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In re Everquote: New York Supreme Court's Commercial Division Holds that Automatic Stay of Discovery Applies in Securities Act Class Actions Filed in State Court

In 2018, the United States Supreme Court in *Cyan, Inc.* v. *Beaver County Employees Retirement Fund*[1] held that class actions asserting claims under the Securities Act of 1933 ("Securities Act") that are filed in state court are not removable under the Securities Litigation Uniform Standards Act ("SLUSA"). In addition to precipitating the increased filing of Securities Act class actions in state courts,[2] *Cyan* left open several questions, including which procedural protections imposed by the Private Securities Litigation Reform Act of 1995 ("PSLRA") are applicable in state court. In particular, lower courts are divided over whether discovery in Securities Act cases—automatically stayed in federal court while a motion to dismiss is pending—is likewise automatically stayed when brought in state court. State courts in California and Michigan have refused to stay discovery,[3] while a Connecticut state court reached the opposite conclusion in *City of Livonia Retiree Health and Disability Benefits Plan* v. *Pitney Bowes Inc.*,[4] and now courts within the New York Supreme Court's Commercial Division—a common forum for Securities Act class actions filed in state courts—are at odds over the answer to this question.

Most recently, on August 6, 2019, Justice Andrew Borrok of the New York Supreme Court's Commercial Division, in a well-reasoned opinion, held[5] that the automatic stay of discovery *does* apply in state court by the PSLRA's plain terms. Together with the *Livonia* decision, Justice Borrok's ruling in *In re Everquote, Inc. Securities Litigation* provides a useful roadmap for litigants who seek the procedural protections of the PSLRA's discovery stay.

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1 *Cyan, Inc.* v. *Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061 (2018).

2 *Securities Class Action Filings: 2018 Year in Review*, Cornerstone Research (Jan. 30, 2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.

3 *See In re Ally Financial Inc., et. al.*, No. 16-013616-CB, at *3–4 (Mich. Cir. Ct. Wayne Cty. Aug. 1, 2018); *Switzer* v. *W.R. Hambrecht & Co., L.L.C.*, Nos. CGC-18-564904, CGC-18-565324, 2018 WL 4704776, at *1 (Cal. Super. Ct. Sept. 19, 2018).

4 *City of Livonia Retiree Health and Disability Benefits Plan* v. *Pitney Bowes Inc.*, No. X08-FST-CV-18-6038160-S, 2019 WL 2293924, at *4 (Conn. Super Ct. May 15, 2019).

5 *In re Everquote, Inc. Sec. Litig.*, No. 651177/2019, 2019 WL 3686065 (Sup. Ct. N.Y. Cty. Aug. 7, 2019).

The New York Supreme Court's Opinion in *Everquote*

Shareholders of Everquote, Inc. ("Everquote") brought a class action in New York state court, alleging claims under Sections 11, 12 and 15 of the Securities Act. Plaintiffs alleged that Everquote inflated its financial metrics and made misrepresentations in the registration statement and prospectus issued in connection with its initial public offering. Everquote moved to dismiss the case and requested a stay of discovery pending the adjudication of the motion to dismiss, pursuant to the PSLRA's automatic stay rule.[6] Plaintiffs opposed the motion, stating that other courts have held that the PSLRA's automatic stay of discovery stay is inapplicable to New York state court actions.

Although noting that *Cyan* "does not control the outcome of the issue presented by the instant motion," Justice Borrok found *Cyan* helpful "in that it further underscores the most basic and fundamental rule in statutory interpretation—the court must start with the express language of the statute and presume that it means what it says."[7] Analyzing the text of the PSLRA and SLUSA, Justice Borrok held that "the simple, plain, and unambiguous language expressly provides that discovery is stayed during a pending motion to dismiss '[i]n ***any private action*** arising under this subchapter,'" and "[n]owhere in [the PSLRA] does the statute indicate that it applies only to actions brought in federal court."[8]

The court also convincingly rejected three arguments that plaintiffs typically deploy on this question.

First, plaintiffs argued that applying the automatic discovery stay would mean "state court practices and procedures would be constrained, including without limitation, that the court could not order a preliminary conference, direct a case to mediation, and the case could not even be assigned to the Commercial Division."[9] Justice Borrok also rejected this assertion, pointing out that "state court proceedings are often stayed for a host of other reasons" and Rule 11(d) of the Supreme Court's Commercial Division "expressly permits the stay of discovery pending the determination of a dispositive motion."[10] The court then leveled one more critique of plaintiffs' argument, encapsulating the broader view of why the PSLRA's automatic discovery stay applies in state court:

> But, most importantly, this procedural/substantive distinction misses the point. The 1933 Act is a federal statute. It was Congress that created the specific rights covered by the 1933 Act including affording concurrent jurisdiction to state courts to adjudicate claims brought under the 1933 Act. This is not an issue of federal common law being applied to supply a rule of decision. Rather, this

6 15 USC § 77z-1(b)(1).

7 *In re Everquote*, 2019 WL 3686065 at *6.

8 *Id.* at *7 (emphasis in original).

9 *Id.* at *8.

10 *Id.*

> is a federal statute creating federal rules of decision that both state and federal courts are required to follow in deciding 1933 Act cases. . . . Simply put, in the Reform Act, Congress is not dictating how state courts are to run their dockets. The Reform Act merely provides for how 1933 Act cases are to be handled that are filed in state and federal court — *i.e.*, Congress provided that during a pending motion to dismiss (except as otherwise provided in the statute), discovery should be stayed as to 1933 Act claims because in enacting the Reform Act and SLUSA, Congress was providing for a federal scheme as to federal claims.[11]

Second, plaintiffs pointed to the PSLRA's provision on evidentiary preservation, which provides that, during a stay, parties must treat documents as if they were subject to a continuing request for documents under the Federal Rules of Civil Procedure ("FRCP"). Therefore, because state courts do not apply the FRCP, plaintiffs argued that the automatic stay can only function in federal court. Justice Borrok dismissed this argument, observing that the PSLRA simply creates a "uniform approach to document preservation," requiring parties to treat documents "as if" they were subject to a continuing request for documents—regardless of the jurisdiction's rules governing document preservation.[12] The "as-if" language, the court noted, "highlights how Congress made clear that Federal Rule principles apply both to state and federal proceedings where document perseveration was concerned during the pendency of the discovery stay."[13]

Finally, plaintiffs pointed to the PSLRA's provision sanctioning abusive litigation, which references Rule 11 of the FRCP regarding court sanctions, and argued that because these do not apply in state court, neither does the automatic stay provision. The court responded that Rule 11 governs the signing of pleadings, motions and other papers, and that it is inapplicable to the discovery stay provision because sanctions for discovery violations are handled separately by the PSLRA's evidentiary preservation provisions.[14] The court added that the PSLRA's evidentiary preservation and sanctions provisions do not refer to the FRCP, "further underscor[ing] that Congress made clear that 15 U.S.C. § 77z-1(b) applies both to state and federal proceedings."[15]

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11 *Id.*

12 *Id.*

13 *Id.*

14 15 U.S.C. § 77z-1(b)(3).

15 *In re Everquote*, 2019 WL 3686065 at *7.

The Emerging Case Law Favoring an Automatic Stay in State Court Securities Act Cases

As noted above, *Everquote* does not stand alone. The decision, together with the Connecticut state court ruling in *City of Livonia*,[16] provides defendants with two post-*Cyan*, well-reasoned blueprints rooted in sound statutory analysis for asserting that the automatic discovery stay should apply in state court.[17]

In *City of Livonia*, the court also relied on the plain language of the PSLRA. *City of Livonia* provides litigants with another argument, which *Everquote* did not utilize: it compared the automatic stay provision to the PSLRA's provision creating a "safe harbor" from liability for forward-looking statements. *City of Livonia* observed that the "safe harbor" provision contained the same "in any private action arising under this subchapter" language as the automatic stay provision,[18] and that the Supreme Court in *Cyan* described this "safe harbor" provision as applying "even when a [Securities Act] suit was brought in state court."[19] Therefore, the *City of Livonia* court reasoned, "[b]ecause the Supreme Court held that language identical to that at issue here applies to both state and federal actions commenced under the Securities Act, the inference is strong that [the automatic stay provision] was meant to apply to actions pending in state court as well as in federal court."[20]

Other recent, contrary authority from the New York Supreme Court can be distinguished for its failure to analyze the plain language of the PSLRA. In two decisions issued earlier this year, *Matter of PPDAI Group Securities Litigation* and *In re Dentsply Sirona, Inc.*, Commercial Division Justice Saliann Scarpulla held that the automatic stay of discovery does not apply in state courts solely because (1) doing so would

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16 *City of Livonia Retiree Health and Disability Benefits Plan* v. *Pitney Bowes Inc.*, No. X08-FST-CV-18-6038160-S, 2019 WL 2293924 (Conn. Super Ct. May 15, 2019).

17 In addition to *Everquote* and *City of Livonia*, litigants may consider cases that either predate *Cyan*, or which suggest, in dicta, that the automatic discovery stay applies in a Securities Act case in state court. *See, e.g.*, *Shores* v. *Cinergi Pictures Entm't, Inc.*, No. BC149861, at 2* (Cal. Super. Ct. L.A. Cty. Sept. 11, 1996) ("[T]he automatic stay provision in Section 27(b) of the Securities Act applies to all cases filed under the Securities Act, whether in state or federal court."); *Milano* v. *Auhll*, No. SB 213 476, 1996 WL 33398997, at *2–3 (Cal. Super. Ct. Oct. 2, 1996) ("[N]o fundamental state policy is offended by the limitation placed on suits for private remedies, brought in state courts, under the [Securities] Act, that plaintiffs must now demonstrate a prima facie case without the aid of discovery, and that discovery is to be stayed while this occurs."); *Antipodean Domestic Partners, LP* v. *Clovis Oncology*, 2017 WL 3611307, at *2 (N.Y. Sup. Ct. Aug. 17, 2017) (granting stay of discovery); *see also Feinberg* v. *Marathon Patent Grp., Inc.*, No. 651463/2018, at *2 (N.Y. Sup. Ct. N.Y. Cty. Jan. 9, 2019) (granting unopposed motion to stay discovery).

18 *City of Livonia*, 2019 WL 2293924 at *4.

19 *Id.*

20 *Id.*

"undermine Cyan's holding" that state courts may hear Securities Act cases, and (2) New York's Commercial Division generally allows discovery to proceed while a motion to dismiss is pending. [21]

Conclusion

In *Cyan*'s wake, state courts have become a more prominent battleground for Securities Act litigation. New York alone has witnessed a significant increase in Securities Act cases, from zero in 2017 to 13 in 2018.[22] Justice Borrok's decision in *Everquote* provides another arrow in defendants' quiver to argue that the PSLRA's procedural protections apply equally in state and federal court.

We will continue to monitor the landscape and report in subsequent client alerts as appropriate.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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21 *Matter of PPDAI Grp. Sec. Litig.*, No. 654482/2018, 2019 WL 2751278 at *7 (Sup. Ct. N.Y. Cty. July 1, 2019); *In re Dentsply Sirona, Inc. S'holders Litig.*, No. 155393/2018, 2019 WL 3526142 at *14 (Sup. Ct. N.Y. Cty. Aug. 2, 2019).

22 *Securities Class Action Filings: 2018 Year in Review*, Cornerstone Research (Jan. 30, 2019), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2018-Year-in-Review.