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NY Discovery Stay Ruling Empowers Securities Defendants

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On Nov. 2, 2023, a New York state appeals court held, in a matter of first impression for the court, that New York state courts hearing claims under the Securities Act of 1933 are required to stay discovery pending the resolution of a motion to dismiss under the Private Securities Litigation Reform Act of 1995.[1]

In its Camelot Event Driven Fund v. Morgan Stanley & Co. opinion, the First Judicial 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."[2]

The First Judicial 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.

The Camelot decision is the first appellate division decision on this issue and will be binding or persuasive authority for a majority of New York courts, unless or until another appellate division or New York state appeals court weighs in on the issue.[3]

This decision has significant ramifications for securities litigation in New York state courts, and is advantageous for defendants in New York state court actions that, until now, periodically have had to incur burdensome discovery costs that they would have been able to delay — and possibly avoid entirely — had the plaintiff elected to file the litigation in any federal jurisdiction, or a number of other state jurisdictions.

Congress enacted the PSLRA in 1995. The legislation contains several provisions intended to combat abusive and frivolous securities suits.

The PSLRA discovery stay is one such provision and provides that in cases brought under the Securities Act of 1933 or the Securities Exchange Act of 1934, "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss."[4]

The intent of this provision is to inhibit a plaintiff's ability to leverage the burdensome costs of discovery against defendants to induce an early settlement in a frivolous suit, even before a court has the opportunity to pass on the sufficiency of the plaintiff's pleading.[5]

The PSLRA discovery stay also limits a plaintiff's ability to conduct a fishing expedition by filing a perfunctory complaint and then exploiting the early discovery process in the hopes of finding a

sustainable claim not alleged in the initial pleading.[6]

The PSLRA clearly applies to 1933 Act and 1934 Act claims filed in federal court. However, while Congress provided for exclusive jurisdiction in federal courts over claims arising under the 1934 Act,[7] it provided for concurrent jurisdiction in federal and state court over claims arising under the 1933 Act.[8]

State courts across the country are divided on the question of whether the PSLRA discovery stay applies to 1933 and 1934 Act cases filed outside of a federal forum.

While some courts have found, as the Camelot panel did, that the plain language of the PSLRA discovery stay makes it applicable to "any private action arising under this subchapter,"[9] irrespective of the forum, other courts have construed it as a federal procedural rule that, under traditional choice of law principles, can be supplanted by divergent state procedural rules when the action is brought in state court.[10]

Until Camelot, the issue in New York was further complicated by inconsistent practices among divisions of New York state trial courts. For example, New York Civil Practice Law and Rules, Section 3214(b), provides for a presumptive "stay[ ] [of] disclosure until determination of the motion [to dismiss] unless the court orders otherwise."

This rule is like the PSLRA discovery stay, although applies more generally to civil cases in New York state trial courts, irrespective of subject matter.

This rule should have, in theory, operated to create some consistency in outcomes, with respect to discovery, between securities cases brought in New York state courts and those brought in federal jurisdictions.

However, the New York Supreme Court Commercial Division is authorized to hear commercial class actions, as well as "fraud, misrepresentation ... [and statutory] violation[s] arising out of business dealings" that exceed monetary thresholds of $50,000 to $500,000, depending on filing county.[11]

The court has its own rules with respect to discovery, including a rule opting out of the presumptive stay under Section 3214(b):

> The court will determine, upon application of counsel, whether discovery will be stayed, pursuant to CPLR 3214(b), pending the determination of any dispositive motion.[12]

Reported decisions reflect that commercial division judges often decline to stay discovery pending a motion to dismiss.[13]

Because securities cases filed in New York state courts arising under the 1933 Act may be classified as commercial class actions or cases sounding in fraud, misrepresentation or statutory violations arising out of business dealings that exceed applicable monetary thresholds, they are often heard in the Commercial Division, which takes them out of the ambit of Section 3214(b) and, until Camelot, placed them back in risk of premotion-to-dismiss discovery that likely would not have transpired in any other forum in New York — whether federal or noncommercial state.[14]

For these reasons, Camelot is an important decision that brings needed clarity on an issue that has perplexed state courts across the country. Indeed, even some individual state-level trial courts in the

same jurisdiction have divided on this issue, as was the case among New York state supreme courts until the Camelot decision.[15]

Because appellate division decisions are generally considered binding on all trial-level courts in New York — regardless of the department — until the local appellate division that covers the trial court addresses the matter,[16] the Camelot decision closes a potential loophole for plaintiffs looking to evade the pleading strictures of the PSLRA in New York state courts and creates uniformity across all state trial courts and federal fora located in the state.

The Camelot decision will also be persuasive authority for any other appellate division court to consider the issue in the future.[17]

In the absence of a U.S. Supreme Court decision on the matter or a decision from the highest court of any state, Camelot arguably has the most wide-reaching application of any decision in any court on this issue to date.[18]

A Supreme Court ruling on the issue nearly occurred in 2021, when certiorari was granted in Pivotal Software Inc. v. Superior Court of California, but the parties settled the case before oral argument.

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[1] See Camelot Event Driven Fund v. Morgan Stanley & Co. LLC, 2023 WL 7198938, at *2 (N.Y. App. Div. Nov. 2, 2023).

[2] Id. at *1.

[3] Id.

[4] 15 U.S.C. § 77z-1(b)(1).

[5] S. REP. 104-98, at 14 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 693 (the "Senate Report").

[6] H.R. CONF. REP. 104-369, at 37 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 736 (the "House Report").

[7] 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.").

[8] Id.

[9] 15 USC § 77z–1(b)(1) (emphasis added); Camelot, 2023 WL 7198938 at *1; see also In re Everquote, Inc. Sec. Litig., 65 Misc. 3d 226, 235 (N. Y. Sup. Ct. 2019).

[10] E.g., Switzer v. W.R. Hambrecht & Co., L.L.C.,Nos, 2018 WL 4704776 (Cal. Super. Ct. Sept. 19, 2018).

[11] N.Y. Comp. Codes R. & Regs. tit. 22, § 202.70(b).

[12] New York Commercial Division Rule 11(g), N.Y. Comp. Codes R. & Regs. tit. 22, § 202.70; see also Chen v. 215 Chrystie Venture, LLC, 77 Misc. 3d 1222(A), No. 655908/2020, 2023 WL 140403, at *3 (N.Y. Sup. Ct. Jan. 9, 2023) ("New York County Commercial Division rule 11(g) places the imposition of a discovery stay, pursuant to CPLR 3214(b), within the sound discretion of the court.... Nothing in the record on defendants' motion before this court persuades it that the invocation of a discovery stay is warranted.").

[13] In re PPDAI Grp. Sec. Litig., 64 Misc. 3d 1208(A), No. 654482/2018, 2019 WL 2751278, *7 (N.Y. Sup. Ct. July 1, 2019) ("[I]n the Commercial Division discovery generally continues during motion practice.").

[14] E.g., City of Pittsburgh Comprehensive Mun. Pension Tr. Fund v. Benefitfocus, Inc., 2021 WL 3863895, at *1 (N.Y. Sup. Ct. Aug. 25, 2021) ("The Court, in the exercise of its discretion, is staying discovery[pursuant to Commercial Division Rule 11(d) and C.P.L.R. 3214(b)] ... because the motions to dismiss will be fully submitted and heard expeditiously, rather than finding there is an automatic stay under PSLRA.").

[15] Compare In re Everquote, Inc. Sec. Litig. 2019 WL 3686065 at *1 with In re PPDAI Grp. Sec. Litig., 2019 WL 2751278 at *7 and Dentsply Sirona, Inc. v. XXX, No. 155393/2018, 2019 WL 3526142, at *6 (N.Y. Sup. Ct. Aug. 2, 2019).

[16] Siegel, N.Y. Prac. § 449 (6th ed.) ("The trial courts in one department should follow an appellate division precedent set in another until the local appellate division addresses the matter."); People v. Turner, 5 N.Y.3d 476, 482 (2005) (Third Department decision "binding on all trial-level courts in the state"); Mountain View Coach Lines, Inc. v. Storms, 102 A.D.2d 663, 664 (2d Dep't 1984) ("[T]he doctrine of stare decisis requires trial courts in this department to follow precedents set by the Appellate Division of another department until the Court of Appeals or this court pronounces a contrary rule.").

[17] Siegel, N.Y. Prac. § 449 (6th ed.) ("[A]mong the departments themselves the holding of one is persuasive, but not binding, on the others.").

[18] See Pivotal Software, Inc. v. Superior Ct. of California, 141 S. Ct. 2884 (2021).