No. 20-1541

IN THE

Supreme Court of the United States

PIVOTAL SOFTWARE, INC., ET AL., *Petitioners*,
v.
SUPERIOR COURT OF CALIFORNIA,
CITY AND COUNTY OF SAN FRANCISCO, ET AL.

ON A WRIT OF CERTIORARI TO THE COURT OF APPEAL FOR THE STATE OF CALIFORNIA,FIRST APPELLATE DISTRICT

AMICUS CURIAE BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF PETITIONERS

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INTERESTS OF AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks, and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation, and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. SIFMA's members frequently serve as underwriters for, or otherwise participate in, securities offerings governed by the Securities Act and will be directly affected by the application of the laws at issue in this case. SIFMA regularly files *amicus curiae* briefs in cases with broad implications for the financial markets.

INTRODUCTION AND SUMMARY OF ARGUMENT

In 1995, Congress enacted the Private Securities Litigation Reform Act (the "Reform Act") to curb abusive securities class action litigation that "was being used to injure the entire U.S. economy." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (internal quotation marks omitted). The Reform Act implemented a number of safeguards to address "those suits whose nuisance value outweighs their merits." *Id.* at 82. One of the most important

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[1] Pursuant to this Court's Rule 37.3(a), counsel of record for all parties consented to the filing of this *amicus curiae* brief. This brief was not authored in whole or in part by counsel for any party, and no person or entity other than SIFMA, its members, or its counsel made a monetary contribution intended to fund the preparation or submission of this brief.

safeguards created by the Reform Act is the discovery stay — in a securities class action, all discovery is automatically stayed until the court rules on the sufficiency of the complaint and determines that the plaintiff has stated a viable cause of action. *See* 15 U.S.C. § 77z-1(b)(1).

The Reform Act discovery stay was not an afterthought or corollary; it was a centerpiece of the legislation. The stay serves two critical functions in protecting issuer and underwriter defendants from meritless litigation. First, "[t]he cost of discovery often forces innocent parties to settle frivolous securities class actions." H.R. Rep. No. 104-369, at 37 (1995); *accord In re LaBranche Sec. Litig.*, 333 F. Supp. 2d 178, 181 (S.D.N.Y. 2004) ("The legislative history of the Reform Act indicates that Congress enacted the discovery stay to prevent plaintiffs from filing securities class actions with the intent of using the discovery process to force a coercive settlement."). Second, Congress intended to stop plaintiffs from using meritless complaints solely to "conduct discovery in the hopes of finding a sustainable claim." S. Rep. No. 104-98, at 14 (1995) ("Accordingly, the Committee has determined that discovery should be permitted in securities class actions only after the court has sustained the legal sufficiency of the complaint."). Congress' goals in adopting the Reform Act discovery stay apply with full force regardless of whether a securities class action is filed in state or federal court.

Applying the Reform Act discovery stay in federal court, but not state court, creates substantial risks for securities class action litigation and the capital markets. Not applying the Reform Act discovery stay in state court will create judicial inconsistencies and

allow plaintiffs with weak claims to fish for support through early discovery. Collectively, these factors increase the risk and thus the costs that issuers and underwriters face when taking part in the IPO market. And allowing discovery prior to a finding that the plaintiff has stated a viable Securities Act claim, will force issuer and underwriter defendants to spend millions of dollars and months, if not years, of effort on the discovery process in cases where the complaint ultimately may be found not to satisfy threshold pleading requirements.

For these reasons, SIFMA respectfully requests that this Court find that the Reform Act automatic discovery stay applies to Securities Act claims brought in state court.

ARGUMENT

I. THE LOWER COURT ERRED IN DECLINING TO APPLY THE REFORM ACT AUTOMATIC DISCOVERY STAY TO SECURITIES ACT CLAIMS BROUGHT IN STATE COURT.

The California trial court erred in declining to apply the Reform Act discovery stay. The plain language of the Reform Act stays discovery during the pendency of a motion to dismiss in "any private action arising under" the Securities Act. 15 U.S.C. § 77z-1(b)(1); *see also Matter of Everquote, Inc. Sec. Litig.*, 65 Misc. 3d 226, 236 (N.Y. Sup. Ct. 2019) (applying Reform Act stay because "[t]he simple, plain, and unambiguous language [of the PSLRA] expressly provides that discovery is stayed" while a dismissal motion is pending " '[i]n *any private action* arising under this subchapter'" (alterations and emphasis in original)). The Reform Act does not limit the stay to Securities Act cases filed in federal court, and actions

brought in state court under the Securities Act plainly "arise under" the Act. *See Christianson v. Colt Indus. Operating Corp.*, 486 U.S. 800, 808 (1988) (a case arises under federal law when "federal law creates the cause of action"). Furthermore, as compared to several other provisions in § 77z-1, this provision is notably not restricted to actions brought "pursuant to the Federal Rules of Civil Procedure." *Compare* § 77z-1(b)(1) *with* § 77z-1(a)(1). Certain lower courts already have adopted this rationale, *see, e.g.*, *Matter of Everquote*, 65 Misc. 3d at 236. Courts declining to apply the discovery stay, however, have offered only cursory explanations that ignore the plain language of the statute. *See, e.g.*, *Switzer v. Hambrecht & Co., L.L.C.*, No. CGC-18-564904, 2018 WL 4704776, at *1 (Cal. Super. Sep. 19, 2018) (reasoning that discovery stay is procedural and therefore does not apply in state court); *In re PPDAI Group Sec. Litig.*, 116 N.Y.S.3d 865, at *7 (N.Y. Sup. Ct. 2019) (reasoning that application of the discovery stay "would undermine *Cyan*'s holding that '33 Act cases may be heard in state courts").

Moreover, reading the text to apply only in federal court would not make any logical sense given Congress' goals of curbing abusive securities litigation and settlements driven by the costs and burdens of class action discovery. The only exception to the discovery stay is that a court may allow discovery if 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." 15 U.S.C. § 77z-1(b)(1). It is critical that this Court correct the error of the California trial court and ensure that the Reform Act is applied to "any private

action" filed under the Securities Act, not just to those filed in federal court.

II. FAILING TO APPLY THE REFORM ACT DISCOVERY STAY IN STATE COURT WILL ADVERSELY AFFECT THE CAPITAL MARKETS.

A. Inconsistent Application of Discovery Stay in State and Federal Court Will Harm Capital Markets Participants.

Unless the discovery stay applies with equal force in both state and federal courts, there will be inconsistent application of the Securities Act — often within the identical cases filed in the federal and state courts of the same state. This inconsistency creates additional risk and uncertainty for issuers and underwriters participating in IPOs. As a result, underwriters may charge issuers increased fees to compensate for the additional risk of having to defend Securities Act cases without the benefit of the Reform Act discovery stay.

This concern is exemplified by the case at hand. Here, Pivotal Software, Inc., certain of its officers and directors, and the Underwriter Petitioners [2] (collectively, "Defendants") were subject to parallel litigation in both state and federal court in California. In both instances, Defendants sought dismissal for

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[2] The Underwriter Petitioners are Morgan Stanley & Co. LLC; Goldman Sachs & Co. LLC; Citigroup Global Markets Inc.; Merrill Lynch, Pierce, Fenner & Smith Inc.; Barclays Capital Inc.; Credit Suisse Securities (USA), LLC; RBC Capital Markets, LLC; UBS Securities LLC; Wells Fargo Securities LLC; KeyBanc Capital Markets Inc.; William Blair & Company, L.L.C.; Mischler Financial Group, Inc.; Samuel A. Ramirez & Co., Inc.; Siebert Cisneros Shank & Co., LLC; and Williams Capital Group, L.P.

failure to state a claim. The federal case was dismissed nearly a year ago. In the state case, however, plaintiffs sought expansive and expensive discovery from Defendants before the trial court ruled on Defendants' dismissal effort, even though a federal court already had determined that the federal plaintiffs failed to plead a plausible Securities Act claim.

In circumstances such as these — with parallel litigation in state and federal court and the discovery stay enforced in just federal court — defendants will, at best, spend significant amounts of time and money engaging in discovery until a state court dismisses an action. At worst, plaintiffs will be able to coerce windfall settlements or cherry-pick soundbites from documents obtained in discovery to attempt to bolster their meritless claims, thereby circumventing the core purpose of the Reform Act. To minimize the risks and costs caused by frivolous securities litigation, Congress required class action plaintiffs to plead facts establishing viable securities law violations ***before*** any discovery can begin.

Both of these results are exactly what Congress sought to avoid in including a discovery stay in the Reform Act, and both create unnecessary conflict between state and federal courts adjudicating the exact same claims.

B. The Substantial Costs Associated with Discovery Will Force Defendants to Settle Regardless of the Merits of the Dispute.

State courts have altered the incentives surrounding litigation and settlement of Securities Act cases and will continue to do so if permitted to

eschew the PSLRA discovery stay. One of the reasons that Congress chose to implement the Reform Act was to avoid "extortionate settlements." *Dabit*, 547 U.S. at 81; *accord* H.R. Rep. No. 104-369, at 31 (1995) (noting that plaintiffs "abuse[d] . . . the discovery process to impose costs so burdensome that it [was] often economical for the victimized party to settle"). Failing to apply the Reform Act discovery stay in state court will subject the defendants sued in state court to the same abuses that the Reform Act sought to curb over twenty-five years ago.

Even prior to this Court's decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), which confirmed that state courts have jurisdiction over Securities Act claims, state court cases alleging Section 11 claims were settling for higher amounts than comparable cases filed in federal court. *See* Joseph Grundfest, Sasha Aganin and Joseph Schertler, *After Cyan: Potential Trends in Section 11 Litigation*, LAW360 (Mar. 27, 2018), https://www.law360.com/articles/1026323/after-cyan-potential-trends-in-section-11-litigation. For example, from 2011 to 2015, the median settlement amount for Section 11 claims filed in California state court was more than twice the median settlement amount for cases filed in federal court. *Id.*

Adding the cost and uncertainty of early discovery will only exacerbate the issue, returning to the pre-Reform Act days of "extortionate" settlement risk. The cost of discovery — coupled with the risk of exposing the defendants to additional liability if plaintiffs are permitted to conduct fishing expeditions into emails, texts, chats, drafts, and other documents — may cause the defendants to settle for higher sums that are unrelated to the actual merits of the case. In

contrast, settlements are lower in courts that enforce the Reform Act discovery stay, where the burden, as mandated by the Reform Act, is on the plaintiff to demonstrate that it has a viable claim without the benefit of early discovery. Thus, the outcome (settlement versus litigation) of two identical cases, one in federal court and one in state court, may be driven *solely* by the forum in which it is filed, a result that is neither contemplated by the Reform Act nor consistent with principles of equality, consistency, and judicial efficiency.

C. Pre-Motion Discovery Is Critical to Plaintiffs, and Permitting It in State Court Will Attract a Growing Number of Cases and Place a Burden on Those Forums.

This Court made clear in its decision in *Cyan* that the concurrent jurisdiction provision of the Securities Act permits a plaintiff to file a Securities Act claim in state or federal court, despite any language in the Securities Litigation Uniform Standards Act ("SLUSA"). 138 S. Ct. at 1078. Based on the sharp increases in state-court filings for Securities Act claims, the benefits of state courts — including pre-motion discovery — are driving plaintiffs' decisions as to where to file cases. If the discovery stay is not enforced in state court as it is in federal courts, plaintiffs will continue to file in state court instead of — or in addition to — federal court, placing a burden on the resources of those state courts.

Based on the filing statistics related to Securities Act claims, plaintiffs already have begun to concentrate their filings in state court. For example, from 2011 to 2017, before the *Cyan* decision, an average of 9.28 Securities Act cases were filed in state

courts per year. *See* Michael Klausner, *State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)*, 75 The Business Lawyer 1769, 1775 (2020). Then, after *Cyan*, from 2018 to 2019, the average more than quadrupled to 38.5 cases a year. *Id.* Across the country, since *Cyan*, "cases filed exclusively in federal court comprise only 29 percent of section 11 filings, compared to 88 percent between 2011 and 2013, and 65 percent between 2014 and March 20, 2018, when *Cyan* was decided." *Id.* at 1776.[3]

The statistics reveal another troubling trend — an increase in parallel and duplicative state and federal court cases. From 2011 to 2013, only 7% of Securities Act claims were brought in both state and federal court, and, from 2014 until March 20, 2018, when *Cyan* was decided, the number of parallel suits grew to only 17% of Securities Act claims. Klausner, *supra*, at 1775. In sharp contrast, 49% of all Securities Act

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[3] While Securities Act filings dropped in 2020, the number of filings still did not return to pre-*Cyan* levels. The drop in filings is due to a number of factors, including the COVID-19 pandemic, which delayed many IPOs to the second half of 2020. Jessica Chen and John Vetterli, *Global IPOs Hit Back Strongly After COVID-19 Crash*, White & Case (Mar. 08 2021), https://www.whitecase.com/publications/insight/global-ipos-hit-back-strongly-after-covid-19-crash (noting that the first half of 2020 saw the lowest volume of IPOs in the last five years). Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, in their 2021 Midyear Assessment, parsed the decline in federal and state Section 11 filing activity and attributed it to "a 33% decline in federal-only Section 11 filings." Cornerstone Research, *Securities Class Action Filings: 2021 Midyear Assessment* (2021), https://www.cornerstone.com/Publications/Reports/Securities-Class-Action-Filings-2021-Midyear-Assessment.pdf, at 14.

claims filed between March 21, 2018 and December 31, 2019 were filed in both state and federal court. *Id.* At the same time, Securities Act cases filed exclusively in federal court dropped from 88% between 2011 and 2013 and 65% between 2014 and March 20, 2018 to a mere 29% after March 21, 2018. *Id.*

Unless this Court reverses the decision below, plaintiffs will continue to file weak Securities Act cases in state court, creating undue burden on courts and litigants.

D. Without a Discovery Stay, Plaintiffs Will Continue to File Weak and Meritless Lawsuits, Contrary to Congress' Intent.

Even before *Cyan* was decided, Plaintiffs already perceived certain state courts to be preferred places to file Securities Act claims because those state courts have dismissed claims at a lower rate in recent years. *See, e.g.*, Klausner, *supra*, at 1777 (finding a dismissal rate of Section 11 cases in state courts of 28% compared to 39% for federal cases, and noting that, in California from 2011 to 2019, only 18% of Section 11 cases were dismissed).

After *Cyan* was decided, there was an overall increase in Section 11 cases that was not accompanied by an increase in the number of public offerings, which "suggests that the increases may have been driven by an increase in low-merit cases that are attracted to state courts . . . ." *Id.* at 1776.

Declining to apply the Reform Act discovery stay can only exacerbate this issue. Plaintiffs with weak claims will file where they are permitted to conduct early discovery, giving them an opportunity to force settlement or, failing that, a chance to try to survive a

pleading challenge by amending their complaints with selective and cherry-picked excerpts from a defendant's emails or other documents (an opportunity not available to identically situated federal plaintiffs).

III. STATE COURTS' DISREGARD OF THE REFORM ACT DISCOVERY STAY INCREASES THE BURDENS AND COSTS THAT THE REFORM ACT SOUGHT TO CURB.

As set out in the appendix to the stay application Petitioners filed in this Court, since *Cyan* was decided, the Underwriter Petitioners "cumulatively have been named as defendants in individual and consolidated actions under the Securities Act in state court at least 287 times—or, counting the number of complaints filed within each individual and consolidated action, cumulatively at least 640 times." Stay App. 175a-219a. As repeat participants in the capital markets generally, and initial and secondary public offerings specifically, these banks will be regularly subject to expensive and expansive discovery if the Reform Act discovery stay is not applied to cases brought in state court.

Most public offerings, including large companies located in California and New York, are underwritten by multiple banks. Those banks, in turn, have indemnification agreements with the issuers that cover, among other things, the cost of defending securities class actions. Given these facts, a rule allowing discovery in state court Securities Act cases — before courts find that the complaints state a claim — risks compounding costs for issuer defendants as well.

In addition, the explosion of Securities Act cases in state court has cost market participants in other ways. For example, the cost of directors and officers insurance has ***quadrupled*** since *Cyan*. Priya Cherian Huskins, *Will D&O Insurance Rates End the IPO Party?*, Woodruff Sawyer (Jan. 15, 2020), https://woodruffsawyer.com/do-notebook/do-insurance-rates-ending-ipo-party/. Insurers are "chopping coverage limits and requiring IPO clients to pick up more costs before a policy kicks in," as well as "requiring companies to pay for a percentage of the eventual loss." Suzanne Barlyn, *D&O Insurance Costs Soar as Investors Run to Court Over IPOs*, Insurance Journal (June 18, 2019), https://www.insurancejournal.com/news/national/2019/06/18/529691.htm. Increased IPO costs already have caused issuers to look to other options for going public. *See, e.g.*, Nicki Locker & Laurie Smilan, *Carving Out IPO Protections*, Harvard Law School Forum on Corporate Governance (Feb. 25, 2020), https://corpgov.law.harvard.edu/2020/02/25/carving-out-ipo-protections (noting increased use of self-help strategies, direct listings, and carve-outs to IPO lock-up agreements). The use of these mechanisms reduces pressure on issuers to adopt governance reforms that protect investors, which undermines the ultimate purpose of the Securities Act. Brent J. Horton, *Spotify's Direct Listing: Is It a Recipe for Gatekeeper Failure?* 72 SMU L. Rev. 177, 202–12 (2019).

If IPO costs remain high, or climb even higher, non-issuer participants may begin to feel the impact as well. Underwriters, consultants, and experts all may demand higher fees or other more favorable

terms before they are willing to participate in an initial or secondary public offering.

CONCLUSION

For the foregoing reasons, SIFMA respectfully request that this Court reverse the orders of the California Court of Appeal and California Superior Court.

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