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.,

Respondents.

On Writ of Certiorari to the Court of Appeal for the State of California, First Appellate District

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*

Washington Legal Foundation (WLF) is a nonprofit, public-interest law firm and policy center with supporters nationwide.[1] Founded in 1977, WLF promotes and defends free enterprise, individual rights, limited government, and the rule of law.

To that end, WLF often appears before this and other federal courts in cases raising the proper scope of the federal securities laws. *See, e.g.*, *China Agritech, Inc. v. Resh,* 138 S. Ct. 1800 (2018)*; Cal. Pub. Emps.' Ret. Sys. v. ANZ Sec., Inc.,* 137 S. Ct. 2042 (2017). And WLF's Legal Studies Division has published many articles on the proper construction of the federal securities laws and related topics. *See, e.g.,* Doug Greene, et al.*, Private Securities Litigation: Making the 1995 Reform Act's "Safe Harbor" Safer*, WLF Working Paper (Nov. 16, 2018).

WLF is concerned about two effects of the decision below. First, in state actions under the Securities Act of 1933 (Securities Act), the decision unduly strips defendants of the important discovery stay protection in the Private Securities Litigation Reform Act of 1995 (PSLRA). Second, by refusing to apply the stay in *state* court, the decision below frustrates Congress's purpose and undermines the PSLRA's public-policy rationale by allowing plaintiffs to obtain backdoor discovery in *federal* court proceedings via parallel state court actions. If affirmed, the decision would encourage meritless

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[1] No counsel for a party authored any part of this brief, and no person other than WLF or its counsel contributed money to the preparation or submission of this brief. All parties consent to the filing of WLF's brief.

suits and coercive settlements that harm shareholders.

SUMMARY OF ARGUMENT

The PSLRA's mandatory discovery stay is a key component of Congress's overall statutory scheme for private securities actions. As the PSLRA's legislative history reveals, Congress was concerned that plaintiffs bringing meritless securities suits were using expensive discovery to bolster their cases, avoid dismissal, and force extortionate settlements. The PSLRA's mandatory discovery stay was enacted to stop this practice in its tracks. Congress's goals in adopting the stay provision apply equally no matter if a federal securities action is filed in federal court or state court.

The California trial court erred in failing to apply the PSLRA's mandatory discovery stay here. As set forth in the Petitioners' brief, the plain language of the PSLRA requires this Court to find that the statute's discovery stay applies in cases, like this one, that assert Securities Act claims in state court.

That view is bolstered by Congress's overall statutory scheme and the public-policy ramifications of failing to apply the mandatory PSLRA discovery stay in state court. The California trial court fundamentally misunderstood Congress's scheme, which includes—as part of the Securities Litigation Uniform Standards Act of 1998 (SLUSA)—another provision that allows defendants to seek a stay of discovery in *any* related state court case. Far from establishing that the PSLRA discovery stay is limited to federal court, the broader SLUSA discovery stay shows that Congress intended to close

any and all avenues by which plaintiffs could circumvent its discovery restrictions.

Congress's concern that failing to apply the PSLRA stay in state court would increase the risk of backdoor discovery abuses in federal court was not merely theoretical. The ever-increasing number of parallel state and federal Securities Act cases, brought by a small group of law firms, provide fertile ground for such abuses. Looking at the state court Securities Act cases cited by the Petitioners in the Appendix to the Stay Application, WLF found that nearly half had a parallel case brought in federal court and just five plaintiffs' law firms were lead counsel in a vast majority of cases.

The Court should hold that the PSLRA discovery stay applies to Securities Act cases brought in state court. Any other decision would not only frustrate Congress's purpose in *state* actions, but also would frustrate that purpose in *federal* actions by effectively allowing (if not encouraging) plaintiffs to circumvent the PSLRA stay in federal actions by obtaining backdoor discovery in parallel state court actions.

ARGUMENT

I. The Plain Language and Public-Policy Goals of the PSLRA Discovery Stay Confirm its Application in State Court.

The plain language of the PSLRA 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). The PSLRA does not limit the stay to Securities Act cases in federal court, and state court actions 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").

Congress passed the PSLRA in response to "significant evidence of abuse in private securities lawsuits," including "the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer." H.R. CONF. REP. NO. 104-369, at 31-32 (1995) (noting that the PSLRA "stay of discovery provisions are intended to prevent unnecessary imposition of costs on defendants"). The mandatory discovery stay was critical because Congress wanted to stop plaintiffs from using a meritless lawsuit to "conduct discovery in the hopes of finding a sustainable claim not alleged in the complaint." 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 also was concerned that the plaintiffs' bar was using the threat of expensive discovery to force defendants in securities cases to enter into "extortionate settlements." *Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 81 (2006); *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").

Congress felt so strongly about the need for the mandatory PSLRA discovery stay that, as part of SLUSA, it passed an additional measure to prevent the plaintiffs' bar from circumventing the stay.

SLUSA provides that "a court may stay discovery proceedings in any private action in a State court, as necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to [the PSLRA]." 15 U.S.C. § 78u–4(b)(3)(D). The aim of this provision was to prevent plaintiffs from using a parallel state court action to obtain discovery that would effectively moot the PSLRA discovery stay. *The Securities Litigation Uniform Standards Act of 1997: Hearing before the Subcommittee on Finance and Hazardous Materials of the Committee on Commerce, House of Representatives on H.R. 1689,* 105th Cong., second session, 14 (1998) (testimony of Representative Anna G. Eshoo)[2] ("[P]laintiff lawyers are able to file a case in state courts, go through a process of discovery, basically a fishing expedition, and then take those documents into federal court."); H.R. CONF. REP. NO. 105-803, at 14 (1998) (noting that enactment of the PSLRA saw "an increase in parallel litigation between state and federal courts in an apparent effort to avoid the federal discovery stay").

Congress's goals in adopting the mandatory PSLRA discovery stay apply equally whether a federal securities action is filed in federal or state court. When looking at the statutory scheme as a whole, it is clear that Congress intended the mandatory PSLRA stay to apply to all private actions arising under the Securities Act (whether brought in federal or state court) and sought to limit, as much as possible, the use of other state court cases to undermine that stay's effectiveness.

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[2] This testimony is hereinafter referred to as "Eshoo Testimony on H.R. 1689."

II. The California Trial Court Fundamentally Misunderstood the Overall Statutory Scheme.

The California trial court's decision below was based, in no small part, on a fundamental misunderstanding of the interaction between the mandatory PSLRA discovery stay and the permissive SLUSA discovery stay. The court held that "[i]f the PSLRA's discovery stay already provided for an automatic stay of discovery in state court securities cases, there would have been no need to enact Section 27(b)(1) of SLUSA to give federal courts the power to stay discovery in related state securities cases." Pet. App. 7a-8a.

In fact, the permissive SLUSA discovery stay applies to *all* state court cases, not just "state court securities cases." That is, Congress created the mandatory PSLRA discovery stay for *all securities actions under federal law* (whether brought in federal or state court) and then added the permissive SLUSA discovery stay to cover *all state court cases* (whether based on federal or state law) that might lead to the circumvention of the PSLRA stay.

III. The Statutory Scheme for Discovery Stays Addresses the Problem of Overlapping Litigation and Attorneys.

In creating the permissive SLUSA discovery stay, Congress addressed an existing and nagging problem. The plaintiffs' bar often brings multiple actions, both in federal and state court, seeking to address the same alleged corporate misconduct. For example, it is common for one investor to bring a federal securities action alleging fraud, while another investor brings a state derivative action

alleging a breach of fiduciary duty, both based on identical events. *See* Stephen J. Choi, Jessica Erickson, & A. C. Pritchard, *Piling On? An Empirical Study of Parallel Derivative Suits*, 14 J. of Empirical Legal Stud. 653, 661 (2017) (finding that from 2005 to 2008, 264 securities class actions were filed with parallel derivative suits; 93 of those derivative suits were brought in state court). In these circumstances, the permissive SLUSA discovery stay allows the defendants in the federal action to move the court to stay discovery in the state derivative action to safeguard the PSLRA's mandatory discovery stay. *See, e.g.*, *In re DPL Inc., Sec. Litig.*, 247 F. Supp. 2d 946 (S.D. Ohio 2003) (staying discovery in state derivative actions pending decision on motion to dismiss in securities class action).

If there is no stay of discovery in a state court action addressing the same conduct as a federal securities action, the absence of a stay can easily render moot the mandatory PSLRA discovery stay in the federal securities case. In particular, either (a) plaintiffs can get discovery in state court and then share those materials with other plaintiffs in the federal securities action, or (b) the discovery in the state court action can become public through motions practice or court hearings. Federal district court decisions applying the PSLRA and SLUSA showcase the reality of these concerns.

In *DPL Inc., Securities Litigation*, for example, the defendants in a federal securities class action moved, under SLUSA, to stay discovery in four related state court derivative cases. 247 F. Supp. 2d at 947. The *DPL* plaintiffs (not the plaintiffs in the

derivative actions) vigorously opposed a stay. It was no mystery why the *DPL* plaintiffs took that position—the plaintiffs in the federal class action and the plaintiffs in the state derivative cases had overlapping attorneys.

Indeed, during oral argument, one of those overlapping attorneys "indicated that he anticipated sharing discovery obtained in that state court proceeding with the other counsel representing Plaintiffs in [the securities class action]." *Id.* at 950. Under these circumstances, the *DPL* court had little difficulty finding that if it did not stay discovery in the derivative actions, "its jurisdiction to rule upon a motion to dismiss the federal securities claims, before any discovery has been conducted, will have been circumvented by discovery in the state court actions and, therefore, compromised." *Id.*

Other courts have reached the same conclusion, finding that both the overlapping nature of the plaintiffs' bar and the risk of deliberate or inadvertent backdoor discovery supports the granting of permissive SLUSA discovery stays. *See, e.g.*, *In re Facebook, Inc. S'holder Derivative Priv. Litig.*, No. 18-CV-01792-HSG, 2019 WL 452034, at *2 (N.D. Cal. Feb. 5, 2019) (granting stay in state action where the same individual was petitioner in the state action and plaintiff in the federal action and noting "the state court petition states that the discovery is sought for the purpose of informing Plaintiff in this action"); *Salameh v. Tarsadia Hotels*, No. 09CV2739 DMS (BLM), 2012 WL 12941995, at *2 (S.D. Cal. July 2, 2012) ("State court discovery requests are subjecting [the defendant] to the risks and expenses which the Congress intended to

prevent with the discovery stay provisions of the PSLRA. The SLUSA's purpose is to prevent plaintiffs from circumventing the PSLRA discovery stay. Accordingly, [the defendant] has made a sufficient showing to warrant a stay of state court discovery under the SLUSA.") (citation omitted); *In re Dot Hill Sys. Corp. Sec. Litig.*, 594 F. Supp. 2d 1150, 1167 (S.D. Cal. 2008) (staying discovery in state court derivative action where "derivative plaintiffs do not deny the fact that they are members of the putative federal class" because "[t]heir receipt of discovery would violate the PSLRA").[3]

IV. Only Broad Application of the Mandatory PSLRA Discovery Stay Will Effectuate Congress's Intent.

Congress's statutory scheme in the PSLRA and SLUSA depends on the mandatory PSLRA discovery stay covering *all* federal law securities claims, including Securities Act claims brought in state court. Otherwise, the problems that Congress sought to address through the permissive SLUSA discovery stay will arise again, but this time in identical Securities Act cases in both federal and state court.

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[3] *See also In re Crompton Corp.*, No. 3:03–CV–1293(EBB), 2005 WL 3797695, *2 (D. Conn. July 22, 2005) (granting stay of discovery in state action when "over 100 paragraphs in [the plaintiff's] amended complaint are nearly identical to the allegations in the federal consolidated complaint," and the state plaintiff's former counsel was also an attorney in the federal action); *In re Cardinal Health, Inc. Sec. Litig.*, 365 F. Supp. 2d 866, 874-75 (S.D. Ohio 2005) (granting stay of discovery in state court action because the court was concerned "that some form of discovery, whether it be a state court order resolving a discovery dispute or a public hearing, will reach Plaintiffs before this Court has decided any dismissal motion").

Indeed, these problems are even more likely to arise in parallel actions involving identical Securities Act claims than in state court actions subject to the permissive SLUSA discovery stay, where the claims likely arise under state law and are only related (not identical) to the federal action at issue.

Since this Court's decision in *Cyan v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), parallel federal and state Securities Act cases have exploded. From 2011 to 2013, only 7% of Securities Act claims were brought in both state and federal court. Michael Klausner, *State Section 11 Litigation in the Post-Cyan Environment (Despite Sciabacucchi)*, 75 The Business Lawyer 1769, 1775 (2020). And from 2014 until *Cyan* was decided on March 20, 2018, the number of parallel suits grew to only 17% of Securities Act claims. *Id.* In contrast, 49% of all Securities Act claims filed between March 21, 2018 and December 31, 2019 were filed in both state and federal court. *Id.* During this same period, Securities Act cases filed exclusively in federal court dropped from 88% between 2011 and 2013 and 65% between 2014 and March 20, 2018, to only 29% after March 21, 2018. *Id.* at 1776.

The prevalence of parallel federal and state Securities Act actions is underscored by the Representative List of Securities Act Cases Filed in State Court Post-*Cyan* included in the Appendix to Petitioners' Stay Application (Representative List). Stay App. 175a-219a.[4] WLF has created a subgroup

[4] Citations to "Stay App." refer to the appendix to Petitioners' stay application, filed concurrently with the underlying petition.

of 99 cases from the Representative List that identifies, through an examination of the relevant case dockets, the plaintiffs' law firms.[5] Of those 99 state court cases, 41 had parallel federal court cases. *See* WLF App. 1a-26a.[6]

A small number of plaintiffs' law firms are involved in the litigation of nearly all these cases. WLF's review revealed that five plaintiffs' firms were counsel in 70% of the 99 state cases. *See* WLF App. 1a-20a (showing that Robbins Geller Rudman & Dowd, the Rosen Law Firm, Pomerantz, Scott + Scott, and Levi & Korsinsky account for plaintiffs' counsel in 70 of the 99 state actions). Likewise, those same five firms served as lead counsel in nearly 70% of the 41 federal cases with parallel state actions. *See* WLF App. 21a-26a (showing that Robbins Geller Rudman & Dowd, the Rosen Law Firm, Pomerantz, Scott + Scott, and Levi & Korsinsky account for lead counsel in 27 of the 41 parallel federal actions).

The disproportionate number of parallel federal and state Securities Act cases handled by a small number of law firms strongly suggests that state courts' failure to apply the mandatory PSLRA discovery stay greatly increases the opportunities for, and likely incidence of, backdoor discovery in the federal cases. In turn, this circumvention of the mandatory PSLRA discovery stay undermines all of

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[5] The Representative List contains 187 total cases identified by case number, but WLF was able to obtain the dockets for only 99 of those cases. The other dockets were not readily available.

[6] Citations to "WLF App." refer to the appendix filed concurrently with this brief of *amicus curiae*.

Congress's public-policy goals for implementing the stay in the first place. Moreover, to the extent that state court actions are filed for the purpose of circumventing the PSLRA discovery stay in a parallel federal action, those actions require defendants to incur the same unnecessary costs that Congress was trying to avoid. *See* Eshoo Testimony on H.R. 1689, at 14.

Any argument that defendants may simply use the permissive SLUSA discovery stay to prevent discovery in parallel state court Securities Act cases is unpersuasive. Nothing in the law prevents a plaintiff from first showing up in state court, getting discovery, and then later using that discovery in a federal action. When that happens, a "court's issuance of a stay order would be totally ineffectual in preventing disclosure of that which has already been disclosed—and such prevention is the whole purpose of the statute." *In re Transcrypt Int'l Sec. Litig.*, 57 F. Supp. 2d 836, 847 (D. Neb. 1999); *see also Glenbrook Cap. Ltd. P'ship v. Kuo*, No. C07-02377 MJJ, 2008 WL 929429, at *8 (N.D. Cal. Apr. 3, 2008) ("The automatic stay provision does not bar a Plaintiff from supporting its contentions in an amended complaint with discovery gained through prior litigation.") Even if the state court action is brought simultaneously with the federal court action, seeking a permissive SLUSA discovery stay requires significant time and resources to litigate. And whether a stay is granted is entirely within the discretion of the federal court.

* * *

In sum, and contrary to the holding of the California trial court, Congress said "all" in the

mandatory PSLRA discovery stay provision to effectuate its purposes. And the permissive SLUSA discovery stay confirms that Congress really meant what it said, not that it was trying to fill a supposed gap in Securities Act cases with a different type of stay. As SLUSA's legislative history explains: "It is the threat of costly discovery that motivates companies to settle. As long as that threat remains at the State court level, we will never know if the stay of discovery, which Congress put into place, is able to weed out meritless cases." Eshoo Testimony on H.R. 1689, at 14. The Court should follow Congress's plain language and clear intent and hold that the mandatory PLSRA discovery stay also applies to Securities Act cases in state court. That is the only way to eradicate the "threat of costly discovery . . . at the state court level," *id.*, and to ensure the proper working of the stay at the federal court level.

CONCLUSION

The Court should reverse the order of the California Court of Appeal.

Respectfully submitted,

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