SECURITIES LITIGATION INVOLVING THE PRIVATE SECURITIES LITIGATION REFORM ACT

Plaintiffs asserting claims under the federal securities laws must comply with the Private Securities Litigation Reform Act of 1995 (PSLRA), a federal law enacted to address perceived litigation abuses and deter frivolous securities class actions. Over the years, the PSLRA has served as a powerful tool protecting corporate issuers and their executives from unfounded litigation. Courts continue to interpret and shape the PSLRA’s terms, making it critical for securities practitioners to stay informed about developments in this area.

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Congress enacted the PSLRA “to protect investors, issuers, and all who are associated with our capital markets from abusive securities litigation” (H.R. Rep. No. 104-369 (Conf. Rep.), at 32 (1995)). In particular, Congress was concerned with the practice of plaintiffs’ lawyers targeting deep-pocketed corporate defendants, racing to the courthouse to file a complaint in a favorable jurisdiction on behalf of a token plaintiff with a minimal stake in the outcome of the case, and imposing on defendants burdensome and costly discovery requests in the hopes of extracting a settlement (see S. Rep. No. 104-98, at 10 (1995); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 81 (2006)).

Congress attempted to address these concerns through procedures and requirements in the PSLRA. Additionally, Congress sought to encourage companies to make full and robust disclosures to the market without fear that projections that later turned out to be inaccurate would trigger securities class action lawsuits. (See H.R. Conf. Rep. No. 104-369, at 31, 43.)

The PSLRA has achieved many of its goals. Although 300 securities class actions were filed in 2016, the most in the last 20 years, courts dismissed a record 149 actions that year. More than half of the dismissals occurred within a year after the complaint was filed. In fact, 2016 was the first year since the PSLRA’s enactment in 1995 that more cases were dismissed than settled, by nearly a third. In all, 262 cases were resolved in 2016, another all-time high. (Stefan Boettrich & Svetlana Starykh, NERA Economic Consulting (NERA), Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review, at 2, 24 (Jan. 2017) (NERA 2016 Full-Year Review).)

However, it remains to be seen whether the dismissal rate in 2016 will continue in 2017 and beyond. Plaintiffs filed 246 securities class actions in the first half of 2017, a 76% increase over the same period in 2016 (Stefan Boettrich & Svetlana Starykh, NERA, Securities Class Actions: 2016 Full-Year Review and Mid-2017 Flash Update, at 15 (July 24, 2017)). For those cases that withstand dismissal, defending a securities class action can be a long, costly process. The median time to resolve a securities class action is 2.4 years (see Box, Hypothetical Timeline of a Putative US Securities Class Action). It is therefore critical for companies and their counsel to understand the applicable law and ways they can limit their exposure to securities class actions, and to consider the many avenues for dismissal under the PSLRA.

This article provides an overview of securities litigation involving the PSLRA and highlights best practices for companies and their counsel. Specifically, it examines:

- The PSLRA’s key provisions and mechanisms to disincentivize plaintiffs from filing frivolous securities claims.
- The procedural and strategic issues parties should consider at each stage of the litigation, including common defenses under the PSLRA.

The PSLRA applies only to private actions asserting violations of the federal securities laws brought in federal court, including claims under both the Securities Act of 1933 (15 U.S.C. § 77z-1) and the Securities Exchange Act of 1934 (15 U.S.C. § 78u-4) (see Box, Elements of a Securities Fraud Claim). Although it arises most often in the context of securities fraud claims filed on behalf of a putative class, the PSLRA also applies to non-class action lawsuits alleging securities law violations (see, for example, CMG Worldwide, Inc. v. Claser, 92 F. Supp. 3d 839, 844 (S.D. Ind. 2015) (collecting cases); Riggs v. Termeer, 2003 WL 21345183, at *1 (S.D.N.Y. June 9, 2003)).

**KEY PROVISIONS OF THE PSLRA**

The PSLRA poses several hurdles for plaintiffs to overcome, including:

- A heightened pleading standard.
- An automatic stay of discovery.
- A safe harbor for forward-looking statements made by the issuer.
- Sanctions provisions.
- Limits on the amount of and liability for damages.
- Requirements for the selection of lead plaintiffs.

**HEIGHTENED PLEADING STANDARD**

Before the PSLRA was enacted, a plaintiff alleging securities fraud had to satisfy the heightened pleading standard for claims of “fraud or mistake” required by Federal Rule of Civil Procedure (FRCP) 9(b), rather than the general pleading standard prescribed in FRCP 8(a). FRCP 8(a) requires a plaintiff to provide only a “short and plain statement of the claim” to give the defendant “fair notice” of what the claim is and the grounds on which it rests, while FRCP 9(b) requires a complaint to “state with particularity the circumstances constituting the fraud.” More specifically, to satisfy FRCP 9(b), a plaintiff asserting a fraud claim must identify:

- The person who made the misrepresentation.
- The time, place, and content of the misrepresentation.
- The method by which the misrepresentation was communicated to the plaintiff.

(See Viacom, Inc. v. Harbridge Merch. Servs., Inc., 20 F.3d 771, 777 (7th Cir. 1994).)

The PSLRA further heightened this standard for securities fraud claims. As a result, motions to dismiss securities fraud class actions are more likely to be granted than in other types of litigation. To plead a securities fraud claim with particularity under the PSLRA, a plaintiff must specify:

- Each misleading statement and the reasons why the statement was misleading.
- If an allegation is based on “information and belief,” all facts on which that belief was formed.
- The facts giving rise to a strong inference that the defendant acted with the required state of mind.


To plead the requisite “strong inference” of scienter, plaintiffs must allege particularized facts that:
ELEMENTS OF A SECURITIES FRAUD CLAIM

Section 10(b) is the most commonly invoked provision of the Securities Exchange Act in securities litigation. It is a “catch-all” antifraud provision that makes it unlawful to “use or employ, in connection with the purchase or sale of any security” a “manipulative or deceptive device” that contravenes any rules or regulations prescribed by the Securities and Exchange Commission (SEC) (15 U.S.C. § 78j(b)). The US Supreme Court has held that Section 10(b) and its implementing regulation, Rule 10b-5, provide an “implied” private right of action for purchasers and sellers of securities to recover damages for fraud (Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 171 (1994)). There is no private right of action under Section 10(b) against one who aided or abetted another in committing securities fraud (see Cent. Bank of Denver, N.A., 511 U.S. at 166, 191).

To plead fraud under Section 10(b), a plaintiff must allege the following elements:

- A material misrepresentation or omission (for more information, search Securities Litigation: Defending Against Materiality Claims on Practical Law).
- A “strong inference” of scienter (for more information, search Securities Litigation: Defending Against Scienter Claims on Practical Law).
- A connection with the purchase or sale of a security (for more information, search Securities Litigation: Defending a Claim Due to No Connection with the Purchase or Sale of a Security on Practical Law).
- Reliance (for more information, search Securities Litigation: Defending Against Reliance Claims on Practical Law).
- Economic loss (for more information, search Securities Litigation: Defending Against Economic Loss Claims on Practical Law).
- Loss causation (for more information, search Securities Litigation: Defending Against Loss Causation Claims on Practical Law).

Show that the defendant had the motive and opportunity to commit fraud. To establish motive, a plaintiff typically must plead that the defendant “benefited in some concrete and personal way” from the alleged fraud, such as unusual profiting from insider trading (Novak v. Kasaks, 216 F.3d 300, 307-08 (2d Cir. 2000)). “Motives that are generally possessed by most corporate directors and officers,” such as the desire to maintain corporate profitability or to maintain a high stock price, do not suffice to plead securities fraud (Kalnit v. Eichler, 264 F.3d 131, 139 (2d Cir. 2001)). Regarding the opportunity prong, courts often assume that corporations and corporate officers and directors would have the opportunity to commit fraud if they so desired (Pension Comm. of Univ. of Montreal Pension Plan v. Banc of Am. Sec., LLC, 446 F. Supp. 2d 163, 181 (S.D.N.Y. 2006)).

Constitute strong circumstantial evidence of conscious misbehavior or recklessness. Conscious misbehavior “encompasses deliberate illegal behavior, such as securities trading by insiders privy to undisclosed and material information, or the knowing sale of a company’s stock at an unwarranted discount.” By contrast, recklessness is “conduct which is ‘highly unreasonable’ and which represents ‘an extreme departure from the standards of ordinary care ... to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it.’” It is “not merely a heightened form of negligence.” (Novak, 216 F.3d at 308, 312 [internal citations omitted].)

The US Courts of Appeals vary slightly in the criteria they use to assess the sufficiency of a plaintiff’s scienter allegations. The
First, Second, and Eighth Circuits, for instance, have held that a plaintiff can plead a strong inference of scienter with allegations of motive and opportunity alone (see *Podraza v. Whiting*, 790 F.3d 828, 836 (8th Cir. 2015); *Shemian v. Research In Motion Ltd.*, 570 F. App’x 32, 35 (2d Cir. 2014); *In re Cabletron Sys., Inc.*, 311 F.3d 11, 39 (1st Cir. 2002)). Other Courts of Appeals, such as the Third, Fifth, Ninth, and Tenth Circuits, have held that allegations of motive and opportunity, “without more, will not fulfill” the PSLRA’s scienter pleading requirements, but nevertheless consider such allegations as part of their “holistic” review under *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, (551 U.S. 308 (2007)) of a plaintiff’s scienter allegations (*Owens v. Jastrow*, 789 F.3d 529, 536-39 (5th Cir. 2015) (emphasis in original); see *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech.*, Inc., 856 F.3d 605, 619 (9th Cir. 2017); *MHC Mut. Conversion Fund*, L.P. v. *Sandler O’Neill & Partners*, L.P., 761 F.3d 1109, 1121-22 (10th Cir. 2014); *Institutional Inv’rs Grp. v. Avaya, Inc.*, 564 F.3d 242, 276-77 (3d Cir. 2009)).

Regardless, under this heightened strong inference standard, nearly half of all securities fraud class action complaints filed between January 2000 and December 2016 were dismissed in their entirety and 30% were dismissed at least in part (NERA 2016 Full-Year Review, at 21). Studies indicate that the failure to plead a strong inference of scienter is the most frequently dismissed at the motion to dismiss stage effectively ends the case. 

**AUTOMATIC STAY OF DISCOVERY**

The PSLRA provides that “all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss” (15 U.S.C. §§ 77z-1(b), 78u-4(b)(3)(B)). This is consistent with Congress’s determination that plaintiffs should have a sufficient factual basis for asserting their claims before they get the benefit of costly discovery (see H.R. Conf. Rep. No. 104-369, at 2). Studies indicate that the failure to plead a strong inference of scienter is the most frequently successful ground for dismissal (see Wendy Gerwick Couture, *Around the World of Securities Fraud in Eighty Motions to Dismiss*, 45 Loy. U. Chi. L.J. 553, 558-59 (2014)).

Unless the court grants leave to replead, or the plaintiff appeals, dismissal at the motion to dismiss stage effectively ends the case.

**Preserve evidence.**

**Prevent undue prejudice to either party.** (15 U.S.C. §§ 77z-1(b)(1), 78u-4(b)(3)(B).) Where either exception to the discovery stay applies, the plaintiff must specify the target of the requested discovery and the types of information needed (15 U.S.C. § 77z-1(b)(1)).

The only example given by Congress on what could constitute undue prejudice that justifies lifting the stay is “the terminal illness of an important witness,” which might “necessitate the deposition of the witness prior to ruling on the motion to dismiss” (S. Rep. 104-98, at 14; see *Faulkner v. Verizon Commc’n, Inc.*, 156 F. Supp. 2d 384, 402 (S.D.N.Y. 2001)).

Most courts have rejected attempts to lift the discovery stay on the ground that a defendant has already produced the documents in a government investigation, a bankruptcy proceeding, an internal investigation, or another action not governed by the PSLRA. For example, most courts hold that blanket requests for all documents produced in parallel actions will not suffice, because those productions may include documents that are irrelevant to the securities litigation. As many courts have recognized, the difference in treatment between PSLRA actions and non-PSLRA actions “is not evidence of undue prejudice, but rather is evidence of Congress’s judgment that PSLRA actions should be treated differently than other actions.” (See, for example, *380544 Canada, Inc. v. Aspen Tech., Inc.*, 2007 WL 2049738, at *4 (S.D.N.Y. July 18, 2007)).

However, a minority of courts have found that the undue prejudice prong was satisfied and lifted the discovery stay where the PSLRA plaintiffs were actively competing against non-PSLRA plaintiffs to recover from the same defendants for the same wrongdoing. These courts reasoned that enforcing the stay would put the PSLRA plaintiffs at a distinct disadvantage, because they would be the only interested parties without access to relevant documents and therefore would be unable to make informed decisions about their litigation strategy going forward. These courts also typically noted that the cost to defendants in reproducing the documents was minimal. (See, for example, *In re WorldCom, Inc. Sec. Litig.*, 234 F. Supp. 2d 301, 305-06 (S.D.N.Y. 2002)).

Other stay-related considerations that defendants should be aware of, which might vary between jurisdictions, include:

- Whether the stay takes effect, for example, whether the stay becomes effective when the complaint is filed, when the defendant gives notice of his intent to move for dismissal, or not until a motion to dismiss is filed (see, for example, *Petrie v. Elec. Game Card, Inc.*, 761 F.3d 959, 968 (9th Cir. 2014); *In re Carnegie Int’l Corp. Sec. Litig.*, 107 F. Supp. 2d 676, 683 (D. Md. 2000)).

- Whether the stay applies to successive motions to dismiss (see, for example, *Sedona Corp. v. Ladenburg Thalmann*, 2005 WL 2647945, at *2-3 (S.D.N.Y. Oct. 14, 2005); *In re Lernout & Hauspie Sec. Litig.*, 214 F. Supp. 2d 100, 105 (D. Mass. 2002)).

- Whether the stay applies to the entire case where only some defendants have moved to dismiss (see, for example, *In re CFS-Related Sec. Fraud Litig.*, 179 F. Supp. 2d 1260, 1263-64 (N.D. Okla. 2001)).
Whether the stay applies to state-court derivative actions also asserting federal securities law claims (see, for example, Newby v. Enron Corp., 338 F.3d 467, 473 (5th Cir. 2003); see also In re Finisar Corp. Derivative Litig., 2012 WL 609835, at *2 (N.D. Cal. Feb. 24, 2012); In re DPL Inc. Sec. Litig., 247 F. Supp. 2d 946, 948 (S.D. Ohio 2003)).

Whether, after the stay has been lifted, plaintiffs can use discovered material to:
- amend their complaint;
- reassert previously dismissed claims; or
- assert additional claims against new or previously dismissed defendants.

(See, for example, Petrie, 761 F.3d at 970; Anderson v. First Sec. Corp., 249 F. Supp. 2d 1256, 1271-72 (D. Utah 2002).)

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

The PSLRA contains a safe harbor provision that protects the makers of forward-looking statements from liability where either:
- The statements were immaterial.
- The plaintiff fails to show that the defendant had actual knowledge that the statements were false or misleading when made.
- The statements were identified as forward-looking and accompanied by meaningful cautionary language identifying important factors that could cause actual results to differ materially from those in the forward-looking statement. (15 U.S.C. §§ 77z-2(c)(1), 78u-5(c)(1).) Forward-looking statements refer to projections, estimates, forecasts, and other information a company publicly discloses about its future plans or prospects (15 U.S.C. §§ 77z-2(i)(1), 78u-5(i)(1)).

This safe harbor is meant “to encourage issuers to disseminate relevant information to the market without fear of open-ended liability” (H.R. Conf. Rep. No. 104-369, at 32).

When considering whether the safe harbor applies, counsel should keep in mind that:
- Boilerplate language is insufficient to constitute meaningful cautionary language. For example, language such as “this is a forward-looking statement: caveat emptor” and similar general warnings that statements are “not guarantees of future performance,” without more, have been found to be too vague and non-specific to qualify. Instead, language is considered meaningfully cautionary only if it contains “substantive company-specific warnings based on a realistic description of the risks applicable to the particular circumstances.” (In re Harman Int’l Indus., Inc. Sec. Litig., 791 F.3d 90, 102 (D.C. Cir. 2015).)

- Misstatements of historical fact are not covered by the safe harbor. A court might conclude that a warning that identifies a circumstance as a potential risk where it has already transpired is not a warning at all. As the Second Circuit explained, the safe harbor does not protect one “who warns his hiking companion to walk slowly because there might be a ditch ahead where he knows with near certainty that the Grand Canyon lies one foot away.” (Rombach v. Chang, 355 F.3d 164, 173 (2d Cir. 2004) (quoting In re Prudential Sec. Inc. P’ships Litig., 930 F. Supp. 68, 72 (S.D.N.Y. 1996)).)

Accordingly, a circumstance that has already materialized must be disclosed accurately and likely cannot constitute a future risk that can be disclaimed away.

In determining whether a statement is truly forward-looking, the key is whether the statement’s truth or falsity can be discerned only after it is made. If a statement is tied to a future event, and its veracity cannot be determined until after this future event takes place, it generally falls within the PSLRA’s safe harbor provision. (Julianello v. K-V Pharm. Co., 791 F.3d 915, 921 (8th Cir. 2015).) However, the Courts of Appeals that have considered the issue agree that the PSLRA’s safe harbor provisions do not protect the non-forward-looking portions of mixed forward and non-forward-looking statements (see In re Quality Sys. Inc. Sec. Litig., 865 F.3d 1130, 1141-42 (9th Cir. 2017) (collecting cases and concluding the safe harbor does not cover a false or misleading non-forward-looking statement embedded in a mixed statement)).

Companies should therefore update any:
- Cautionary language regularly to add new, specific, and important risks.
- Disclosures to add developments in facts and circumstances.

SANCTIONS

To deter the abusive filing of frivolous securities lawsuits, Congress included in the PSLRA a sanctions provision meant to give “teeth” to the otherwise ineffective sanctions regime under FRCP 11 (H.R. Conf. Rep. No. 104-369, at 39; see Simon DeBartolo Grp., L.P. v. Richard E. Jacobs Grp., Inc., 186 F.3d 157, 166-67 (2d Cir. 1999)).

The PSLRA’s sanctions provision differs significantly from FRCP 11. Under FRCP 11, a party can file a separate motion for sanctions after providing the offending party with a 21-day period to correct or withdraw the deficient paper, or the court can conduct a sanctions inquiry on its own if it believes FRCP 11 has been violated. However, the PSLRA removes a court’s discretion and requires the court to:
- Conduct a sanctions inquiry at the final adjudication of a case.
- Impose sanctions for any violation of FRCP 11. (15 U.S.C. §§ 77z-1(c)(1)-(2), 78u-4(c)(1)-(2).)

Where the FRCP 11 violation relates to a responsive pleading or dispositive motion, the PSLRA presumes that the appropriate sanction is the opposing party’s attorneys’ fees incurred as a result of the violation (15 U.S.C. §§ 77z-1(c)(3), 78u-4(c)(3)).

The PSLRA does not prevent a party from moving for sanctions under FRCP 11. To the contrary, the PSLRA prevents a court from denying a motion for sanctions without making explicit findings of fact regarding compliance (15 U.S.C. §§ 77z-1(c)(1), 78u-4(c)(1)).

Despite the mandatory nature of sanctions under the PSLRA, studies suggest that sanctions are imposed infrequently in these cases (see Couture, Around the World, 45 Loy. U. Chi. L.J. at 567.
Outside directors in private actions brought under Section 11

Defendants in private actions brought under the Securities Act of 1933 and the Securities Exchange Act, which imposes strict liability. (15 U.S.C. § 78u-4(e)(1)). This provision applies to:

- Defendants in private actions brought under the Securities Exchange Act, which requires a plaintiff to show that the defendant acted with intent.
- Outside directors in private actions brought under Section 11 of the Securities Act, which imposes strict liability. (15 U.S.C. § 78u-4(f)(10)(C).)

If a defendant is found to have violated the securities laws knowingly, the defendant remains subject to joint and several liability for the entire damages award, less the proportional amounts paid by other defendants, including those who have settled before the final verdict (15 U.S.C. § 78u-4(f)(2)).

Effect of Settlement

The PSLRA instituted a “bar order” to encourage settlement. This protects a settling defendant from future claims for contribution, indemnification, and other similar claims by non-settling defendants. (15 U.S.C. § 78u-4(f)(7)(A).)

Additionally, the PSLRA provides a damages offset for non-settling defendants, ensuring that they pay no more than their proportionate share of liability (15 U.S.C. § 78u-4(f)(7)(B)).

LEAD PLAINTIFF PROVISIONS

Before the PSLRA, individuals with small holdings of many stocks would serve as repeat plaintiffs in numerous actions filed rapidly after stock drops, represented by the same lawyer. One of the PSLRA’s key goals was to shift control of securities class actions away from lawyers racing to the courthouse to file the first complaint on behalf of figurehead individual plaintiffs who lacked a meaningful economic stake in the outcome of the case.

To limit the advantage of filing first, the PSLRA directs courts to apply a rebuttable presumption that the plaintiff with the greatest economic stake in the outcome should serve as the lead plaintiff (15 U.S.C. § 78u-4(a)(3)(B)(i), (iii)). This presumption was designed to encourage institutional investors to lead cases. In addition to their large financial interest in the case, institutional investors have the sophistication and experience to manage their lawyers effectively. Perhaps unsurprisingly, there has been an increase in institutional investors serving as lead plaintiffs. In 2016, the median settlement amount in cases with institutional investor lead plaintiffs was more than two-and-one-half times that of cases with no institutional investor as lead plaintiff (Laari T. Bulan, Cornerstone Research, Securities Class Action Settlements — 2016 Review and Analysis, at 14 (Apr. 18, 2017)).

LIFECYCLE OF A PSLRA CLASS ACTION

Parties to a securities class action must consider various procedural and strategic options at each stage of the litigation. A typical action involving the PSLRA proceeds as follows:

- A company experiences a triggering event for the filing of a securities class action and plaintiffs commence a putative class action by filing a complaint.
- The plaintiffs consider whether and where to consolidate similar actions.
- The court appoints a lead plaintiff.
- The defendants respond to the complaint, generally with a motion to dismiss.
- If the action survives a motion to dismiss, the plaintiffs will seek class certification and the case will also proceed to discovery.

The parties may move for summary judgment and, in some instances, may file pretrial motions challenging the methodology and adequacy of any expert opinions submitted by the opposing party. Most securities cases settle in advance of trial. When a case advances past the class certification stage, the party that prevails on a summary judgment or Daubert motion often has critical leverage in settlement negotiations, so counsel should plan on dedicating significant resources to these motions.

DAMAGES

The PSLRA contains provisions limiting both the amount of a plaintiff’s damages and the defendant’s liability for damages, including in the context of a settlement.

Damages Cap

The PSLRA imposes a “nominal loss” cap on damages, which limits damages to the difference between the purchase price paid by the plaintiff and the stock’s average trading price during the 90-day period after the last corrective disclosure (15 U.S.C. § 78u-4(e)(1)). This 90-day period, typically referred to as the “bounce-back” provision, was intended to limit a plaintiff’s damages to losses actually caused by the fraud or violation, as opposed to other unrelated market conditions, by allowing the market to incorporate all the relevant information and the stock price to adjust accordingly (H.R. Conf. Rep. No. 104-369, at 42; S. Rep. No. 104-98, at 20). This cap can limit damages substantially, if not entirely, where the stock rallies following a stock drop purportedly caused by a fraud or violation.

Proportionate Liability

Before the PSLRA was enacted, a defendant found to have violated the federal securities laws was jointly and severally liable for the entire damages award, regardless of the defendant’s knowledge of, or level of participation in, the violation. Recognizing that this incentivized fringe participants to settle for amounts disproportionate to their level of fault, Congress included in the PSLRA provisions limiting damages to the proportion of the judgment that corresponds to the percentage of responsibility of each defendant, but only if the defendant was found to have committed the violation unknowingly (15 U.S.C. § 78u-4(f)(2)).

This provision applies to:

- Defendants in private actions brought under the Securities Exchange Act, which requires a plaintiff to show that the defendant acted with intent.
- Outside directors in private actions brought under Section 11 of the Securities Act, which imposes strict liability.


If a defendant is found to have violated the securities laws knowingly, the defendant remains subject to joint and several liability for the entire damages award, less the proportional amounts paid by other defendants, including those who have settled before the final verdict (15 U.S.C. § 78u-4(f)(2)).

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The PSLRA instituted a “bar order” to encourage settlement. This protects a settling defendant from future claims for contribution, indemnification, and other similar claims by non-settling defendants. (15 U.S.C. § 78u-4(f)(7)(A).)
THE SECURITIES LITIGATION UNIFORM STANDARDS ACT

Before the PSLRA, national securities class actions in state courts were rare. However, after the PSLRA was enacted, state securities laws often were viewed as more plaintiff-friendly than the federal laws, and plaintiffs sought to circumvent the hurdles of the new statutory requirements by filing securities fraud suits in state courts. Indeed, studies showed that there was a substantial increase in state court litigation in the two years after the PSLRA took effect (S. Rep. No. 105-182, at 3 (1998); see H.R. Rep. No. 105-640, at 10 (1998)).

To prevent this practice, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which prohibits private plaintiffs from filing in state court any class actions based on alleged misrepresentations or omissions of material facts in connection with the purchase or sale of a security. Putative class actions filed in state court that meet this criteria must be dismissed as preempted by federal law. (Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit, 547 U.S. 71, 87 (2006); see also Goldberg v. Bank of Am., N.A., 846 F.3d 913, 916 (7th Cir. 2017) (holding that SLUSA extends to class actions that could be pursued under the federal securities laws).)

It is debatable whether SLUSA has achieved its goals, and open questions about the statute’s scope remain. Recently, the Supreme Court granted certiorari in Cyan, Inc. v. Beaver County Employees Retirement Fund to consider whether, in light of SLUSA, state courts retain concurrent jurisdiction for liability lawsuits that exclusively assert Securities Act claims (137 S. Ct. 2325 (2017)).

Search Securities Litigation: Class Actions Arising from IPOs for more on Cyan and concurrent jurisdictional issues in securities fraud cases filed in state court.

COMMENCEMENT OF ACTION

The most common triggering event for a securities class action is a sudden drop in a company’s stock price. Several plaintiffs might file putative class action lawsuits alleging that the drop in stock price was due to newly public information that the company previously misrepresented. According to NERA, nearly half of securities class actions filed in 2016 were filed within 13 days after a stock drop (which usually marks the end of a class period), and 90% of cases were filed within one year (NERA 2016 Full-Year Review, at 18). Recognizing the events that typically lead to securities class actions will help companies prepare for possible litigation.

Warning Signs

Some common precursors to stock drops that might foreshadow the filing of a securities class action include when a company:

- Files a restatement of financial data with the SEC.
- Discloses government investigations.
- Replaces executive officers after an internal investigation.
- Devalues significant assets.
- Fails to develop a key product or loses patent rights.
- Experiences an unexpected decline in revenue or profits significantly out of line with prior projections.
- Recalls a product.

Additionally, certain plaintiffs’ firms have been known to issue press releases concerning investigations into possible securities class actions against companies. Although many of these alerts do not lead to the filing of a complaint, some do. Accordingly, monitoring news releases posted on financial websites can help a company recognize potential securities class action threats.

Initial Steps

Once a complaint is filed, the company should promptly:

- Issue a litigation hold and prepare a protocol for collecting and preserving documents and electronic information. Securities class actions are usually document-intensive, so the company should put procedures in place to manage potentially voluminous discovery as early as possible. (For more information, search Litigation Hold Toolkit on Practical Law.)
- Notify the company’s insurance carriers and review coverage limits and potential exclusions that the insurer might raise. For example, the action might fall within the scope of a directors and officers liability insurance policy or a public offering of securities insurance (POSI) policy.
- Notify the company’s auditors and, depending on the company’s industry, consider notifying relevant regulators.

Additionally, a company facing a securities class action should make certain strategic decisions as soon as possible, such as whether to:

- Retain separate counsel, if the action involves both corporate and individual defendants (which often is the case in securities class actions).
- Enter into a joint defense or common interest agreement, if the action involves multiple defendants with separate counsel. These agreements can allow the defendants to share information with each other without waiving privilege protections. (For more information, search Joint Defense and Confidentiality Agreement on Practical Law.)
- Consider whether and how to contact the company’s current or former employees (to obtain more information, inform them that they have no obligations to speak with plaintiffs’ counsel, and instruct them not to disclose any information...
that is privileged). Securities class action plaintiffs often rely on the allegations of confidential witnesses who contend they have relevant information about the conduct of the company and its officers and directors. The company also should consider what steps it should take in response to any confidential witness allegations. (For more information, search Securities Litigation: Defending Against Confidential Witness Allegations on Practical Law.)

CONSORTIUM

After a triggering event occurs, different plaintiffs commonly file multiple, similar lawsuits in different jurisdictions. The plaintiffs must consider whether to agree to consolidate the related actions and, if so, in what forum. Additionally, if the actions are consolidated, the parties must consider whether to stipulate to deadlines and page limits.

Search Bifurcation, Consolidation, Joinder, and Transfer Toolkit (Federal) for a collection of resources to help counsel prepare, file, and serve a motion for consolidation under FRCP 42(a).

Under FRCP 42(a), a court may consolidate actions “involving common questions of law or fact.” In the securities class action context, consolidation is appropriate “where the complaints are based on the same ‘public statements and reports.’” (Mitchell v. Complete Mgmt., Inc., 1999 WL 728678, at *1 (S.D.N.Y. Sept. 17, 1999)).

When considering where to consolidate the related actions, plaintiffs should be aware that jurisdictions apply different standards to various pleading requirements that can affect a forthcoming motion to dismiss.

A defendant may have the ability to move the case from the forum in which it is filed to a different forum, such as the company’s home forum (see City of Sterling Heights Police & Fire Ret. Sys. v. Kohl’s Corp., 2013 WL 5656086, at *1-2 (S.D.N.Y. Oct. 9, 2013)).

Settlement discussions may occur at any time.

*After a securities class action is filed, defense counsel may collect documents from the company and its officers, directors, and employees, and seek to hold interviews with them to learn more about the facts of the case (January 2018 onward).

**The time to file a motion to dismiss is commonly negotiated with the plaintiffs or is set by the court. A time period of 45 or 60 days is typical. Generally, there is no discovery until the court determines the motion to dismiss.
APPOINTMENT OF LEAD PLAINTIFF

Once consolidation (if appropriate) is complete, the lead plaintiff selection process begins. The PSLRA provides that within 20 days of filing the complaint, the filing plaintiff must publish a notice to members of the putative class containing certain information about the action, including:

- The claims asserted.
- The class period.
- A statement that any putative class member can move to serve as lead plaintiff.


Plaintiffs have 60 days after the notice is published to move for appointment as lead plaintiff, and courts typically consider those motions within 90 days of the filing of the notice.

If the plaintiffs have served the complaint, defense counsel should consider whether to stipulate to adjourn certain deadlines until after either:

- The court appoints a lead plaintiff and lead counsel.
- The lead plaintiff files an amended complaint under FRCP 15, which permits a plaintiff to amend the complaint once as a matter of course without seeking leave from the court.
- The lead plaintiff confirms that it will not further amend the complaint.

The lead plaintiff has 40 days from the time of its appointment to file a consolidated complaint.

Although there is no obligation to amend the complaint, lead plaintiffs, once appointed, often decide to do so because they have increased incentive to invest in the case. Amendments can substantially change the initial complaint. Defense counsel should keep this in mind when assessing the relative strength of the case and considering possible strategies based on the initial complaint.

RESPONDING TO THE COMPLAINT

The vast majority of defendants begin their substantive defense by moving to dismiss the complaint. This can be the most
important phase in a securities fraud class action, because nearly half of these types of complaints are dismissed entirely and nearly three-quarters are dismissed at least in part, at the motion to dismiss stage (NERA 2016 Full-Year Review, at 21).

The arguments available to defendants on a motion to dismiss in other types of cases also might apply in securities cases (for example, the expiration of the statute of limitations). However, the PSLRA permits certain additional arguments. Specifically, defense counsel should consider whether to move to dismiss the complaint based on the plaintiff’s failure to adequately:

- Plead the claims with particularity.
- Include facts giving rise to a strong inference of scienter.
- Allegate that the statements at issue are false or misleading.
- Allegate an economic loss caused by the misstatements.

Under the PSLRA, grounds for dismissal might exist where a plaintiff does not plead the elements of his claims with particularity, including:

- Identifying the specific misstatements and the speaker.
- Explaining why the alleged misstatements are false or misleading.
- Specifying when and where the alleged misstatements were made.


**Pleading Claims with Particularity**

Under the PSLRA, grounds for dismissal might exist where a plaintiff does not plead the elements of his claims with particularity, including:

- Identifying the specific misstatements and the speaker.
- Explaining why the alleged misstatements are false or misleading.
- Specifying when and where the alleged misstatements were made.


**Strong Inference of Scienter**

As discussed above, the PSLRA requires that a plaintiff’s complaint state with particularity facts giving rise to a “strong inference” that the defendant acted with the required state of mind (15 U.S.C. § 78u-4(b)(2)(A)). A strong inference is “more than merely plausible or reasonable — it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent” (Tellabs, 551 U.S. at 314).

Grounds for dismissal based on a lack of scienter might exist where the complaint:

- Alleges a motive that is common to all corporate officers and directors, such as increasing the performance of the company.
- Alleges insider stock sales, but does not show that those sales were:
  - unusual — that is, that they constituted a significant portion of the insiders’ holdings or that the timing of the sales was suspicious; or
  - not part of an existing 10b5-1 trading plan that predetermined the timing and amount of the sales (for

- Relies on an irrational economic theory.
- Relies on conduct that would be readily discoverable within a short period of time.
- Alleges conduct that is merely negligent or reflects a good faith mistake.
- Relies on the allegations of confidential witnesses and:
  - the witnesses are unreliable; or
  - the complaint fails to describe the witnesses’ positions with sufficient detail to show they had access to the information they claim to have had.
- Fails to identify any documents, meetings, or conversations that help support the allegations.
- Impermissibly tries to establish corporate scienter through the core operations doctrine, group pleading doctrine, or some other method that is not applicable in the relevant jurisdiction.

**False or Misleading Statements**

Dismissal based on a complaint’s failure to allege that the statements at issue were false or misleading might be warranted where:

- The complaint failed to adequately specify which statements were false or misleading and why they were so.
- The alleged misstatements were not facially false or misleading, even when viewed against the allegations of the complaint.
- The alleged misstatements were forward-looking statements accompanied by meaningful cautionary language that identified important and specific factors that could cause actual results to differ materially from those suggested in the forward-looking statements.
- The alleged misstatements were immaterial, because there was not a substantial likelihood that a reasonable investor would view their disclosure as having significantly altered the total mix of information available to the market about that particular security.
- The alleged misstatements were puffery or otherwise too vague or imprecise for a reasonable investor to have relied on them.
- An individual defendant was not the “maker” of the alleged misstatements under Janus.

In Janus Capital Group v. First Derivative Traders, the Supreme Court limited the scope of who may be held liable for making alleged misstatements by adopting a narrow interpretation of the term “make.” Specifically, “the maker of a statement is the person or entity with ultimate authority over the content of the statement and “whether and how to communicate it.” A statement made by a corporate insider (such as an officer, a director, or an employee) in his capacity as such can be attributed to a corporate defendant. However, “[w]ithout control, a person or entity can merely suggest what to say, not ‘make’ a statement
in its own right.” (564 U.S. 135, 142 (2011).) Accordingly, liability cannot attach to those individuals who lack the requisite control.

Economic Loss

Although economic loss is a less common ground for dismissing securities complaints at the motion to dismiss stage, some potentially successful arguments that defense counsel should consider include that:
- The plaintiffs suffered no loss because:
  - the stock price rebounded during the 90-day bounce-back period; or
  - the plaintiff sold his shares before the corrective disclosure was issued.
- The corrective disclosure did not cause the company’s stock price to fall because the disclosure:
  - was not related to the alleged fraud; or
  - revealed no new information to the market.

CLASS CERTIFICATION

Even if the complaint survives a motion to dismiss, a putative securities class action becomes a class action only if the court finds that the plaintiffs have satisfied the requirements of FRCP 23(a) and (b).

Defense counsel should first consider potential challenges to each prerequisite for certification set out in FRCP 23(a)(1)-(4).

Specifically, counsel might argue that the plaintiffs failed to establish:
- Commonality. For example, counsel should consider if the claims are not capable of classwide resolution, that is, a common answer would not resolve the controversy (see Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 350 (2011)).
- Typicality. For example, the lead plaintiff’s claim might be unrepresentative of the claims of other class members, because its transaction size, type, or timeline is atypical of the rest of the class.
- Adequacy. For example, counsel might argue that:
  - a conflict of interest exists between or among named parties, other class members, or class counsel; or
  - the lead plaintiff lacks credibility for reasons such as a prior conviction for fraud or dishonesty during depositions.
- Predominance. For example, counsel should consider if:
  - there is evidence that the alleged misrepresentation did not impact the price of the security, which rebuts the fraud on the market presumption of classwide reliance (see Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2414 (2014) and Box, Elements of a Securities Fraud Claim);
  - communications containing the alleged misstatements varied between, or were never received by, certain class members;
  - there are specific complications or flaws in the plaintiffs’ proposed methodology for calculating classwide economic loss; or
  - the market for the shares at issue, such as those issued during an initial public offering, is not efficient.

Save for a few notable exceptions, the fraud on the market presumption established in Basic permits putative class members to bypass showing individual reliance on an alleged corporate misstatement (see Box, Elements of a Securities Fraud Claim). This showing likely would defeat class certification under FRCP 23’s requirement that the plaintiff must show that common questions predominate. The presumption is rebuttable, however, and counsel should consider whether:
- The plaintiff has failed to show that the market for a security efficiently incorporates new information into the price.
- There is evidence that an alleged misstatement did not actually affect the market price of the security.

These are the most common means of challenging class certification.

Defense counsel should then consider whether the plaintiffs satisfied one of the three alternative requirements in FRCP 23(b).

In the securities fraud context, plaintiffs typically seek to demonstrate that common questions of law or fact predominate over any questions affecting only individual members, and that a class action is the best way to fairly and efficiently adjudicate the case (see, for example, Amgen, Inc. v. Conn. Ret. Plans & Tr. Funds, 568 U.S. 455, 459 (2013)).

A court may order discovery solely to determine whether certification is appropriate. Although the certification inquiry is distinct from the merits of the case, “a court’s class-certification analysis must be ‘rigorous’ and may ‘entail some overlap with the merits of the plaintiff’s underlying claim.” (Amgen, Inc., 568 U.S. at 465-66 (quoting Wal-Mart Stores, Inc., 564 U.S. at 351)). Therefore, defendants may introduce evidence to defeat any of the requirements the plaintiff must meet to certify a class, including in the form of expert testimony or analysis (see Wal-Mart Stores, Inc., 131 S. Ct. at 2551-52 (2011); IBEW Local 98 Pension Fund v. Best Buy Co., 818 F.3d 775, 783 (8th Cir. 2016)).