2 (N.Y. Sup. Ct. 2020); but see *In re Netshoes Sec. Litig.*, 126 N.Y.S.3d 856, 863-65 (N.Y. Sup. Ct. 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 [f]ederal and [s]tate 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.*, 46 Cal. App. 5th 946 (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)).

Search Securities Litigation: Motion to Dismiss Toolkit for a collection of resources to help counsel prepare, file, and serve motions to dismiss in federal court actions asserting private claims under the Securities Act and the Exchange Act.

MOTIONS TO STAY DISCOVERY

In federal court, 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)). Moreover, 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).

However, state courts have not consistently decided the issue of whether they should apply the PSLRA's automatic stay provision. Some judges have held that the plain language of the automatic stay provision "compels the conclusion" that it "applies to actions commenced in 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 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)).

Where a state court is unwilling to stay discovery, defendants should attempt to coordinate discovery between the federal and state court actions, if possible.

In July 2021, the Supreme Court granted a petition for a writ of *certiorari* to address whether the PSLRA's automatic discovery stay provision applies to securities claims filed in state court (*Pivotal Software, Inc.*, 2021 WL 2742794). The petition was brought by defendants to parallel Securities Act claims who were denied a stay of discovery in California state court (*Pivotal Software, Inc. v. Tran*, 2021 WL 1816827, at *1-3 (U.S. May 2021)).

In the meantime, if a state court declines to apply the PSLRA's automatic stay provision, defense counsel should consult the applicable state rules of civil procedure and local rules to determine whether

they allow for a discretionary stay (see, for example, *Greensky, Inc. Sec. Litig.*, 2019 WL 6310525, at *2 (N.Y. Sup. Ct. Nov. 25, 2019)). Some state courts may view the pendency of the *Pivotal Software* appeal in the Supreme Court as a reason to grant a discretionary stay.

Where a state 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 also may be willing to coordinate their rulings on discovery issues, which fosters consistent rulings on the same, or similar, 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)).

At the start of discovery, defendants should also move for protective orders in the actions to ensure that:

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

Search Securities Litigation Involving the Private Securities Litigation Reform Act for more on the PSLRA's discovery stay.

Search Defending Parallel Proceedings: Discovery Tips Checklist for more on coordinating discovery in parallel litigation.

DAMAGES

Parallel federal and state class actions asserting claims under the Securities Act 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 following:

- 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 that the time the suit was brought means 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 *11-12 (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).

Although 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)), they generally have not ruled on whether to apply all of the damages limitations that have been recognized under federal securities laws, including the PSLRA.

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 on which the state court action is based, and the value of the stock was higher when the federal action was filed, 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 federal court action was filed, even if the federal claims were brought under the Exchange Act (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, defense counsel 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 the securities exceeded the plaintiff's purchase price, and ruling otherwise would give a Securities Act plaintiff an incentive to file Exchange Act claims and "delay filing Securities Act claims until stock prices fall")).
- If the plaintiff filed a state court action asserting Securities Act claims before filing a federal court action asserting Exchange Act claims, defense counsel can argue that the federal court should limit damages to the damages that were available 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 that the plaintiffs were unable to recover damages for Exchange Act claims that they asserted in federal court after commencement of a Securities Act claim in state court because the plaintiffs failed to mitigate their damages by waiting

to file their Exchange Act claims even though they had notice of the defendants' alleged wrongdoing, as evidenced by the state court filing)).

SETTLEMENT

Although parties settle federal and state court actions asserting Securities Act claims at 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% of federal court settlements occur before a final ruling on a motion to dismiss, while only 20% 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 from 2011 through 2019, the mean settlement in state courts was $7,941,875, while the mean settlement in federal courts was $17,900,000)).

When settling parallel federal and state court actions asserting Securities Act claims, defense counsel should consider the implications of seeking:

- Settlement approval in a single forum versus both the federal and state forums.
- Broad settlement releases encompassing all related pending claims.

Search Federal Securities Class Action Settlement Toolkit for a collection of resources to assist counsel with settling class actions under the federal securities laws.

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 distributing class notice, funding the settlement, and effectuating the terms of the settlement, on obtaining approval from both courts.

Defendants should also consider attempting to settle both the federal and state court actions at a single mediation with the same mediator. The discussions should 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.

Search Settling Securities Class Actions for more on the settlement approval process, mediation, and the role of insurers in securities class action settlements.

SEEKING BROAD SETTLEMENT RELEASES

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 other 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 granted a motion to continue a preliminary class settlement approval hearing and then denied preliminary approval (without prejudice to renew) because the plaintiffs in a parallel state court proceeding intervened and argued that they could not "effectively object or consider whether to opt-out of the settlement" while the state court action was pending (see *Gomes v. Eventbrite, Inc.*, 2020 WL 6381343, at *1, *3-4 (N.D. Cal. Oct. 30, 2020) (noting that the proposed release would cover the Securities Act claims asserted in the state court action); see also *Gomes v. Eventbrite, Inc.*, Order Denying Motion for Preliminary Approval of Class Action Settlement, No. 19-02019 (N.D. Cal. Jan. 22, 2021) (Dkt. No. 76)).

Additionally, state court plaintiffs may argue that the court should not enforce a settlement release because the settlement constitutes a "reverse auction." 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 because they undermine the settlement of parallel class actions in that "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))).

However, even if the court rejects a reverse auction challenge, 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 a 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 LITIGATION

Corporations hoping to limit exposure to Securities Act claims in state court should consider:

- Including in their certificates of incorporation a federal forum selection provision specifying that Securities Act claims must be brought in federal court (known as a federal-forum provision).
- Taking precautionary measures before a public offering of securities.

FEDERAL-FORUM PROVISIONS

Corporations seeking to avoid Securities Act litigation in state court should consider adopting in their certificates of incorporation a federal-forum provision. In *Salzberg v. Sciabacucchi*, the Delaware Supreme Court upheld federal-forum provisions in the certificates of incorporation of several Delaware corporations. The court determined that Delaware law permits federal-forum provisions for intra-corporate litigations that address the management of the business and the conduct of the affairs of the corporation. Further, the court 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." (*Sciabacucchi*, 227 A.3d 102, 113-15, 137 (Del. 2020).)

A few California superior courts have enforced Delaware corporations' federal-forum provisions in the wake of *Sciabacucchi* (see, for example, Order Granting Defendants' Motion to Dismiss, *In re Uber Techs., Inc. Sec. Litig.*, CGC-19-579544, at 3, 7-8, 10 (Cal. Super. Ct. Nov. 16, 2020); Order Re: Motions to Dismiss, *Wong v. Restoration Robotics, Inc.*, 18-CIV-02609 (Cal. Super. Ct. Sept. 1, 2020)). In one decision, the court held that the relevant federal-forum provision was "lawful and valid under California law," a holding that could have significant implications for parallel securities litigation given that a large number of Securities Act claims have been filed in California state courts (Order Granting Defendants' Motion to Dismiss, *In re Uber Techs., Inc.*, at 3, 10-14).

In general, the number of securities class actions filed in 2020 decreased by 20% compared to the average number of filings between 2017 and 2019, potentially because of pandemic-related court closures. But the number of Securities Act claims filed in state courts in 2020 decreased even more substantially, for reasons that also might include state court rulings upholding federal-forum provisions (see Cornerstone 2020 Year in Review, at 4-5 (finding that the number of state court Securities Act filings in 2020 "fell sharply from 53 to 17, particularly in the second half of 2020" and that this decline may be in response to the *Sciabacucchi* ruling, as well as strong stock market performance)). Federal-forum provisions are likely to become even more prevalent, especially if additional state courts dismiss claims based on these provisions.

PRECAUTIONARY MEASURES BEFORE PUBLIC OFFERINGS OF SECURITIES

Before any public offering of securities, 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. 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 ensuring appropriate due diligence all help to reduce the risk of Securities Act exposure.

Search Securities Litigation and Enforcement for Transactional Lawyers for more on issues that corporate counsel should consider to best position their client to avoid securities litigation.

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Securities Act: Federal Private Lawsuit Defense Toolkit

The Securities Act: Federal Private Lawsuit Defense Toolkit available on Practical Law offers a collection of resources to help counsel defend lawsuits brought by private plaintiffs based on violations of the Securities Act. It features a range of continuously maintained resources, including:

- Securities Act: Section 11 Standing
- Securities Act: Jurisdictional Defenses
- Securities Act: Answer
- Securities Act: Section 12(a)(1) Elements and Defenses
- Defending Underwriters Against Securities Claims
- Securities Act: Section 11 Summary Judgment Checklist
- Challenging Standing in Securities Class Actions
- Securities Act: Motion to Dismiss Memorandum of Law
- Securities Act: Section 12(a)(2) Elements and Defenses
- Securities Litigation: Class Actions Arising from IPOs
- Securities Act: Request for the Production of Documents (Defendant to Plaintiff)
- Defending Against Control Person Claims
- Securities Act: Section 11 Opposing Class Certification Checklist