Association of Corporate Counsel
GREATER PHILADELPHIA

TRENDS IN SECURITIES LITIGATION

The Rise of Securities Act Cases in State Courts

[Insert Sponsor Name and/or Logo and Date]

Follow us on social media!

@accgp @delvacca

Presenters:

- Tim McKenna, Associate Director at NERA Economic Consulting
- Ginene Lewis, Associate Counsel and Manager at Vanguard
- Marc Sonnenfeld, Partner at Morgan, Lewis & Bockius LLP
- Laura McNally, Partner at Morgan, Lewis & Bockius LLP

ACC Association of Corporate Counsel
GREATER PHILADELPHIA

NERA
ECONOMIC CONSULTING

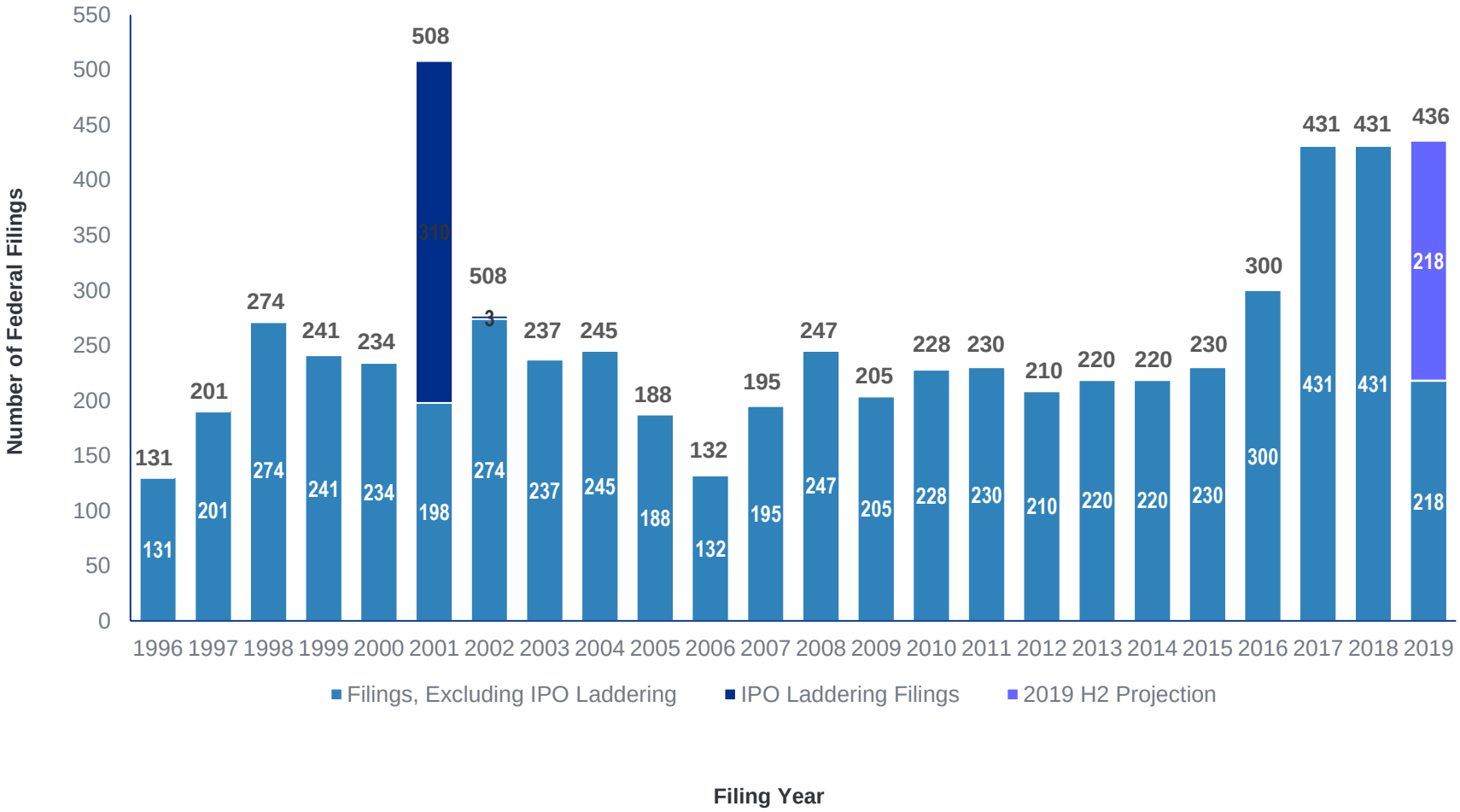
RECENT TRENDS IN SECURITIES CLASS ACTION LITIGATION
2019 H1 UPDATE

Svetlana Starykh & Janeen McIntosh

Insight in Economics™

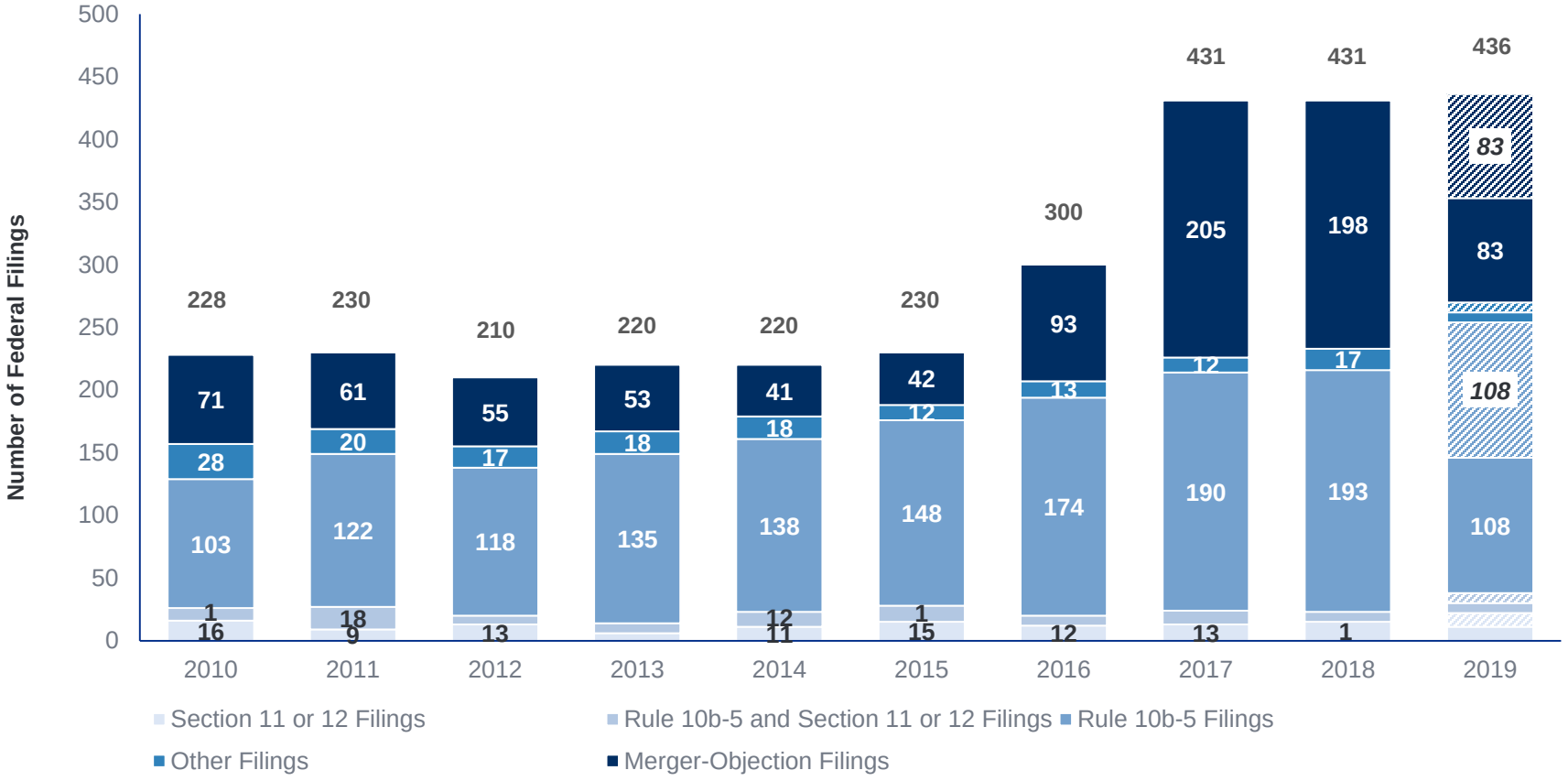
Federal Filings

January 1996–June 2019



Federal Filings by Type

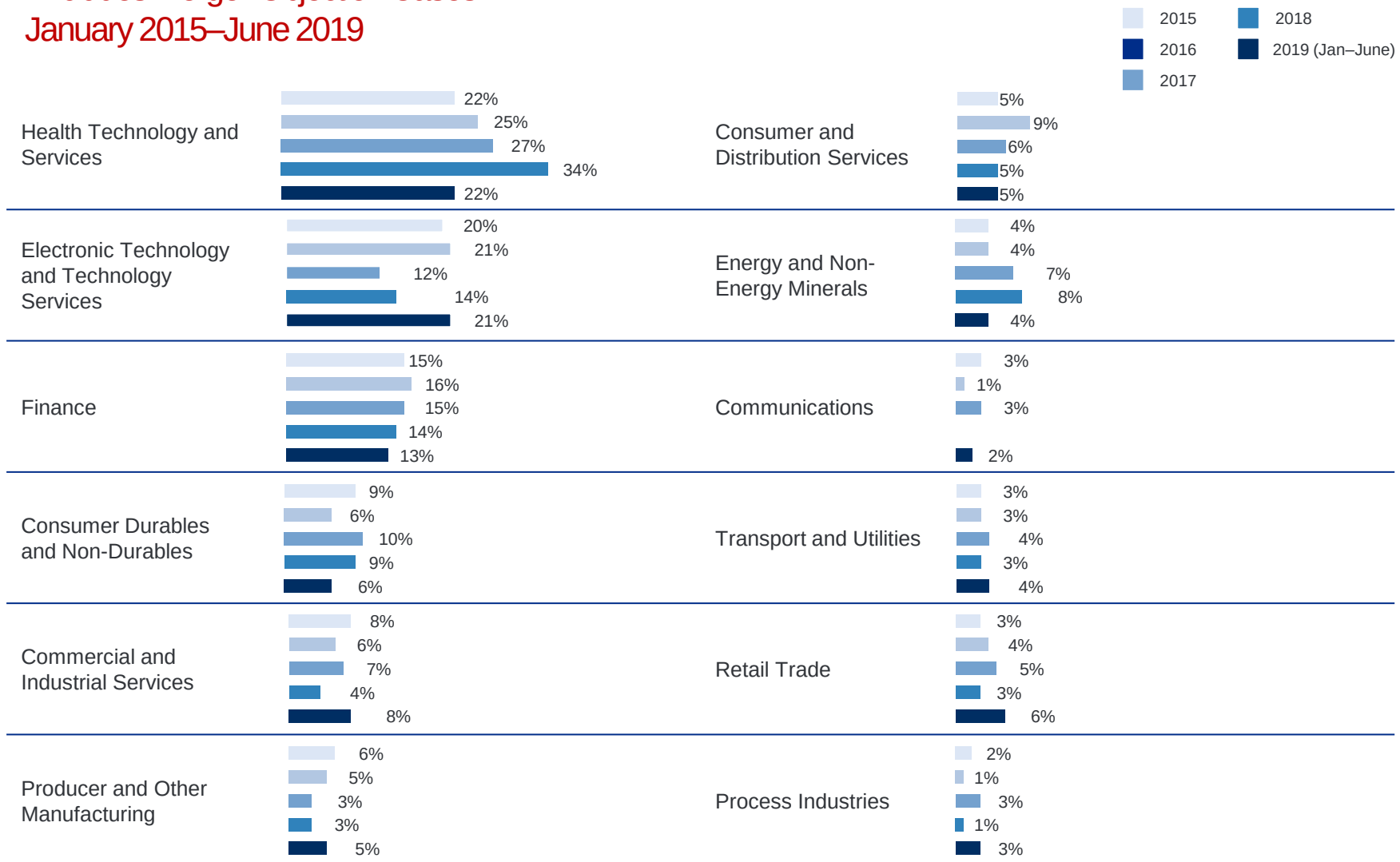
January 2010–June 2019



2019 H2 projections are italicized and denoted with crosshatching

Percentage of Federal Filings by Sector and Year

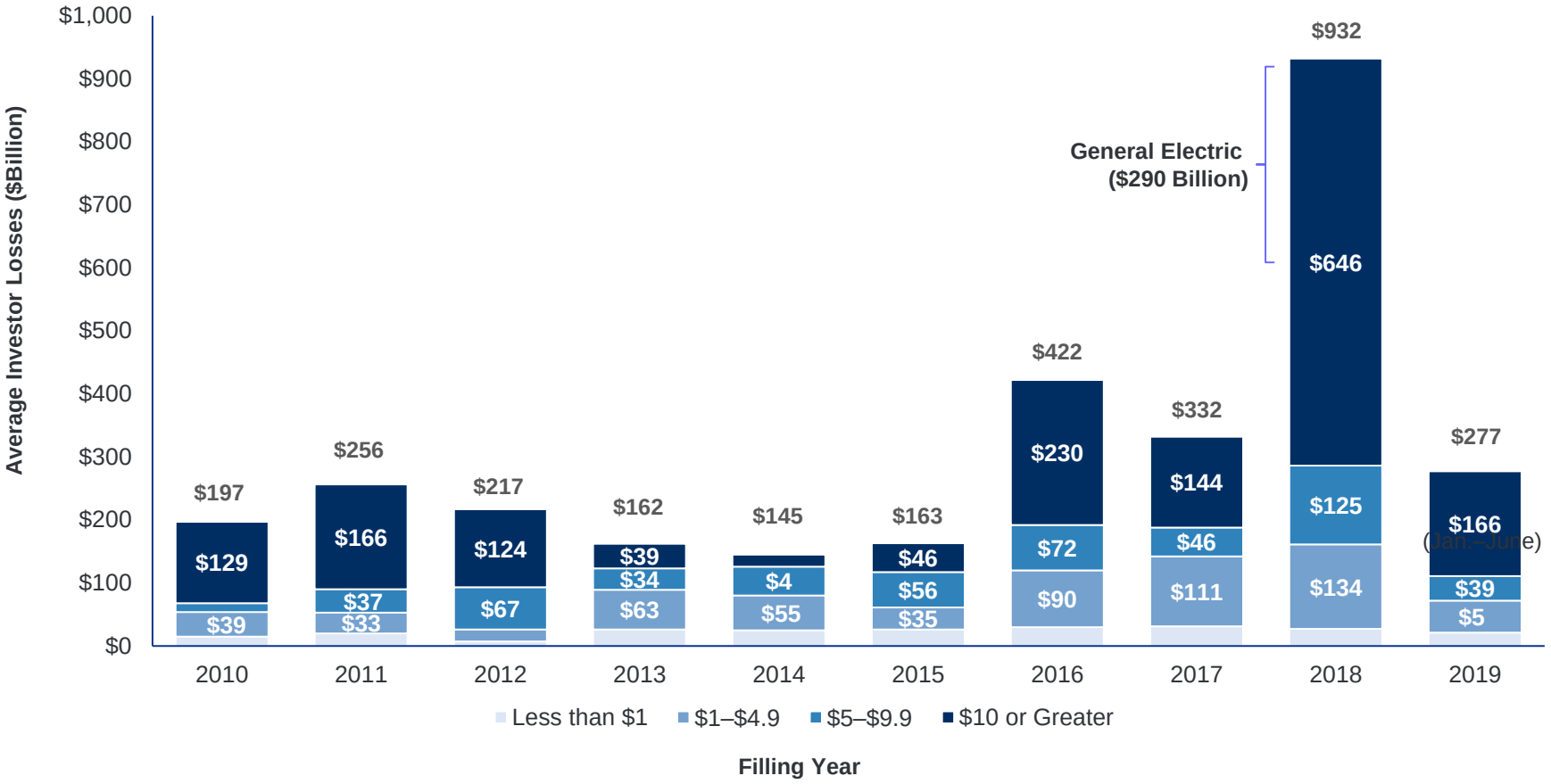
Excludes Merger-Objection Cases
January 2015–June 2019



Note: This analysis is based on FactSet Research System, Inc. economic sector classification. Some of the FactSet economic sectors are combined for presentation

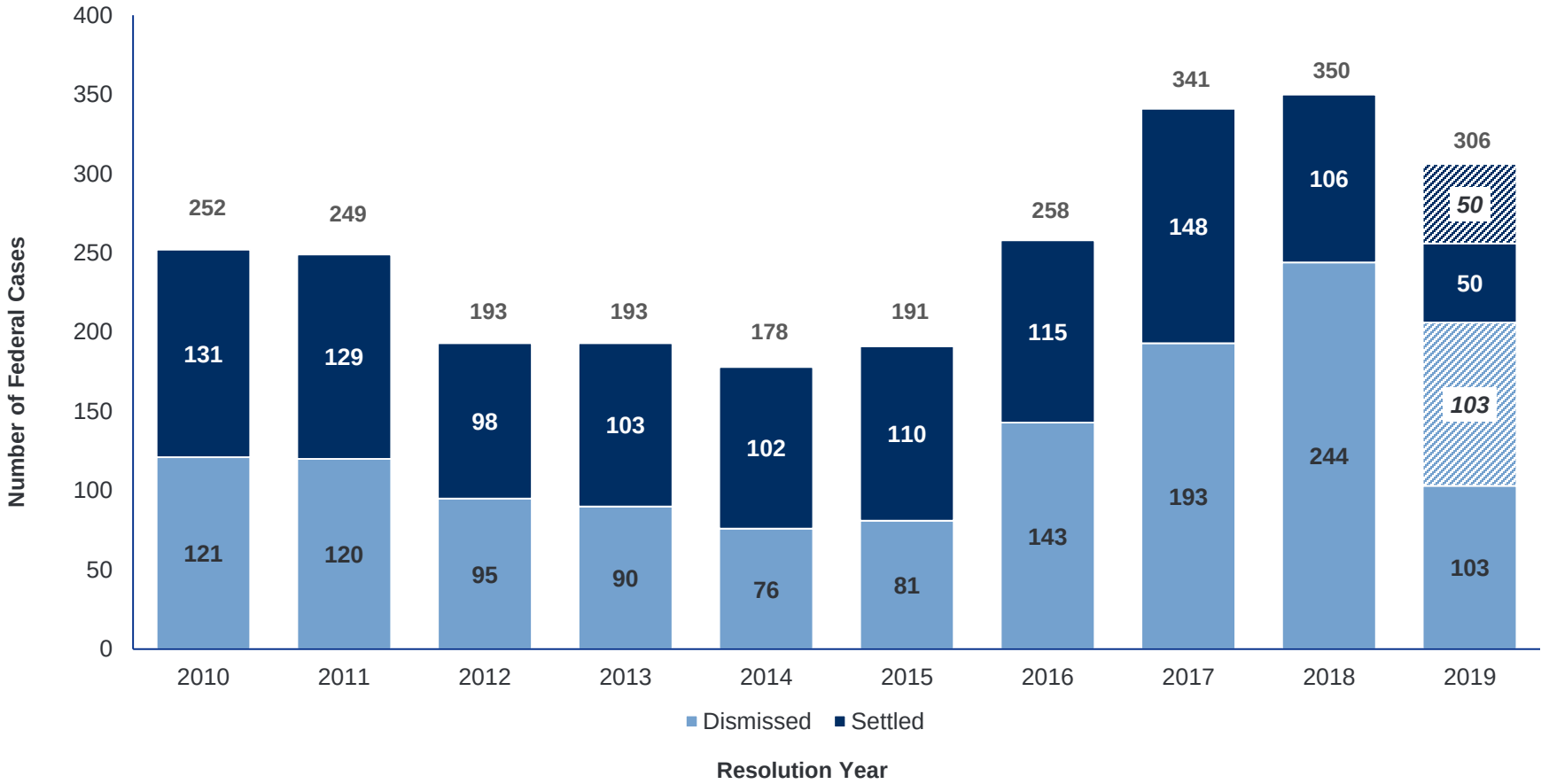
Aggregate NERA-Defined Investor Losses

Shareholder Class Actions with Alleged Violations of Rule 10b-5, Section 11, and/or Section 12
January 2010–June 2019



Number of Resolved Cases: Dismissed or Settled

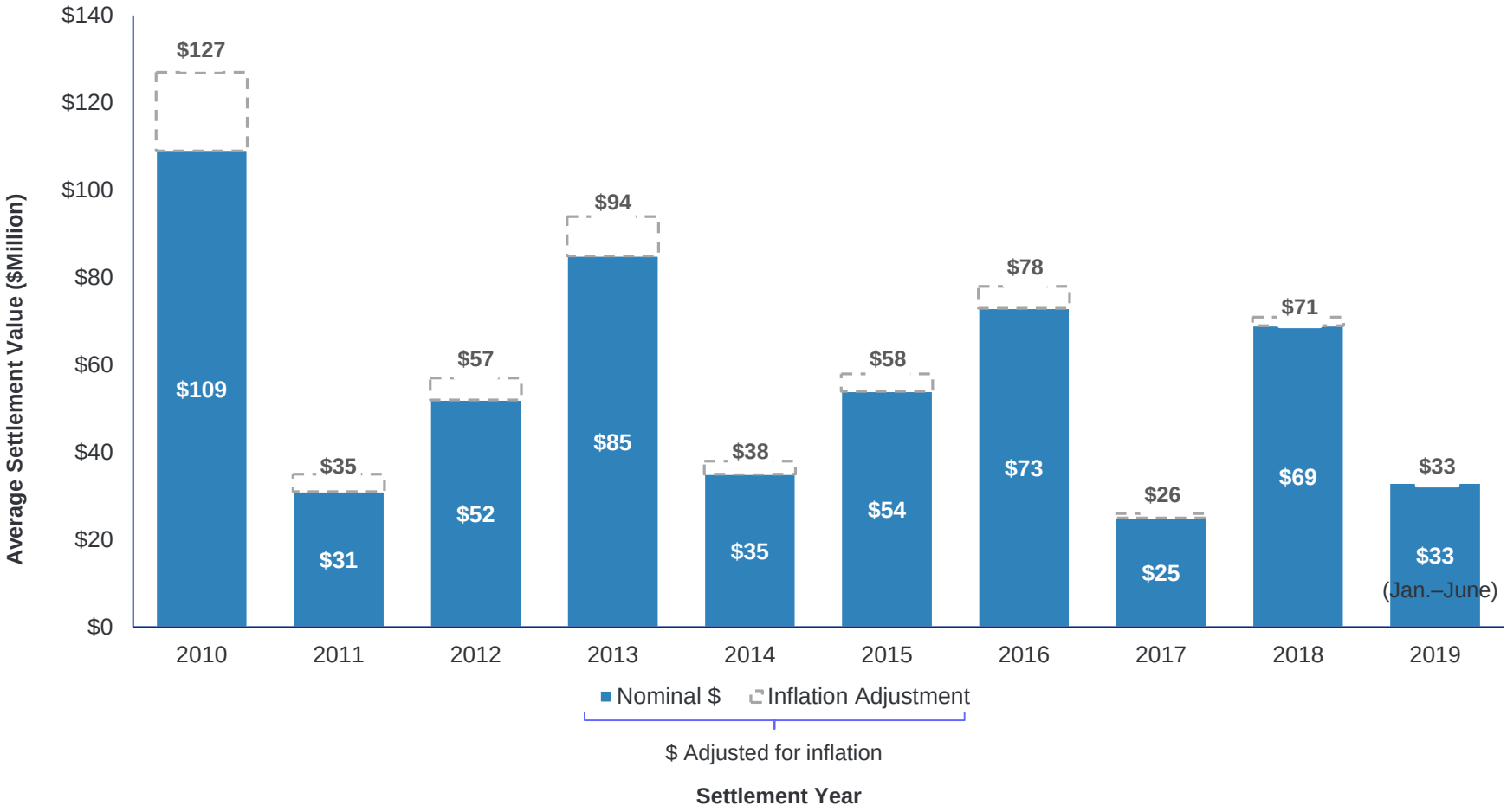
January 2010–June 2019



2019 H2 projections are italicized and denoted with crosshatching

Average Settlement Value

Excludes Merger-Objection Cases and Settlements for $0 to the Class
January 2010–June 2019

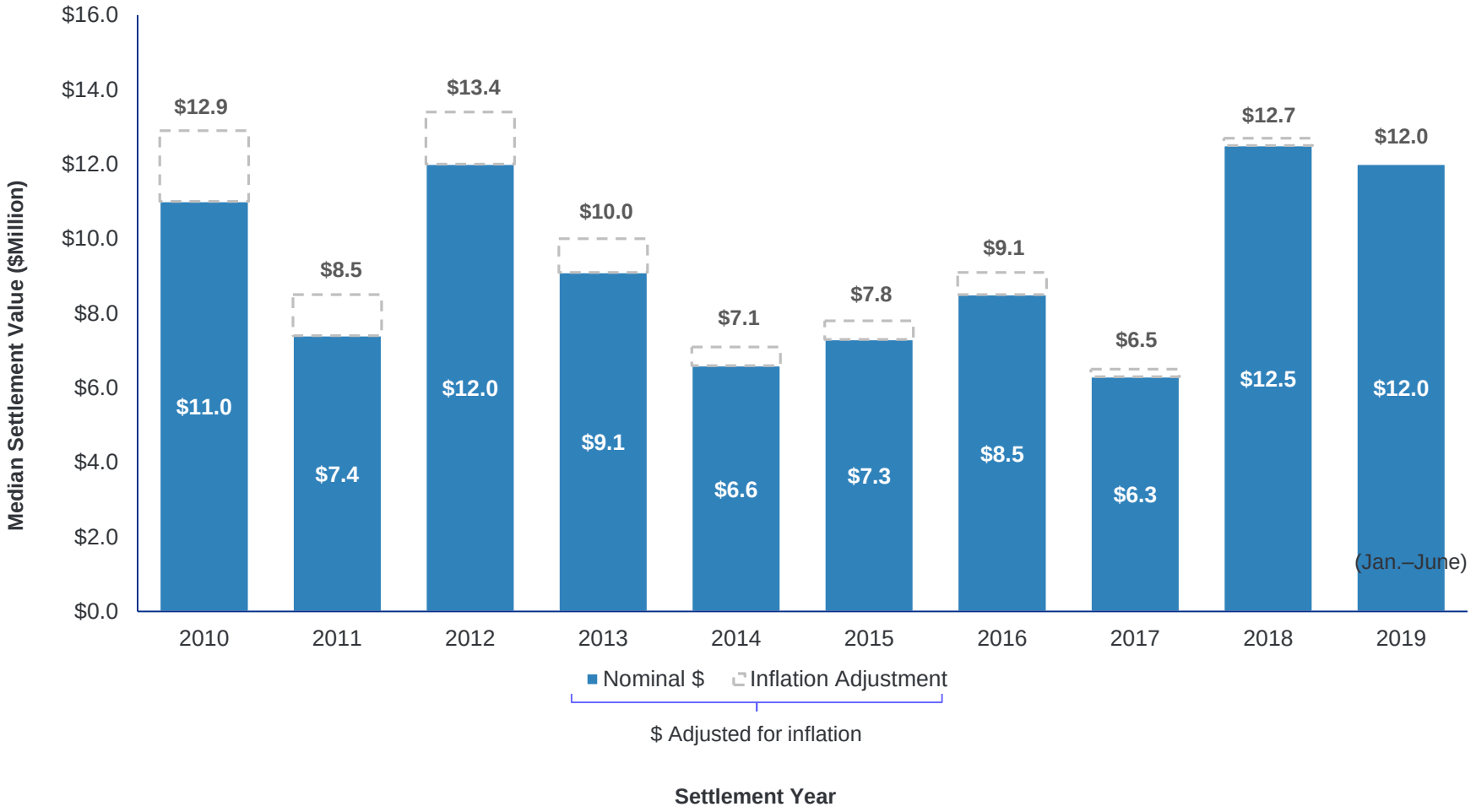


Average Settlement Value

Excludes Settlements over $1 Billion, Merger-Objection Cases, and Settlements for $0 Payment to the Class
January 2010–June 2019

Average Settlement Value

Excludes Settlements over $1 Billion, Merger-Objection Cases, and Settlements for $0 Payment to the Class
January 2010–June 2019



A Brief History of Securities Act Claims

- The Securities Act of 1933 ("1933 Act") was enacted by Congress on May 27, 1933. The 1933 Act regulates the offer and sale of securities by ensuring that buyers of securities receive complete and accurate information before they purchase securities. To that end, the 1933 Act requires companies offering securities to the public to make "full and fair disclosure" of relevant information, making them liable for any inaccurate statements in registration statements. The statute creates private rights of action, authorizes federal and state courts to exercise concurrent jurisdiction over those private suits, and bars removal of actions from state to federal court.

- One year later, Congress enacted the Securities Exchange Act of 1934 (1934 Act), which regulates not the original issuance of securities but their subsequent trading. The 1934 Act also provides for enforcement through private actions, but federal courts have exclusive jurisdiction over those suits.

- Historically, Securities Act claims were generally brought in federal court.

- In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA) to amend the 1933 and 1934 Acts and address concerns of "abuses of the class-action vehicle in litigation involving nationally traded securities." As a result, plaintiffs began bringing class actions under state law to circumvent the PSLRA's substantive and procedural hurdles.

- In 1998, Congress enacted the Securities Litigation Uniform Standards Act of 1988 ("SLUSA") to further amend both Acts. SLUSA added a significant qualification, called the "except clause," to the 1933 Act's authorization of concurrent federal and state court jurisdiction: state courts now exercise concurrent jurisdiction "except as provided in section 77p . . . with respect to covered class actions."

The Supreme Court's Decision In *Cyan*

- On March 20, 2018, in *Cyan, Inc. v. Beaver County Employees Retirement Fund, et al.*, 138 S. Ct. 1061 (2018), the Supreme Court unanimously affirmed a California Superior Court ruling that SLUSA left intact state court jurisdiction over claims under the 1933 Act. Specifically, the Court held that SLUSA's amendments to the 1933 Act did not bar state court jurisdiction over class actions alleging only 1933 Act violations, nor did it authorize the removal of such suits from state to federal court.

- In 2014, the Beaver County Employees Retirement Fund, a pension fund that purchased Cyan stock in the IPO, filed a class action in California Superior Court alleging only violations of the 1933 Act. Cyan moved to dismiss, arguing that the 1933 Act, as amended by SLUSA, deprived the court of jurisdiction over the action. The Superior Court rejected Cyan's argument and denied the motion, and the state appellate court denied review. The Supreme Court then granted certiorari to resolve a split among federal and state courts about whether SLUSA deprived state courts of jurisdiction over class actions that allege only 1933 Act claims.

- Cyan urged that the term "covered class action," defined in Section 77p(f)(2) of the 1933 Act as a suit seeking damages on behalf of more than 50 persons, informed the scope of SLUSA's "except clause." According to Cyan, class actions of more than 50 persons were exempted from state court jurisdiction—regardless of whether the action was based on the 1933 Act or state securities law.

- The Court rejected that interpretation of the "except clause" as giving insufficient consideration to other provisions in Section 77p. Examining SLUSA's amendments of provisions in the section, the Court noted that Section 77p(b) disallows, in both state and federal courts, any class actions in which damages are sought on behalf of more than 50 persons that are founded on *state* securities law with respect to a nationally traded security's purchase or sale. As a corollary, Section 77p(c) requires any class action set forth in Section 77p(b) and brought in state court to be removed to federal court and dismissed. But as the Court explained, "the section says nothing, and so does nothing, to deprive state courts of jurisdiction over class actions based on *federal* law." The Court concluded that the the "except clause" does not prevent state courts from exercising jurisdiction over class actions based on the 1933 Act.

Cyan Continued

- Cyan also pointed to statements in SLUSA's legislative reports that the purpose of the statute was "to prevent plaintiffs from seeking to evade the protections that Federal law provides against abusive litigation by filing suit in State, rather than Federal court." Because SLUSA was enacted to finish the work of the PSLRA, Cyan argued that the only way to accomplish this was by divesting state courts of jurisdiction over all 1933 Act class actions that qualified as "covered class actions."

- The Court disagreed, noting that SLUSA "largely accomplished the purpose articulated in the Conference Report" of moving securities class actions to federal court. In addition, the Court acknowledged, "We do not know why Congress declined to require as well that 1933 Act class actions be brought in federal court," noting that "[i]f further steps are needed, they are up to Congress."

- As a result, corporate and individual defendants may have to litigate 1933 Act class actions in multiple jurisdictions, in both state and federal court, or in multiple state courts. Litigation in multiple state courts could become a particular concern because in state court, where the PSLRA's substantive and procedural protections may be unavailable, judges are far less likely to dismiss these actions, and may not stay discovery pending any motion to dismiss. This leaves defendants with greater risk and higher litigation costs. Until Congress acts—if it does—*Cyan* likely will increase the number of 1933 Act suits invoking state court jurisdiction.

The Rise of Securities Act Cases in State Courts

- Petitioners in Cyan warned of a continued "flood of Securities Act class actions" in state courts.
- While these warnings did not sway the Court, as we saw in the NERA data, there has been a post-*Cyan* spike in Securities Act class actions filed in state courts.
- The theory is that Plaintiffs are filing in state court to take advantage of lower pleading standards.
- This could lead to defendants facing increasingly complex and expensive litigation, and increase the risk of inconsistent rulings by state court judges unfamiliar with the Securities Act.
- Defendants have approached these cases in a variety of ways, including moving to stay the case where there is a parallel federal action, transferring venue intrastate and/or dismissing cases on *forum non conveniens* grounds.

ACC Association of Corporate Counsel
GREATER PHILADELPHIA

Cases Pending in Pennsylvania State Courts

- *Fir Tree Value Master Fund, LP, et al., v. Teva Pharmaceutical Industries Ltd., et al.*, No. 2018-19713-0, Montgomery County Court of Common Pleas (2018) – Petition to Dismiss on *Forum Non Conveniens* filed on October 16, 2018 (pending).
- *Aaron Taylor v. the Vanguard Group, Inc., et al.*, No. 01015, Court of Common Pleas of Philadelphia County (2018) – Preliminary Objections filed on July 1, 2019 (pending).
- *Plymouth County Retirement Association v. Livent Corporation, et al.*, No. 190501229, Court of Common Pleas of Philadelphia County (2019) – Motion to Stay the case in favor of overlapping federal litigation was filed on July 2, 2019 (pending).
- *In Re BrightView Holdings, Inc. Securities Litigation*, No. 2019-07222, Court of Common Pleas of Montgomery County (2019) - Petition to Dismiss or Stay on *Forum Non Conveniens* and Preliminary Objections were filed on August 12, 2019 (pending).
- *City of Warren Police & Fire Retirement System v. USA Technologies, Inc., et al.*, No. 2019-04821-MJ, Chester County Court of Common Pleas (2019) – Petition to Stay was filed on August 9, 2019 (pending).

A Recent State Court Dismissal

Netshoes Sec. Litig. v. XXX, No. 157435/2018, 2019 WL 3227251 (N.Y. Sup. Ct. July 16, 2019)

- On July 16, 2019, Judge Andrew Borrock of the New York Supreme Court entered an order dismissing a post-*Cyan* securities suit.
- In 2018, shareholders filed a securities class action lawsuit against Netshoes, and certain of its directors and officers, and its offering underwriters, alleging that the company's offering documents contained a materially false and misleading picture of Netshoes' business, resulting in an artificial inflation of the offering price. The complaint alleged that the defendants' misrepresentations and omissions violated Sections 11 and 12(a)(2) of the Securities Act of 1933.
- Judge Borrock held that plaintiffs failed to allege that the statement on which plaintiffs sought to rely relating to Netshoes' customer loyalty and past performance of the vitamin and supplements business were not false or misleading when made, and therefore do not give rise to a securities claim.
- In addition, Judge Borrock ruled that the statements of belief in Netshoes' offering documents about the level of competition and its competitive position in Brazil were unactionable opinion. Judge Borrock also noted that the statements of opinion about competition were counterbalanced by extensive disclosure in the Risk Factor section of the prospectus.
- Although this is just one instance, this decision represents a reality check for plaintiffs seeking an advantage at the motion to dismiss stage by filing in state court. Judge Borrock's opinion shows no discomfort in working with the federal securities laws and relevant case law.

Does the PSLRA Discovery Stay Apply?

- The Private Securities Litigation Reform Act of 1995 ("PSLRA") contains a discovery stay that states that "In any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party."

- The PSLRA's automatic discovery stay reflects Congress' determination that complaints in securities actions should stand or fall based on the actual knowledge of the plaintiffs rather than on information produced by the defendants after the action has been filed. The discovery stay is an important mechanism that limits the burden of discovery on defendants in securities litigation.

- In federal courts, defendants file motions to dismiss with the expectation that discovery will be automatically stayed pending resolution of the motion.

Does the PSLRA Discovery Stay Apply?

- A key question in the aftermath of *Cyan* is whether the PSLRA's discovery stay applies to actions filed in state court. The *Cyan* Court did not address the applicability of the discovery stay provision found in the PSLRA on state courts. However, at least two other state courts have declined to stay discovery under the PSLRA since the Supreme Court decided *Cyan*.

- In *City of Livonia Retiree Health and Disability Benefits Plan v. Pitney Bowes Inc., et al.*, No. X08-FST-CV-18-6038160-S (Conn. Super. Ct. May 17, 2019), the Court applied the "plain meaning rule" and granted defendants' motion for a discovery stay pending defendants' motion to strike. The court examined 15 USC 77z-1(a)(1), the subsection of the PSLRA preceding the discovery stay subsection, which applies to private class actions and states that "[t]he provisions of this subsection shall apply to each private action arising under this subchapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure," contrasting it against the language of 15 USC 77z-1(b)(1), the discovery stay subsection, which applies to "[a]ny private action arising under this subchapter." The court held that, because the discovery stay subsection does not have the same language as the private class actions subsection, it is not limited to actions commenced in federal court.

- The Court also noted that 15 USC 77z-2(c)(1), the provision following the discovery stay subsection, provides a "safe harbor" for forward-looking statements "in any action arising under this subchapter," and uses identical language as the discovery stay subsection. The Supreme Court in *Cyan* found that this safe harbor provision applied even when a Securities Act case is brought in state court. The Court held that because the language in the discovery stay and safe harbor subsections are identical, the discovery stay subsection applies to actions pending in state court as well as in federal court.

- *In Re Everquote, Inc. Securities Litigation*, No. 651177/2019 (N.Y. Sup. Ct. Aug. 7, 2019) is another example of a state court holding that the PSLRA's discovery stay applies in state court as well as federal court securities litigation. Judge Borrock granted defendants' motion to stay discovery pending decision on their motion to dismiss. Judge Borrock held that *Cyan* "d[id] not control" the question before him, as *Cyan* "only addressed" the issue of state courts' jurisdiction to adjudicate 1933 Act claims and whether removal of such claims is permitted. Judge Borrock interpreted the plain meaning of the PSLRA's discovery stay section, which states that discovery is stayed during a pending motion to dismiss "[i]n any private action arising under this subchapter," finding that the discovery stay applies to securities actions in state court. Judge Borrock noted that nowhere in this section does the statute indicate that it only applies to actions brought in federal court.

- These decisions may be persuasive to other state courts, and could provide a useful litigation tactic to reduce defendants' litigation costs and change the perception that state courts are more friendly to plaintiffs in Securities Act suits.

Prohibition on Securities Act Cases In State Court Via Bylaws?

- Another question that remains open in the aftermath of *Cyan* is whether a company can write into its bylaws that Securities Act cases must be brought in federal court.

- In recent years, the number of companies that have adopted forum-selection clauses in their charters has skyrocketed.

- The Delaware Court of Chancery wrestled with this is issue for the first time in *Sciabacucchi v. Salzberg*, No. 2017-0931-JTL, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018). On December 19, 2018, the Court issued an order invalidating provisions that three companies adopted in their certificates of incorporation before their initial public offerings, that would have required shareholders to file securities class actions in federal court.

- Relying on Delaware General Corporation Law, the Court held that bylaws can regulate internal affairs brought by stockholders qua stockholders, but does not authorize a Delaware corporation to regulate external relationships. The Court held that a 1933 Act claim is external to the corporation in that federal law creates the claim, defines the elements of the claim, and specifies who can be a plaintiff or defendant. Because a 1933 Act claim exists outside of the corporate contract, the Court held that bylaws dictating the forum for tort or contract claims against a company are invalid.

Prohibition on Securities Act Cases In State Court Via Bylaws?

- This issue is currently up on appeal before the Delaware Supreme Court.

- The Chancery Court reached its conclusion by interpreting a 1933 Act claim as external to the corporation. However, there is an argument that a 1933 Act claim should be interpreted as an internal affair which bylaws can regulate because they necessarily involve the relationship between those who manage the corporation and the corporation's stockholders by holding managers and directors accountable for the representations they make to stockholders pursuant to a registration statement.

- The Delaware Supreme Court's decision could be persuasive to other courts on this issue. Notwithstanding the Court's decision, it remains to be seen whether incorporating a jurisdictional provision into the terms of a security itself could be a viable way for companies to protect against having to litigate Securities Act cases in state courts.

Additional Complications To Consider

- The premiums that corporations incur to protect their directors and officers against alleged violations of the Securities Act of 1933 have increased as much as 200% in the last three years. Securities Act claims that are litigated in a state forum inhibit transparency in the securities class action arena.

- The approval of a proposed lead plaintiff in a state claim may require individualized inquiry from proposed class members in a parallel federal claim. Any requirement of individualized inquiry in either of the proposed federal or state classes of allegedly defrauded investors will render them uncertifiable. Carving out a subclass in a state claim to avoid individualized inquiry in the parallel federal claim would lead to fractured class actions, waste judicial resources, unduly burden defendants, and harm absent class members.

- The methodology for estimating aggregate damages in securities class actions that allege violations of Section 11 is straightforward: maximum recoverable damages for a proposed class of allegedly defrauded investors equal the difference between the purchase price at the IPO or SPO and the price when the class action was filed. After *Cyan*, parallel actions present several damages issues that complicate how investors will attain equitable redress

A reminder about the benefits of ACC membership…

- Free CLE, like the one you're attending right now
- Roundtables
- Networking meetings
- Special events
  - Spring Fling, Fall Gala, Diversity Summer Program, Golf Outing, Pro Bono clinics, Charity Softball Game & Family Fun Day, and more!

- Access to ACC resources, including:
  - ACC Newsstand (customizable updates on more than 40 practice area)
  - ACC Docket Magazine
  - InfoPAKs
  - QuickCounsel Guides

- **For more information or to refer a new member, see your hosts today or contact Chapter Administrator, Chris Stewart, at ChrisStewart@ACCglobal.com.**

ACC Association of Corporate Counsel
GREATER PHILADELPHIA