

New York Appellate Division, First Department Holds That PSLRA Discovery Stay Applies to State Court Actions

November 8, 2023

Contact

George S. Canellos, Partner
+1 212.530.5792
gcanellos@milbank.com

Sean M. Murphy, Partner
+1 212.530.5688
smurphy@milbank.com

Katherine Kelly Fell, Partner
+1 212.530.5207
kfell@milbank.com

John J. Hughes III, Special Counsel
+1 212.530.5127
jhughes2@milbank.com

Bradley J. Hershon, Associate
+1 212.530.5241
bhershon@milbank.com

On November 2, 2023, the New York Appellate Division, First Department held for the first time that New York state courts hearing claims under the Securities Act of 1933 are required to stay discovery pending resolution of a motion to dismiss under the Private Securities Litigation Reform Act of 1995 (“PSLRA”).¹

Congress enacted the PSLRA in 1995 to address abusive and frivolous securities suits. The PSLRA sought to curb the practice of private plaintiffs leveraging the burdensome costs of litigation and discovery against defendants to induce settlement in meritless suits and the practice of conducting discovery in the hopes of finding a sustainable claim not alleged in the complaint. To address this potential for abuse, the PSLRA provides that in cases brought under the Securities Act of 1933 (the “1933 Act”) or the Securities Exchange Act of 1934 (the “1934 Act”), “all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss.”²

The PSLRA applies to 1933 Act and 1934 Act claims filed in federal court. While Congress provided for exclusive jurisdiction in federal courts over claims arising under the 1934 Act, it provided for concurrent federal and state jurisdiction over claims arising under the 1933 Act and the PSLRA included a provision that arguably created some uncertainty about whether the automatic stay of discovery applied only in actions brought in federal court.³ Prior to the First Department’s ruling, New York state trial courts had reached differing conclusions as to whether the discovery stay provided under the PSLRA applies to securities fraud cases brought in state court.

In its opinion, however, the First Department held that the plain language of the PSLRA demonstrates that the discovery stay “applies to any private action, whether brought in state or federal court.”⁴ The First Department also concluded that the PSLRA stay does not apply during the pendency of appeals from lower court rulings denying a defendant’s motion to dismiss.⁵ The First Department noted that the plain text of the statute only imposes a stay for the initial motion to dismiss, not any subsequent appeals. Moreover, the First Department noted that, because federal courts do not ordinarily allow interlocutory appeals from the

¹ *Camelot Event Driven Fund etc. v. Morgan Stanley & Co. LLC, et al.*, No. 2023-03270, 2023 WL 7198938 (1st Dep’t Nov. 2, 2023).

² 15 U.S.C. § 77z-1(b)(1).

³ See 15 U.S.C. § 77z-1(a)(1) (“The 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.”).

⁴ *Camelot*, 2023 WL 7198938, at *1.

⁵ *Id.*

denial of a motion to dismiss, this approach creates uniformity between federal and state court and disincentivizes forum shopping.⁶

Because the First Department's decision is binding on state trial courts in Bronx and New York counties and on trial-level courts in the Second, Third, and Fourth Departments until those departments or the Court of Appeals address the matter, this decision will lower the risk of defendants in New York state securities fraud actions incurring burdensome discovery costs before motions to dismiss are resolved.

The applicability of the PSLRA discovery stay to state court filings remains an open question in some other states. For example, some lower state courts in California have held, like the First Department, that the PSLRA stay applies in state court, but others have held it does not.⁷ The US Supreme Court had previously granted a petition for certiorari in one such case, but the case settled before the Supreme Court heard argument.⁸ The recent First Department ruling in New York may result in more courts in California applying the PSLRA discovery stay, but the issue may be unsettled until it is resolved by a California appellate court.

Practice/Group Contacts

New York | 55 Hudson Yards, New York, NY 10001

George S. Canellos gcanellos@milbank.com +1 212.530.5792

Sean M. Murphy smurphy@milbank.com +1 212.530.5688

Katherine Kelly Fell kfell@milbank.com +1 212.530.5207

John J. Hughes III jhughes2@milbank.com +1 212.530.5127

Bradley J. Hershon bhershon@milbank.com +1 212.530.5241

Please feel free to discuss any aspects of this Client Alert with your regular Milbank contacts or any member of our Litigation & Arbitration Group.

This Client Alert is a source of general information for clients and friends of Milbank LLP. Its content should not be construed as legal advice, and readers should not act upon the information in this Client Alert without consulting counsel.

© 2023 Milbank LLP

All rights reserved. Attorney Advertising. Prior results do not guarantee a similar outcome.

⁶ *Id.* at *1-2.

⁷ See, e.g., *Switzer v. Hambrecht & Co., L.L.C.*, No. CGC-18-564904, 2018 WL 4704776, at *1 (Cal. Super. Sept. 19, 2018) (“[T]he PSLRA’s provision for a discovery stay is of a procedural nature, and therefore only applies in actions filed in federal court.”), *In re Pacific Biosciences of California Inc.*, No. CIV509210, 2012 WL 1932469 (Cal. Super. May 25, 2012) (“[T]he very language of the statute indicates that it is only a discovery stay of federal securities class actions filed in federal court.”), *Ocampo v. Dfinity USA Research LLC.*, No. 21-CV-03843 (Cal. Super. Ct., San Mateo Cnty. July 25, 2022) (“[T]he Court concludes that the automatic stay provision does apply to state court actions.”).

⁸ *Pivotal Software, Inc. v. Superior Court of Cal.*, 141 S. Ct. 2884 (2021).